SOUTHSIDE BANCSHARES INC
Form 10-K
March 12, 2015

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

Form 10-K
(Mark One)

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014
or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From _______ to _______

Commission file number 0-12247
Southside Bancshares, Inc.
(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o 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 Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

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

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

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

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

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2014 was $464,441,188.

As of February 27, 2015, 24,110,953 shares of common stock of Southside Bancshares, Inc. were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Registrant's proxy statement to be filed for the Annual Meeting of Shareholders to be held April 30, 2015 are incorporated by reference into Part III of this Annual Report on Form 10-K. Other than those portions of the proxy statement specifically incorporated by reference pursuant to Items 10-14 of Part III hereof, no other portions of the proxy statement shall be deemed so incorporated.

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IMPORTANT INFORMATION ABOUT THIS REPORT

In this report, the words “the Company,” “we,” “us,” and “our” refer to the combined entities of Southside Bancshares, Inc. and its subsidiaries. The words “Southside” and “Southside Bancshares” refer to Southside Bancshares, Inc. The words “Southside Bank” and “the Bank” refer to Southside Bank. “FWBS” refers to Fort Worth Bancshares, Inc., a bank holding company acquired by Southside. “SFG” refers to SFG Finance, LLC (formerly Southside Financial Group, LLC) which is a wholly-owned subsidiary of the Bank as of July 15, 2011. “OABC” refers to OmniAmerican Bancorp, Inc., a bank holding company acquired by Southside in 2014.

As mentioned in our Form 10-K for the year ended December 31, 2012, we decided to close our broker-dealer subsidiary, Southside Securities, Inc. We completed the closure during the second quarter of 2013.

On April 28, 2014, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with OmniAmerican Bancorp, Inc., a Maryland corporation and the holding company for OmniAmerican Bank, a federal savings association based in Fort Worth, Texas. On October 14, 2014, the shareholders of the Company approved the issuance of shares of Company common stock to the stockholders of OABC, and the stockholders of OABC approved the merger. The merger was completed on December 17, 2014. Pursuant to the Merger Agreement, each outstanding share of common stock of OABC was converted into (a) 0.4459 of a share of common stock of the Company and (b) $13.125 in cash. For additional information concerning the effect of the merger and the fair value of assets assumed in relation to the merger, see “Note 2 - Acquisition.”

PART I

ITEM 1. BUSINESS

FORWARD-LOOKING INFORMATION

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

GENERAL

Southside Bancshares, Inc., incorporated in Texas in 1982, is a bank holding company for Southside Bank, a Texas state bank headquartered in Tyler, Texas that was formed in 1960. We operate through 64 banking centers, 19 of which are located in grocery stores, and 26 motor bank facilities.

At December 31, 2014, our total assets were $4.81 billion, total loans were $2.18 billion, deposits were $3.37 billion, and total equity was $425.2 million. For the years ended December 31, 2014 and 2013, our net income was $20.8 million and $41.2 million and diluted earnings per common share were $1.09 and $2.19, respectively. We have paid a cash dividend every year since 1970 (including dividends paid by Southside Bank prior to the incorporation of Southside Bancshares).

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

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

We offer a variety of deposit accounts with a wide range of interest rates and terms, including savings, money market, interest and noninterest bearing checking accounts and certificates of deposit (“CDs”). Our trust services include investment management, administration and advisory services, primarily for individuals and, to a lesser extent, partnerships and corporations. At December 31, 2014, our trust department managed approximately $932.6 million of trust assets.

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

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

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

RECENT DEVELOPMENTS

During the fourth quarter of 2014, we completed the sale of all of the loans purchased by SFG and the repossessed assets SFG held.

During the fourth quarter of 2014, we received regulatory approval to acquire OmniAmerican Bancorp, Inc. and the acquisition was completed on December 17, 2014.

MARKET AREA

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

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

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

Our 64 branches and 26 motor bank facilities are located in and around Tyler, Longview, Lindale, Gresham, Jacksonville, Bullard, Chandler, Hawkins, Seven Points, Palestine, Forney, Gun Barrel City, Athens, Whitehouse, Fort Worth, Arlington, Cleburne, Euless, Flower Mound, Granbury, Grapevine, Irving, Watauga, Weatherford and Austin. Our advertising is designed to target the market areas we serve. The type and amount of advertising done in each market area is directly attributable to our market share in that market area combined with overall cost. Additionally, our customers may access various banking services through a network of over 70 automated teller machines ("ATMs") and ATMs owned by others, through debit cards, and through our automated telephone, internet and electronic banking products. These products allow our customers to apply for loans from their computers, access account information and conduct various other transactions from their telephones, smart phones and computers.

THE BANKING INDUSTRY IN TEXAS

The banking industry is affected by general economic conditions such as interest rates, inflation, recession, unemployment and other factors beyond our control. During the last thirty years the Texas economy has continued to diversify, decreasing the overall impact of fluctuations in oil and gas prices; however, the oil and gas industry is still a significant component of the Texas economy. In the last three to five years, economic growth and business activity across a wide range of industries and regions in the U.S. has been slow and uneven. During that time economic growth and business activity in Texas has exceeded the U.S. average. However, recent decisions by certain members of the Organization of Petroleum Exporting Countries ("OPEC") to maintain higher crude oil production levels have led to increased global oil supplies which has resulted in significant declines in market oil prices. Decreased market oil prices have compressed margins for many U.S. and Texas-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. As of December 31, 2014, the price per barrel of crude oil was approximately $53 compared to approximately $98 as of December 31, 2013. A prolonged period of low oil prices could have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Texas. We cannot predict whether current economic conditions will improve, remain the same or decline.

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COMPETITION

The activities we are engaged in are highly competitive. Financial institutions such as credit unions, consumer finance companies, insurance companies, brokerage companies and other financial institutions with varying degrees of regulatory restrictions compete vigorously for a share of the financial services market. During 2014, the number of financial institutions in our market areas increased, a trend that we expect will continue. Brokerage and insurance companies continue to become more competitive in the financial services arena and pose an ever-increasing challenge to banks. Legislative changes also greatly affect the level of competition we face. Federal legislation allows credit unions to use their expanded membership capabilities, combined with tax-free status, to compete more fiercely for traditional bank business. The tax-free status granted to credit unions provides them with a significant competitive advantage. Many of the largest banks operating in Texas, including some of the largest banks in the country, have offices in our market areas with capital resources, broader geographic markets, and legal lending limits substantially in excess of those available to us. We face competition from institutions that offer products and services we do not or cannot currently offer. Some institutions we compete with offer interest rate levels on loan and deposit products that we are unwilling to offer due to interest rate risk and overall profitability concerns. We expect the level of competition to continue to increase.

EMPLOYEES

At February 28, 2015, we employed approximately 813 full time equivalent persons. None of our employees are represented by any unions or similar groups, and we have not experienced any type of strike or labor dispute. We consider the relationship with our employees to be good.

SUPERVISION AND REGULATION

General

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

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

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

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

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

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

Holding Company Regulation

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

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

- banking or managing or controlling banks;
- furnishing services to or performing services for our subsidiaries; and
- any activity that the Federal Reserve determines to be so closely related to banking as to be a proper incident to the business of banking, including:

factoring accounts receivable;
making, acquiring, brokering or servicing loans and usual related activities;
leasing personal or real property;
operating a nonbank depository institution, such as a savings association;
performing trust company functions;
conducting financial and investment advisory activities;

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

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

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

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

Capital Adequacy. Each of the federal banking agencies, including the Federal Reserve and the FDIC, has issued substantially similar risk-based and leverage capital guidelines applicable to the banking organizations they supervise. As a result of new regulations, we were required to begin complying with higher minimum capital requirements as of

January 1, 2015. The new capital rules (“Updated Capital Rules”), which are discussed below, implement certain provisions of the Dodd-Frank Act and a separate, international regulatory capital initiative known as “Basel III.” These Updated Capital Rules also make important changes to the “prompt corrective action” framework discussed below in Bank Regulation - Prompt Corrective Action and Undercapitalization.

The agencies’ risk-based guidelines applicable to the Company prior to January 1, 2015 define a three-tier capital framework. Tier 1 capital principally consists of shareholders’ equity less any amounts of goodwill, other intangible assets, interest-only strips receivables, deferred tax assets, nonfinancial equity investments and other items that are required to be deducted by the Federal Reserve. Perpetual, non-cumulative preferred stock, certain amounts of trust-preferred securities and minority interests in consolidated subsidiaries also may be included in Tier 1 capital, but the Federal Reserve requires that common stock be the predominant form of Tier 1 capital. Tier 2 capital principally consists of perpetual and trust preferred stock not qualifying as Tier 1 capital, mandatorily convertible debt, limited amounts of term-subordinated debt, intermediate-term preferred stock, and, subject to limitations, general allowances for loan and lease losses, and other adjustments. Tier 3 capital includes subordinated debt that is unsecured, fully paid, has an original maturity of at least two years, is not redeemable before maturity without prior approval by the Federal Reserve and includes a lock-in clause precluding payment of either interest or principal if the payment would cause the issuing bank's risk-based capital ratio to fall or remain below the requirement minimum. The sum of Tier 1 and Tier 2 capital less investments in unconsolidated subsidiaries represents qualifying total capital.

Risk-based capital ratios are calculated by dividing, as appropriate, total capital and Tier 1 capital by risk-weighted assets. Assets and off-balance sheet exposures are assigned to one of four categories of risk weights, based primarily on relative credit risk. Under the existing risk-based capital requirements, the Company and Southside Bank are each generally required to maintain a minimum ratio of total capital to risk-weighted assets of at least 8% and a minimum ratio of Tier 1 capital to risk-weighted assets of at least 4%. To the extent we engage in trading activities, we are required to adjust our risk-based capital ratios to take into consideration market risks that may result from movements in market prices of covered trading positions in trading accounts, or from foreign exchange or commodity positions, whether or not in trading accounts, including changes in interest rates, equity prices, foreign exchange rates or commodity prices. Any capital required to be maintained under these provisions may consist of Tier 3 capital.

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

The ratios of Tier 1 capital and total capital to risk-weighted assets, and the leverage ratios of the Company and Southside Bank as of December 31, 2014, are shown in the following table.

	Capital Adequacy Ratios			
	Regulatory Minimums	Regulatory Minimums to be Well Capitalized	Southside Bancshares, Inc.	Southside Bank
Risk-based capital ratios:				
Tier 1 capital [(1)]	4.00 %	6.00 %	16.12 %	15.55 %
Total risk-based capital [(2)]	8.00 %	10.00 %	16.69 %	16.13 %
Tier 1 leverage ratio [(3)]	4.00 %	5.00 %	11.35 %	10.95 %

(1) Common shareholders' equity excluding unrealized gains or losses on debt securities available for sale, unrealized gains on equity securities available for sale and unrealized gains or losses on cash flow hedges, net of deferred income taxes; plus certain mandatorily redeemable capital securities, less nonqualifying intangible assets net of applicable deferred income taxes, and certain nonfinancial equity investments; computed as a ratio of risk-weighted assets, as defined in the risk-based capital guidelines.

(2) The sum of Tier 1 capital, a qualifying portion of the allowance for credit losses, qualifying subordinated debt and qualifying unrealized gains on available for sale equity securities; computed as a ratio of risk-weighted assets, as defined in the risk-based capital guidelines.

(3) Tier 1 capital computed as a percentage of fourth quarter average assets less nonqualifying intangibles and certain nonfinancial equity investments.

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

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

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

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

In addition, reflecting the importance that regulators place on managing capital and other risks, on June 16, 2011, the banking agencies also issued proposed guidance on stress testing for banking organizations with more than $10 billion in total consolidated assets. This guidance, which was finalized on May 14, 2012, outlines four "high-level" principles for stress testing practices that should be a part of a banking organization's stress-testing framework. Specifically, the guidance calls for the framework to (i) include activities and exercises that are tailored to and sufficiently capture the banking organization's exposures, activities and risks; (ii) employ multiple conceptually sound stress testing activities and approaches; (iii) be forward-looking and flexible; and (iv) be clear, actionable, well-supported, and used in the decision-making process. Moreover, the federal bank regulators have issued a series of guidance and rulemakings applicable to "large banks." While many of these do not currently apply to us due to our asset size, these issuances could impact industry capital standards and practices in many, potentially unforeseeable, ways.

Source of Strength. Federal Reserve policy requires a bank holding company to act as a source of financial strength and to take measures to preserve and protect bank subsidiaries in situations where additional investments in a troubled bank may not otherwise be warranted. As a result, a bank holding company may be required to contribute additional capital to its subsidiaries in the form of capital notes or other instruments which qualify as capital under regulatory rules. Any loans from the holding company to its subsidiary banks likely will be unsecured and subordinated to the bank's depositors and perhaps to other creditors of the bank. Notably, the Dodd-Frank Act codified the Federal Reserve's "source of strength" policy; this statutory change became effective July 21, 2011. In addition to the foregoing requirements, the Dodd-Frank Act's provisions authorize the Federal Reserve and other federal banking regulators to require a company that directly or indirectly controls a bank to submit reports that are designed both to assess the ability of such company to comply with its "source of strength" obligations and to enforce the company's compliance with these obligations. As of December 31, 2014 the Federal Reserve and other federal banking regulators have not yet issued rules implementing this requirement.

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

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

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

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

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

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

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

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

Bank Regulation

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

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

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

Brokered Deposits. Southside Bank also may be restricted in its ability to accept, renew or roll over brokered deposits, depending on its capital classification. Only "well-capitalized" banks are permitted to accept, renew or roll over brokered deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized to accept brokered deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank. Undercapitalized banks generally may not accept, renew or roll over brokered deposits.

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

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

Deposit Insurance and Assessments. The deposits of Southside Bank are insured by the DIF of the FDIC, up to the applicable limits established by law and are subject to the deposit insurance premium assessments of the DIF. The Dodd-Frank Act amended the statutory regime governing the DIF. Among other things, the Dodd-Frank Act established a minimum designated reserve ratio ("DRR") of 1.35 percent of estimated insured deposits (which the FDIC has set at 2.0 percent each year since 2010), required that the fund reserve ratio reach 1.35 percent by September 30, 2020 and directed the FDIC to amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. Specifically, the Dodd-Frank Act requires the assessment base to be an amount equal to the average consolidated total assets of the insured depository institution during the assessment period, minus the sum of the average tangible equity of the insured depository institution during the assessment period and an amount the FDIC determines is necessary to establish assessments consistent with the risk-based assessment system found in the FDIA. Furthermore, on February 7, 2011, the FDIC issued a final rule changing its assessment system from one based on domestic deposits to one based on the average consolidated total assets of a bank minus its average tangible equity during each quarter. This rule modified two adjustments added to the risk-based pricing system in 2009 (an unsecured debt adjustment and a brokered deposit adjustment), discontinued a third adjustment added in 2009 (the secured liability adjustment), and added an adjustment for long-term debt held by an insured depository institution where the debt is issued by another insured depository institution. Under these revisions to the DIF rules, the total base assessment rates will vary depending on the DIF reserve ratio. For example, for banks in the best risk category, the initial total base assessment rates will be between 2.5 and 9 basis points when the DIF reserve ratio is below 1.15 percent, between 1.5 and 7 basis points when the DIF reserve ratio is between 1.15 percent and 2 percent, between 1 and 6 basis points when the DIF reserve ratio is between 2 percent and 2.5 percent and between 0.5 and 5 basis points when the DIF reserve ratio is 2.5 percent or higher.

In addition, all FDIC-insured institutions are required to pay a pro rata portion of the interest due on bonds issued by the Financing Corporation ("FICO") to fund the closing and disposal of failed thrift institutions by the Resolution Trust Corporation. FICO assessments, which are calculated off the new assessment base established by the Dodd-Frank Act, are set quarterly, and was .620 (annual) basis points for all four quarters of 2014 and .600 (annual) basis points for the first quarter of 2015. These assessments will continue until the FICO bonds mature in 2017 through 2019.

Capital Adequacy.

See Holding Company Regulation - Capital Adequacy.

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

- Well Capitalized - The insured depository institution exceeds the required minimum level for each relevant capital measure. A well-capitalized insured depository institution is one (1) having a total risk-based capital ratio of 10 percent or greater, (2) having a Tier 1 risk-based capital ratio of 6 percent or greater, (3) having a leverage capital ratio of 5 percent or greater, and (4) that is not subject to any order or written directive to meet and maintain a specific capital level for any capital measure. Under the Updated Capital Rules that started to phase in on January 1, 2015, a well-capitalized insured depository institution is one (1) having a total risk-based capital ratio of 10 percent or greater, (2) having a Tier 1 risk-based capital ratio of 8 percent or greater, (3) having a CET1 capital ratio of 6.5 percent or greater, (4) having a leverage capital ratio of 5 percent or greater and (5) that is not subject to any order or written directive to meet and maintain a specific capital level for any capital measure.
- Adequately Capitalized - The insured depository institution meets the required minimum level for each relevant capital measure. An adequately capitalized insured depository institution is one (1) having a total risk-based capital ratio of 8 percent or greater, (2) having a Tier 1 risk-based capital ratio of 4 percent or greater, and (3) having a leverage capital ratio of 4 percent or greater, or a leverage capital ratio of 3 percent or greater if the institution is rated composite 1 under the CAMELS (Capital, Assets, Management, Earnings, Liquidity and Sensitivity to market risk) rating system, and (4) failing to meet the definition of a well-capitalized bank. Under the Updated Capital Rules, an adequately-capitalized depository institution is one having (1) a total risk based capital ratio of 8 percent or more, (2) a Tier 1 capital ratio of 6 percent or more, (3) a CET1 capital ratio of 4.5 percent or more, and (4) a leverage ratio of 4 percent or more.
- Undercapitalized - The insured depository institution fails to meet the required minimum level for any relevant capital measure. An undercapitalized insured depository institution is one (1) having a total risk-based capital ratio of less than 8 percent, (2) having a Tier 1 risk-based capital ratio of less than 4 percent, or (3) a leverage capital ratio of less than 4 percent, or if the institution is rated a composite 1 under the CAMELS rating system, a leverage capital ratio of less than 3 percent. Under the Updated Capital Rules, an undercapitalized depository institution is one having (1) a total capital ratio of less than 8 percent, (2) a Tier 1 capital ratio of less than 6 percent, (3) a CET1 capital ratio of less than 4.5 percent, or (4) a leverage ratio of less than 4 percent.
- Significantly Undercapitalized - The insured depository institution is significantly below the required minimum level for any relevant capital measure. A significantly undercapitalized insured depository institution is one (1) having a total risk-based capital ratio of less than 6 percent, (2) a Tier 1 risk-based capital ratio of less than 3 percent, or (3) a leverage capital ratio of less than 3 percent. Under the Updated Capital Rules, a significantly undercapitalized institution is one having (1) a total risk-based capital ratio of less than 6 percent (2) a Tier 1 capital ratio of less than 4 percent, (3) a CET1 ratio of less than 3 percent or (4) a leverage capital ratio of less than 3 percent.
- Critically Undercapitalized - The insured depository institution fails to meet a critical capital level set by the appropriate federal banking agency. A critically undercapitalized institution is one having a ratio of tangible equity to total assets that is equal to or less than 2 percent. The Updated Capital Rules retain the 2 percent threshold but make certain changes to the framework for calculating an institution's ratio of tangible equity to total assets.

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

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

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

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

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

Dividends. All dividends paid by Southside Bank are paid to the Company, as the sole shareholder of Southside Bank. The ability of Southside Bank, as a Texas state bank, to pay dividends is restricted under federal and state law and regulations. As an initial matter, the FDICIA and the regulations of the FDIC generally prohibit an insured depository institution from making a capital distribution (including payment of dividend) if, thereafter, the institution would not be at least adequately capitalized. Under Texas law, Southside Bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Texas Banking Commissioner. All dividends must be paid out of net profits then on hand, after deducting expenses, including losses and provisions for loan losses. Southside Bank's general dividend policy is to pay dividends at levels consistent with maintaining liquidity and preserving applicable capital ratios and servicing obligations. Southside Bank's dividend policies are subject to the discretion of its board of directors and will depend upon such factors as future earnings, financial conditions, cash needs, capital adequacy, compliance with applicable statutory and regulatory requirements and general business conditions. The exact amount of future dividends paid by Southside Bank will be a function of its general profitability (which cannot be accurately estimated or assured), applicable tax rates in effect from year to year and the discretion of its board of directors.

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

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

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

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

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

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

On a periodic basis, the FDIC is charged with preparing a written evaluation of our record of meeting the credit needs of the entire community and assigning a rating - outstanding, satisfactory, needs to improve or substantial noncompliance. Banks are rated based on their actual performance in meeting community credit needs. The FDIC will take that rating into account in its evaluation of any application made by the bank for, among other things, approval of the acquisition or establishment of a branch or other deposit facility, an office relocation, a merger or the acquisition of shares of capital stock of another financial institution. A bank's CRA rating may be used as the basis to deny or condition an application. In addition, as discussed above, a bank holding company may not become a financial holding company unless each of its subsidiary banks has a CRA rating of at least "satisfactory." As of January 1, 2014, the most recent exam date, Southside Bank has a CRA rating of "outstanding."

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

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

Consumer Protection Regulation. The activities of Southside Bank are subject to a variety of statutes and regulations designed to protect consumers. Interest and other charges collected or contracted for by the banks are subject to state usury laws

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and federal laws concerning interest rates. Loan operations are also subject to federal laws and regulations applicable to credit transactions, such as:

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

Deposit and other operations also are subject to:

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

Many of the foregoing laws and regulations have recently changed and are subject to further change resulting from the provisions in the Dodd-Frank Act and other developments. In addition to numerous new disclosure requirements, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks, in an effort to encourage lenders to verify a borrower's ability to repay. In January 2013, the Bureau issued rules to implement this "ability-to-repay" requirement and provide lenders with protection from liability for "qualified mortgages," as required by the Dodd-Frank Act. In May, July and October 2013 the Bureau issued rules amending certain provisions of the January 2013 rule. The final rule, which took effect on January 10, 2014, will likely impact our residential mortgage lending practices, and the residential mortgage market generally. Most significantly, the new "qualified mortgage" standards generally limit the total points and fees that financial institutions and/or a broker may charge on conforming and jumbo loans to 3 percent of the total loan amount. Also, the Dodd-Frank Act, in conjunction with the Federal Reserve's final rule on loan originator compensation issued August 16, 2010 and effective April 1, 2011, prohibits certain compensation payments to loan originators and steering consumers to loans not in their interest because it will result in greater compensation for a loan originator. In addition, the Bureau recently issued additional rules pertaining to loan originator compensation, and that established qualification, registration and licensing requirements for loan originators. These standards will result in a myriad of new system, pricing, and compensation controls in order to ensure compliance and to decrease repurchase requests and foreclosure defenses. In addition, the Dodd-Frank Act generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans the lender sells and other asset-backed securities that the securitizer issues if the loans have not complied with the ability to repay standards. The final rule, which will become effective on December 24, 2015 for residential mortgage-backed securitizations, generally requires the securitizer to retain not less than 5 percent of the credit risk.

Moreover, the Bureau has republished the transferred regulations in a new section of the Code of Federal Regulations and has requested comments regarding an effort to "streamline" these regulations. It is also anticipated that the Bureau will be making substantive changes to a number of consumer protection regulations and associated disclosures in the near term including significant changes to certain requirements related to lending. The Bureau has also established a series of mechanisms to collect, track and make public consumer complaints, including complaints against individual financial institutions and is using this, and other information it has gathered, in connection with a variety of initiatives to address issues in markets for consumer financial products and services. The Bureau also has broad authority to prohibit unfair, deceptive and abusive acts and practices ("UDAAP") and to investigate and penalize financial institutions that violate this prohibition.

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

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

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

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

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

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

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

- establishment of anti-money laundering programs, including adoption of written procedures and an ongoing employee training program, designation of a compliance officer and auditing of the program;
- establishment of a program specifying procedures for obtaining information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time;
- establishment of enhanced due diligence policies, procedures and controls designed to detect and report money laundering, for financial institutions that administer, maintain or manage private bank accounts or correspondent accounts for non-U.S. persons;
- prohibitions on correspondent accounts for foreign shell banks and compliance with recordkeeping obligations with respect to correspondent accounts of foreign banks;
- filing of suspicious activities reports if a bank believes a customer may be violating U.S. laws and regulations; and
- requirements that bank regulators consider bank holding company or bank compliance in connection with merger or acquisition transactions.

Bank regulators routinely examine institutions for compliance with these obligations and have been active in imposing cease and desist and other regulatory orders and money penalty sanctions against institutions found to be violating these obligations. In addition, FinCEN issued a Notice of Proposed Rulemaking on August 4, 2014 that would require financial institutions to obtain beneficial ownership information for certain accounts, however, it has yet to issue a final rule on this topic.

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

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

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

In addition, federal and state banking agencies have prescribed standards for maintaining the security and confidentiality of consumer information. Southside Bank is subject to such standards, as well as standards for notifying consumers in the event of a security breach. Under existing federal law, Southside Bank must disclose its privacy policy for collecting and protecting confidential customer information to consumers, permit consumers to “opt out” of having nonpublic customer information disclosed to non-affiliated third parties, with some exceptions, and allow customers to opt out of receiving marketing solicitations based on information about the customer received from another subsidiary. On October 28, 2014, the Bureau amended the annual privacy notice requirement to permit a financial institution to provide the annual privacy notice through posting the annual notice on its website if the financial institution meets certain conditions. States may adopt more extensive privacy protections. Southside Bank is similarly required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Regulatory Examination.

See Holding Company Regulation - Regulatory Examination.

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

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

Evolving Legislation and Regulatory Action. Proposals for new statutes and regulations are frequently circulated at both the federal and state levels, and may include wide-ranging changes to the structures, regulations and competitive relationships of financial institutions. We cannot predict whether new legislation or regulations will be enacted and, if

enacted, the effect that it, or any regulations, would have on our business, financial condition or results of operations.
Other Regulatory Matters. The Company and their affiliates are subject to oversight by the SEC, the Financial Industry Regulatory Authority, the New York Stock Exchange, the NASDAQ Stock Market and various state securities regulators. The Company and its subsidiaries have from time to time received requests for information from regulatory authorities in various states, including state attorneys general, securities regulators and other regulatory authorities, concerning their business practices. Such requests are considered incidental to the normal conduct of business.

ITEM 1A. RISK FACTORS

An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that management believes affect us are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our business operations. This report is qualified in its entirety by these risk factors. If any of the following risks actually occur, our financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of our common stock could decline significantly, and you could lose all or part of your investment.

RISKS RELATED TO OUR BUSINESS

We are subject to an economic environment that continues to pose significant challenges for us and could adversely affect our financial condition and results of operations.

We continue to operate in a challenging and uncertain economic environment. In the last three to five years, economic growth and business activity across a wide range of industries and regions in the U.S. has been slow and uneven. There can be no assurance that economic conditions will continue to improve, and these conditions could worsen. In addition, declining oil prices, on-going federal budget negotiations, the implementation of the employer mandate under the Patient Protection and Affordable Care Act and the level of U.S. debt may have a destabilizing effect on our financial markets. Declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including unemployment and new job losses, could have an adverse effect on our borrowers or their customers, which could adversely affect our financial condition and results of operations. In addition, should we see a decline in national or regional economic conditions, the residual deterioration in local economic conditions in our markets could drive losses beyond those which are provided for in our allowance for loan losses and result in the following consequences:

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

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

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

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

Current market developments may adversely affect our industry, business and results of operations.

Dramatic declines in the housing market during prior years, with falling home prices and increased foreclosures and high levels of unemployment, resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities, caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors, primarily from 2008 to 2010, reduced, and in some cases, ceased to provide funding to borrowers including other financial institutions. In the past few years availability of credit has increased. Should conditions deteriorate the resulting lack of available credit, lack of confidence in the financial sector, increased volatility in the financial markets and reduced business activity could materially and adversely affect our business, financial condition and results of operations.

We are subject to interest rate risk.

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

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

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

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

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

We have and continue to purchase MBS at significant premiums due to the low interest rate environment. Our prepayment assumptions take into account Bloomberg consensus speeds, current trends and past experience. On October 24, 2011, the Federal Housing Finance Agency (the “FHFA”) announced expanded initiatives to assist homeowners that might not otherwise have been able to qualify for a new mortgage to refinance their mortgage. The FHFA announced changes to the guidelines related to loan-to-value, appraisals, and certain fees, among other things, subject to a variety of qualifications and the extension of the end date for the Home Affordable Refinance Program (“HARP”) until December 31, 2014. It does not change the time period which these loans were originated, maintaining the requirement that the loans must have been guaranteed by Fannie Mae or Freddie Mac on or before May 31, 2009. These changes could cause MBS prepayments to significantly exceed our projections. If actual prepayments exceed our projections, the amortization expense associated with these MBS will increase, thereby decreasing our net income. The increase in amortization expense and the corresponding decrease in net income could have a material adverse effect on our financial condition and results of operations.

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

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

Our interest rate risk, liquidity, fair value of securities and profitability are subject to risks associated with the successful management of our balance sheet strategy.

We implemented a balance sheet strategy for the purpose of enhancing overall profitability by maximizing the use of our capital. The effectiveness of our balance sheet strategy, and therefore our profitability, may be adversely affected by a number of factors, including reduced net interest margin and spread, adverse fair value changes to the investment securities and U.S. agency

MBS, adverse changes in the market liquidity of our investment securities and U.S. agency MBS, incorrect modeling results due to the unpredictable nature of MBS prepayments, the length of interest rate cycles and the slope of the interest rate yield curve. In addition, we may not be able to obtain wholesale funding to profitably and properly fund the balance sheet strategy. If our balance sheet strategy is flawed or poorly implemented, we may incur significant losses. See the section captioned "Balance Sheet Strategy" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

A significant portion of our loan portfolio is dependent on real estate. In addition to the financial strength and cash flow characteristics of the borrower in each case, often loans are secured with real estate collateral. At December 31, 2014, approximately 65.0% of our loans have real estate as a primary or secondary component of collateral. The real estate in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. Beginning in the third quarter of 2007 and continuing throughout 2008, 2009 and 2010, there were well-publicized developments in the credit markets, beginning with a decline in the sub-prime mortgage lending market, which later extended to the markets for collateralized mortgage obligations, MBS and the lending markets generally. This decline has continued to result in restrictions in the resale markets during 2011 and 2012 for non-conforming loans and has had an adverse effect on retail mortgage lending operations in many markets. A further decline in the credit markets generally could adversely affect our financial condition and results of operations if we are unable to extend credit or sell loans in the secondary market. An adverse change in the economy affecting values of real estate generally or in our primary markets specifically could significantly impair the value of collateral and our ability to sell the collateral upon foreclosure. Furthermore, it is likely that, in a declining real estate market, we would be required to further increase our allowance for loan losses. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values or to increase our allowance for loan losses, our profitability and financial condition could be adversely impacted.

We have a high concentration of loans directly related to the medical community in our market areas. A negative change adversely impacting the medical community, for any reason, could result in losses and materially and adversely affect our business, financial condition, results of operations and future prospects.

A significant portion of our loan portfolio is dependent on the medical community. The primary source of repayment for loans in the medical community is cash flow from continuing operations. However, changes in the amount the government pays the medical community through the various government health insurance programs could adversely impact the medical community, which in turn could result in higher default rates by borrowers in the medical industry. Healthcare reform or increased regulation of the medical community could also negatively impact profitability and cash flow in the medical community. It is likely that, should there be any significant adverse impact to the medical community, our profitability and financial condition would also be adversely impacted.

Our allowance for probable loan losses may be insufficient.

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

We may be adversely affected by declining crude oil prices.

Recent decisions by certain members OPEC to maintain higher crude oil production levels have led to increased global oil supplies which has resulted in significant declines in market oil prices. Decreased market oil prices have compressed margins for many U.S. and Texas-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. As of December 31, 2014, energy loans comprised approximately 1.8% of our loan portfolio. Energy production and related industries represent a part of the economies in our primary markets. As of December 31, 2014, the price per barrel of crude oil was approximately $53 compared to approximately $98 as of December 31, 2013. If oil prices remain at these low levels for an extended period, we could experience weaker energy loan demand and increased losses within our energy portfolio. A prolonged period of low oil prices could also have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Texas. Accordingly, a prolonged period of low oil prices could have a material adverse effect on our business, financial condition and results of operations.

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

Management regularly reviews and updates our disclosure controls and procedures, including our internal control over financial reporting. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, 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. Failure to achieve and maintain an effective internal control environment could result in us not being able to accurately report our financial results, prevent or detect fraud, or provide timely and reliable financial information pursuant to our reporting obligations, which could have a material adverse effect on our business, financial condition, and results of operations. Further, it could cause our investors to lose confidence in the financial information we report, which could affect the trading price of our common stock.

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. If hazardous or toxic substances are found, 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 or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

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

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

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

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

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

New lines of business or new products and services may subject us to additional risks.
From time to time, we may implement new delivery systems, such as internet banking, or offer new products and services within existing lines of business. In developing and marketing new delivery systems and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, results of operations and financial condition.
We rely on dividends from our subsidiary for most of our revenue.
Southside Bancshares, Inc. is a separate and distinct legal entity from our subsidiaries. We receive substantially all of our revenue from dividends from our subsidiary, Southside Bank. These dividends are the principal source of funds to pay dividends on our common stock and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that Southside Bank, and certain nonbank subsidiaries may pay to Southside Bancshares, Inc. Also, Southside Bancshares, Inc.'s right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event Southside Bank is unable to pay dividends to Southside Bancshares, Inc., Southside Bancshares, Inc. may not be able to service debt, pay obligations or pay dividends on common stock. The inability to receive dividends from Southside Bank could have a

material adverse effect on Southside Bancshares, Inc.'s business, financial condition and results of operations. See the section captioned "Supervision and Regulation" in "Item 1. Business" and "Note 13 – Shareholders' Equity" to our consolidated financial statements included in this report.

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

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

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

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

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

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

We occasionally evaluate merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions and financial services companies. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. During 2014, we acquired OABC. Acquisitions typically involve the payment of a premium over book and fair values, and, therefore, some dilution of our tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits and synergies from an acquisition could have a material adverse effect on our financial condition and results of operations.

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

As of December 31, 2014, we had $101 million of goodwill and other intangible assets. A significant decline in our expected future cash flows, a significant adverse change in the business climate, slower growth rates or a significant and sustained decline in the price of our common stock may necessitate taking charges in the future related to the impairment of our goodwill and other intangible assets. If we were to conclude that a future write-down of goodwill and other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

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

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

We continually encounter technological change.

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

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

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

RISKS ASSOCIATED WITH THE BANKING INDUSTRY

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

Southside Bancshares, Inc., primarily through Southside Bank, and certain nonbank subsidiaries, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect our lending practices, capital structure, investment practices and dividend policy and growth, among other things. The statutory and regulatory framework under which we operate will change substantially over the next several years as the result of the enactment of the Dodd-Frank Act. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, addressing, among other things, systemic risk, capital adequacy, deposit insurance assessments, consumer financial protection, as implemented through the Bureau, interchange fees, derivatives, lending limits, mortgage lending practices, registration of investment advisors and changes among bank regulatory authorities. To date, there are a number of provisions of the Dodd-Frank Act that have not taken effect and many important provisions require implementing rules to become effective. In addition to these developments, Congress and federal and state regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit deposit fees and other types of fees we charge, limit the types of financial services and products we may offer and/or increase the ability of nonbanks to offer competing financial services and products, among other things. While we cannot predict the impact caused by the Dodd-Frank Act and forthcoming implementing rules, or the impact of any additional regulatory changes that may arise out of the current financial and economic environment, any regulatory changes or increased regulatory scrutiny could increase costs directly related to complying with new regulatory requirements. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations. While our policies and procedures are designed to prevent any such violations, there can be no assurance that such violations will not occur. See the section captioned “Supervision and Regulation” in “Item 1. Business” and “Note 13 – Shareholders’ Equity” to our consolidated financial statements included in this report.

We may become subject to increased regulatory capital requirements.

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

The earnings of financial services companies are significantly affected by general business and economic conditions.

Our operations and profitability are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, and the strength of the U.S. economy and the local economies in which we operate, all of which are beyond our control. A deterioration in economic conditions could result in an increase in loan delinquencies and nonperforming assets, decreases in loan collateral values and a decrease in demand for our products and services, among other things, any of which could have a material adverse impact on our financial condition and results of operations.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on our business, financial condition and results of operations.

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

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

The soundness of other financial institutions could adversely affect us.

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

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

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

RISKS ASSOCIATED WITH OUR COMMON STOCK

Our stock price can be volatile.

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

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

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

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

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

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

On September 4, 2003, we issued $20.6 million of floating rate junior subordinated debentures in connection with a $20.0 million trust preferred securities issuance by our subsidiary, Southside Statutory Trust III. These junior subordinated debentures mature in September 2033. On August 8 and 10, 2007, we issued $23.2 million and $12.9 million, respectively, of five-year fixed rate converting to floating rate thereafter, junior subordinated debentures in connection with $22.5 million and $12.5 million, respectively, trust preferred securities issuances by our subsidiaries Southside Statutory Trust IV and V, respectively. Trust IV matures October 2037 and Trust V matures September 2037. As part of the acquisition of FWBS on October 10, 2007, we assumed $3.6 million of floating rate junior subordinated debentures issued to Magnolia Trust Company I in connection with $3.5 million of trust preferred securities issued in 2005 that matures in 2035.

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

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

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

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

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

Any individual, acting alone or with other individuals, who are seeking to acquire, directly or indirectly, 10.0% or more of our outstanding common stock must comply with the Change in Bank Control Act, which requires prior notice to the Federal Reserve for any acquisition. Additionally, any entity that wants to acquire 5.0% or more of our outstanding common stock, or otherwise control us, may need to obtain the prior approval of the Federal Reserve under the BHCA of 1956, as amended. As a result, prospective investors in our common stock need to be aware of and comply with those requirements, to the extent applicable.

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

Southside Bank owns and operates the following properties:

- Southside Bank main branch at 1201 South Beckham Avenue, Tyler, Texas. The primary executive offices of Southside Bancshares, Inc. are located at this location;
- Fort Worth main branch located at 1320 South University Drive, Fort Worth, Texas. Additional executive offices of Southside Bancshares, Inc. are located at this location;
- Southside Bank Annex at 1211 South Beckham Avenue, Tyler, Texas. The Southside Bank Annex is directly adjacent to the main bank building. Human Resources, and other support areas are located in this building;
- Operations Annex at 1221 South Beckham Avenue, Tyler, Texas. Various back office, lending and training facilities and other support areas are located in this building;
- Southside Bank Trust at 1305 South Beckham Avenue, Tyler, Texas. The Trust Department is located in this building;
- Southside Bank Technology Center at 1010 East First Street, Tyler, Texas;
- Southside Bank main branch motor bank facility at 1010 East First Street, Tyler, Texas;
- South Broadway branch at 6201 South Broadway, Tyler, Texas;
- South Broadway branch motor bank facility at 6019 South Broadway, Tyler, Texas;
- Downtown branch at 113 West Ferguson Street, Tyler, Texas;
- Gentry Parkway branch and motor bank facility at 2121 West Gentry Parkway, Tyler, Texas;
- Highway 64 West branch and motor bank facility at 3815 State Highway 64 West, Tyler, Texas;
- Longview main branch and motor bank facility at 2001 Judson Road, Longview, Texas;
- Lindale main branch and motor bank facility at 2510 South Main Street, Lindale, Texas;
- Whitehouse main branch and motor bank facility at 901 Highway 110 North, Whitehouse, Texas;
- Jacksonville main branch and motor bank at 1015 South Jackson Street, Jacksonville, Texas;
- Gresham main branch and motor bank at 16691 FM 2493, Tyler, Texas;
- Gun Barrel City main branch and motor bank facility at 901 West Main, Gun Barrel City, Texas;
- Irving branch at 1401 Walnut Hill Lane, Irving, Texas;
- Cleburne branch at 1204 West Henderson, Cleburne, Texas;
- Euless branch at 2311 West Euless Boulevard, Euless, Texas;
- Arlington branch and motor bank facility at 2831 West Park Row, Arlington, Texas;
- Arlington branch at 950 West Arbrook Boulevard, Arlington, Texas;
- Fort Worth branch at 1000 Pennsylvania Avenue, Fort Worth, Texas;
- Fort Worth branch at 2330 East Rosedale Street, Fort Worth, Texas;
- Fort Worth branch at 6001 Bryant Irvin Road, Fort Worth, Texas;
- Fort Worth branch at 7800 White Settlement Road, Fort Worth, Texas;
- Fort Worth branch and motor bank facility at 9516 Clifford Street, Fort Worth, Texas;
- Watauga branch at 8024 Denton Highway, Watauga, Texas;
- Weatherford branch at 318 South Main Street, Weatherford, Texas; and
- 48 ATM's located throughout our market areas.

Southside Bank currently operates full service banks in leased space in 19 grocery stores and nine full service branches in leased office space in the following locations:

- one in Bullard, Texas;
- one in Lindale, Texas;
- one in Flint, Texas;
- one in Whitehouse, Texas;
- one in Chandler, Texas;
- one in Seven Points, Texas;
- one in Palestine, Texas;
- one in Athens, Texas;
- one in Hawkins, Texas;
- three in Longview, Texas;
- seven in Tyler, Texas;
- Fort Worth operations branch at 5001 North Riverside Drive, Suite 111, Fort Worth, Texas;
- Fort Worth branch and motor bank facility at 701 West Magnolia, Fort Worth, Texas;
- Fort Worth branch at 707 West Magnolia, Fort Worth, Texas;
- Forney branch at 413 North McGraw, Forney, Texas;
- Flower Mound branch at 2341 Justin Road, Flower Mound, Texas;
- Granbury branch at 1030 East Highway 377, Suite 138, Granbury, Texas;
- Grapevine branch at 1616 West Northwest Highway, Grapevine, Texas;
- Austin branch at 8200 North Mopac, Suite 130, Austin, Texas; and
- Austin branch at 1250 South Capital of Texas Hwy, Bldg 1, Suite 101, Austin, Texas.

SFG currently operates its business in leased office space in the following location:

- 700 West Arkansas Lane, Arlington, Texas.

All of the properties detailed above are suitable and adequate to provide the banking services intended based on the type of property described. In addition, the properties for the most part are fully utilized but designed with productivity in mind and can handle the additional business volume we anticipate they will generate. As additional potential needs are identified, individual property enhancements or the need to add properties will be evaluated.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

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

MARKET INFORMATION

Our common stock trades on the NASDAQ Global Select Market under the symbol "SBSI." Set forth below are the high and low sales prices on the NASDAQ Global Select Market for each full quarterly period from January 1, 2013 to December 31, 2014. During 2014 and 2013, we declared and paid a 5% stock dividend. Stock prices listed below have been adjusted to give retroactive recognition to such stock dividends.

Year Ended December 31,	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2014	$ 30.10 – 23.98	$ 31.15 – 25.54	$ 34.35 – 28.48	$ 34.30 – 28.88
2013	$ 19.66 – 19.00	$ 23.14 – 19.05	$ 25.97 – 23.14	$ 27.24 – 24.70

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

SHAREHOLDERS

There were approximately 1,440 holders of record of our common stock, the only class of equity securities currently issued and outstanding, as of February 28, 2015.

DIVIDENDS

Cash dividends declared and paid were $0.96 and $0.91 per share for the years ended December 31, 2014 and 2013, respectively. Stock dividends of 5% were also declared and paid during both of the years ended December 31, 2014 and 2013. We have paid a cash dividend at least once every year since 1970 (including dividends paid by Southside Bank prior to the incorporation of Southside Bancshares). Future dividends will depend on our earnings, financial condition and other factors that our board of directors considers to be relevant. In addition, we must make payments on our junior subordinated debentures before any dividends can be paid on the common stock. For additional discussion relating to restrictions that limit our ability to pay dividends refer to “Item 1. Business – Supervision and Regulation” and “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources.” The cash dividends were paid quarterly each year as listed below.

Quarterly Cash Dividends Paid

Year Ended December 31,	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2014	$0.21	$0.21	$0.22	$0.32
2013	$0.20	$0.20	$0.20	$0.31

ISSUER SECURITY REPURCHASES

During the quarter ended December 31, 2014, we did not purchase any of our common stock.

RECENT SALES OF UNREGISTERED SECURITIES

There were no equity securities sold by us during the years ended December 31, 2014, 2013, or 2012 that were not registered under the Securities Act of 1933.

FINANCIAL PERFORMANCE

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

Southside Bancshares, Inc.

	Period Ending					
Index	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14
Southside Bancshares, Inc.	100.00	117.66	132.65	142.66	201.97	231.56
Russell 2000	100.00	126.86	121.56	141.43	196.34	205.95
SBSI Peer Group 2013 Index*	100.00	114.15	114.22	129.30	191.76	178.41
SBSI Peer Group 2014 Index*	100.00	114.19	113.79	128.08	190.23	176.95

*SBSI Peer Group 2013 Index consist of Cullen/Frost Bankers, Inc. (CFR), First Financial Bankshares, Inc. (FFIN), International Bancshares Corporation (IBOC), MetroCorp Bancshares, Inc. (MCBI - This is historical now), Prosperity Bancshares, Inc. (PB), Texas Capital Bancshares, Inc. (TCBI).

*SBSI Peer Group 2014 Index consist of Cullen/Frost Bankers, Inc. (CFR), First Financial Bankshares, Inc. (FFIN), International Bancshares Corporation (IBOC), Prosperity Bancshares, Inc. (PB), Texas Capital Bancshares, Inc. (TCBI).

Source : SNL Financial LC, Charlottesville, VA

www.snl.com

We used a different index from the Index used the preceding fiscal year because a peer issuer in the SBSI Peer Group 2013 Index was acquired and is no
longer publicly traded.

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial data regarding our results of operations and financial position for, and as of the end of, each of the fiscal years in the five-year period ended December 31, 2014. This information should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 8. Financial Statements and Supplementary Data," as set forth in this report.

	As of and For the Years Ended December 31,				
	2014 [(1)]	2013	2012	2011	2010
	(in thousands, except per share data)				
Balance Sheet Data:					
Investment Securities	$695,529	$728,981	$618,716	$284,452	$300,839
Mortgage-backed Securities	$1,395,498	$1,115,827	$1,051,898	$1,729,516	$1,364,117
Loans, Net of Allowance for Loan Losses	$2,167,841	$1,332,396	$1,242,392	$1,068,690	$1,057,209
Total Assets	$4,807,261	$3,445,663	$3,237,403	$3,303,817	$2,999,759
Deposits	$3,374,417	$2,527,808	$2,351,897	$2,321,671	$2,134,428
Long-term Obligations	$660,363	$559,660	$429,408	$321,035	$433,790
Shareholders' Equity	$425,243	$259,518	$257,763	$258,927	$214,461
Income Statement Data:					
Interest Income	$123,778	$119,602	$116,020	$131,038	$131,374
Interest Expense	$16,956	$17,968	$26,895	$35,631	$45,307
Deposit Service Income	$15,280	$15,560	$15,433	$15,943	$16,819
Net Gain on Sale of Securities Available for Sale	$2,830	$8,472	$17,966	$11,795	$25,789
Noninterest Income	$24,489	$35,245	$40,021	$35,322	$50,798
Noninterest Expense	$97,704	$81,713	$76,107	$72,348	$71,314
Net Income Attributable to Southside Bancshares, Inc.	$20,833	$41,190	$34,695	$39,133	$39,103
Per Share Data:					
Earnings Per Common Share:					
Basic	$1.09	$2.19	$1.82	$2.06	$2.04
Diluted	$1.09	$2.19	$1.82	$2.06	$2.04
Cash Dividends Paid Per Common Share	$0.96	$0.91	$1.11	$0.90	$0.85

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

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

The following discussion and analysis provides a comparison of our results of operations for the years ended December 31, 2014, 2013, and 2012 and financial condition as of December 31, 2014 and 2013. This discussion should be read in conjunction with the financial statements and related notes included elsewhere in this report. All share data has been adjusted to give retroactive recognition to stock splits and stock dividends.

CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

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

- general economic conditions, either globally, nationally, in the State of Texas, or in the specific markets in which we operate, including, without limitation, the deterioration of the commercial real estate, residential real estate, construction and development, energy, oil and gas, credit and liquidity markets, which could cause an adverse change in our net interest margin, or a decline in the value of our assets, which could result in realized losses;
- legislation, regulatory changes or changes in monetary or fiscal policy that adversely affect the businesses in which we are engaged, including the impact of the Dodd-Frank Act, the Federal Reserve's actions with respect to interest rates and other regulatory responses to current economic conditions;
- adverse changes in the status or financial condition of the Government-Sponsored Enterprises (the "GSEs") impacting the GSEs' guarantees or ability to pay or issue debt;
- adverse changes in the credit portfolio of other U.S. financial institutions relative to the performance of certain of our investment securities;
- economic or other disruptions caused by acts of terrorism in the United States, Europe or other areas;
- changes in the interest rate yield curve such as flat, inverted or steep yield curves, or changes in the interest rate environment that impact interest margins and may impact prepayments on the mortgage-backed securities ("MBS") portfolio;
- increases in our nonperforming assets;
- our ability to maintain adequate liquidity to fund operations and growth;
- the failure of our assumptions underlying allowance for loan losses and other estimates;
- unexpected outcomes of, and the costs associated with, existing or new litigation involving us;
- changes impacting our balance sheet and leverage strategy;

- risks related to actual U.S. agency MBS prepayments exceeding projected prepayment levels;
- risks related to U.S. agency MBS prepayments increasing due to U.S. Government programs designed to assist homeowners to refinance their mortgage that might not otherwise have qualified;
- our ability to monitor interest rate risk;
- significant increases in competition in the banking and financial services industry;

- changes in consumer spending, borrowing and saving habits;
- technological changes;
- our ability to increase market share and control expenses;
- the effect of changes in federal or state tax laws;
- the effect of compliance with legislation or regulatory changes;
- the effect of changes in accounting policies and practices;
- risks of mergers and acquisitions including the related time and cost of implementing transactions and the potential failure to achieve expected gains, revenue growth or expense savings;
- impairment of our goodwill or other intangible assets;
- credit risks of borrowers, including any increase in those risks due to changing economic conditions; and
- risks related to loans secured by real estate, including the risk that the value and marketability of collateral could decline.

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

IMPACT OF DODD-FRANK ACT

On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, although some of its provisions apply to companies that are significantly larger than us. The Dodd-Frank Act directs applicable regulatory authorities to promulgate regulations implementing its provisions, and its effect on us and the financial services industry as a whole will be clarified as those regulations are issued. Major elements of the Dodd-Frank Act include:

- A permanent increase in deposit insurance coverage to $250,000 per account, unlimited deposit insurance on noninterest bearing transaction accounts beginning December 31, 2010 through December 31, 2012, and an increase in the minimum Deposit Insurance Fund reserve requirement from 1.15% to 1.35%, with assessments to be based on assets as opposed to deposits;
- New disclosure and other requirements relating to executive compensation and corporate governance;
- New prohibitions and restrictions on the ability of a banking entity and nonbank financial company to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund;
- Amendments to the Truth in Lending Act aimed at improving consumer protections with respect to mortgage originations, including originator compensation, minimum repayment standards, and prepayment considerations;
- The establishment of the Financial Stability Oversight Council, which will be responsible for identifying and monitoring systemic risks posed by financial firms, activities, and practices;
- The development of regulations to limit debit card interchange fees;
- The future elimination of newly issued trust preferred securities as a permitted element of Tier 1 capital;
- The creation of a special regime to allow for the orderly liquidation of systemically important financial companies, including the establishment of an orderly liquidation fund;
- The development of regulations to address derivatives markets, including clearing and exchange trading requirements and a framework for regulating derivatives-market participants;
- Enhanced supervision of credit rating agencies through the Office of Credit Ratings within the SEC;
- Increased regulation of asset-backed securities, including a requirement that issuers of asset-backed securities retain at least 5% of the risk of the asset-backed securities; and
- The establishment of a Bureau of Consumer Financial Protection with centralized authority, including examination and enforcement authority, for consumer protection in the banking industry.

Regulatory agencies are still in the process of issuing regulations, rules and reporting requirements as mandated by the Dodd-Frank Act. As a result, we are continuing to evaluate the potential impact of the Dodd-Frank Act on our business, financial condition and results of operations and expect that some provisions may have adverse effects on us, such as the cost of complying with the numerous new regulations and reporting requirements mandated by the Dodd-Frank Act.

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CRITICAL ACCOUNTING ESTIMATES

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

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

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

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to allocate the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $50,000 or more is updated on a quarterly basis in order to properly allocate the necessary allowance and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

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

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

As of December 31, 2014, our review of the loan portfolio indicated that a loan loss allowance of $13.3 million was appropriate to cover probable losses in the portfolio.

Refer to "Loan Loss Experience and Allowance for Loan Losses" and "Note 6 – Loans and Allowance for Probable Loan Losses" to our consolidated financial statements included in this report for a detailed description of our estimation process and methodology related to the allowance for loan losses.

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

At September 30, 2008 and continuing until the date of sale, the valuation inputs for our available for sale ("AFS") trust preferred securities ("TRUPs") became unobservable as a result of the significant market dislocation and illiquidity in the marketplace. We continued to rely on nonbinding prices compiled by third party vendors, which we verified to be an appropriate measure of fair value. However, the significant illiquidity in this market results in a fair value not clearly based on observable market data but rather a range of fair value data points from the market place. Accordingly, we had determined that the TRUPs security valuation was based on Level 3 inputs.

Defined Benefit Pension Plan. The plan obligations and related assets of our defined benefit pension plan (the "Plan") are presented in "Note 11 – Employee Benefits" to our consolidated financial statements included in this report. Entry into the Plan by new employees was frozen effective December 31, 2005. Plan assets, which consist primarily of marketable equity and debt instruments, are valued using observable market quotations. Plan obligations and the annual pension expense are determined by independent actuaries and through the use of a number of assumptions that are reviewed by management. Key assumptions in measuring the plan obligations include the discount rate, the rate of salary increases and the estimated future return on plan assets. In determining the discount rate, we utilized a cash flow matching analysis to determine a range of appropriate discount rates for our defined benefit pension and restoration plans. In developing the cash flow matching analysis, we constructed a portfolio of high quality noncallable bonds (rated AA or better) to match as close as possible the timing of future benefit payments of the plans at December 31, 2014. Based on this cash flow matching analysis, we were able to determine an appropriate discount rate.

Salary increase assumptions are based upon historical experience and our anticipated future actions. The expected long-term rate of return assumption reflects the average return expected based on the investment strategies and asset allocation on the assets invested to provide for the Plan's liabilities. We considered broad equity and bond indices, long-term return projections, and actual long-term historical Plan performance when evaluating the expected long-term rate of return assumption. At December 31, 2014, the weighted-average actuarial assumptions of the Plan were: a discount rate of 4.14%; a long-term rate of return on Plan assets of 7.25%; and assumed salary increases of 3.50%. At December 31, 2014, we changed from the mortality assumption table RP-2000 projected 10 years beyond the valuation date using Scale AA to the RP-2014 projected 15 years beyond the valuation date using MP-2014 scale (static). This change in mortality assumptions increased the expected average life of the participants which increased the liability and the expense. Material changes in pension benefit costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the number of Plan participants, changes in the level of benefits provided, changes in the discount rates, changes in the expected long-term rate of return, changes in the level of contributions to the Plan and other factors.

OVERVIEW

OPERATING RESULTS

During the year ended December 31, 2014, our net income decreased $20.4 million, or 49.4%, to $20.8 million, from $41.2 million for the same period in 2013. The decrease in net income was primarily attributable to merger expenses related to the acquisition of OABC, a loss on the sale of loans purchased by SFG which resulted in an increase in the provision for loan losses and an impairment of the investment in SFG, and a decrease in net gain on sale of securities available for sale. These items were partially offset by a decrease in income tax expense and an increase in net interest income. Noninterest expense increased primarily due to merger related expenses which is reflected primarily in salaries and employee benefits, software and data processing expense and professional fees. Earnings per diluted share decreased $1.10, or 50.2%, to $1.09 for the year ended December 31, 2014, from $2.19 for the same period in 2013.

During the year ended December 31, 2013, our net income increased $6.5 million, or 18.7%, to $41.2 million, from $34.7 million for the same period in 2012. The increase in net income was primarily attributable to the increase in net interest income, the decrease in the provision for loan losses and a reduction in the FHLB advance option impairment charge. These items were partially offset by a decrease in the net gain on sale of securities available for sale and an increase in noninterest expense. Noninterest expense increased primarily due to an increase in salaries and employee benefits. Earnings per diluted share increased to $2.19 for the year ended December 31, 2013, from $1.82 for the same period in 2012.

FINANCIAL CONDITION

Our total assets increased $1.36 billion, or 39.5%, to $4.81 billion at December 31, 2014 from $3.45 billion at December 31, 2013 primarily as a result of the acquisition of OABC on December 17, 2014. See "Note 2 -

Acquisition." This increase was attributable to increases in our loans and in our investment and mortgage-backed securities ("MBS"). Loans increased $829.9 million, or 61.4% to $2.18 billion compared to $1.35 billion at December 31, 2013. The increase in our loans was comprised of $298.8 million of 1-4 family residential, $222.7 million of commercial real estate, $118.3 million of construction, $100.5 million of loans to individuals, $77.7 million of commercial and $11.9 million of municipal loans. Our securities portfolio increased by $246.2 million, or 13.3%, to $2.09 billion compared to $1.84 billion at December 31, 2013. The increase in our securities was comprised of approximately $279.7 million of MBS and a decrease of approximately $33.5 million of investment securities, comprised of U.S. Treasury, Agency and Texas municipal securities. The increase in loans was funded by deposits and FHLB advances.

Our nonperforming assets at December 31, 2014 decreased to $12.3 million, and represented 0.26% of total assets, compared to $13.6 million, or 0.39% of total assets at December 31, 2013. Nonaccruing loans decreased $4.0 million to $4.1 million and the ratio of nonaccruing loans to total loans decreased to 0.19% at December 31, 2014 compared to 0.60% at December 31, 2013. Other Real Estate Owned ("OREO") increased to $1.7 million at December 31, 2014 from $726,000 at December 31, 2013. Accruing loans past due more than 90 days at December 31, 2014 increased to $4,000 compared to $3,000 at December 31, 2013. Repossessed assets decreased to $565,000 at December 31, 2014 from $901,000 at December 31, 2013. Restructured performing loans at December 31, 2014 increased to $5.9 million compared to $3.9 million at December 31, 2013.

Our deposits increased $846.6 million to $3.37 billion at December 31, 2014 from $2.53 billion at December 31, 2013. Our deposits, net of brokered deposits, increased $877.6 million during 2014. The increase in our deposits during 2014 was primarily the result of the acquisition of OABC. See "Note 2 - Acquisition." During 2014, our non-interest bearing deposits increased $131.1 million, and interest bearing deposits increased $715.5 million. During 2014, our brokered deposits decreased $31.0 million and our public fund deposits decreased $814,000. Total FHLB advances increased $324.6 million to $897.4 million at December 31, 2014, from $572.8 million at December 31, 2013. Short-term FHLB advances increased $223.9 million to $297.4 million at December 31, 2014 from $73.4 million at December 31, 2013. Long-term FHLB advances increased $100.7 million to $600.1 million at December 31, 2014 from $499.3 million at December 31, 2013. Other borrowings at December 31, 2014 and 2013 totaled $64.5 million and $61.2 million, respectively, and at December 31, 2014 consisted of $4.2 million of short-term borrowings and $60.3 million of long-term debt compared to $859,000 of short-term borrowings and $60.3 million of long-term debt at December 31, 2013.

Assets under management in our trust department increased during 2014 and were approximately $932.6 million at December 31, 2014 compared to $880.5 million at December 31, 2013.

Shareholders' equity at December 31, 2014 totaled $425.2 million compared to $259.5 million at December 31, 2013. The increase is primarily the result of the acquisition of OABC. See "Note 2 - Acquisition." To a lesser extent the increase reflects net income of $20.8 million recorded for the year ended December 31, 2014, the $1.2 million of common stock issued under our dividend reinvestment plan and a decrease in accumulated other comprehensive loss of $5.5 million. This was partially offset by cash dividends paid of $17.9 million. The decrease in accumulated other comprehensive loss is comprised primarily of an increase of $14.9 million, net of tax, in the unrealized gain on securities, net of reclassification adjustment and a decrease of $9.4 million, net of tax, related to the change in the funded status of our defined benefit plan. See "Note 4 – Accumulated Other Comprehensive (Loss) Income" to our consolidated financial statements included in this report.

Economic conditions in our market areas have continued to perform generally better than many other parts of the country. There continues to be some economic headwinds including a decline in oil prices, however despite these headwinds, many economists predict the national economy and the economy in markets we serve will continue to grow at a slow to modest pace in 2015.

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

BALANCE SHEET STRATEGY

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

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

Determining the appropriate size of the balance sheet is one of the critical decisions any bank makes. Our balance sheet is not merely the result of a series of micro-decisions, but rather the size is controlled based on the economics of assets compared to the economics of funding. The current low interest rate environment and investment and economic landscape make it unlikely that we will experience asset growth driven by an increase in the securities portfolio until one or more of these conditions change.

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

The year ended December 31, 2014 was marked by proactive management of the securities portfolio. The overall size of the portfolio increased as a result of the acquisition of OABC. During the first quarter of 2014, we sold longer duration municipal securities and U.S. Agency MBS to reduce duration and tax free income. We purchased U.S. Agency MBS with maturities ten years or less and premium U.S. Agency MBS at prices that create a favorable risk reward scenario with limited extension. During the second quarter of 2014, as long-term interest rates decreased, we sold shorter duration CMOs where prepayment concerns increased. Certain longer duration securities were sold due to the yield on those securities. We purchased U.S. Agency CMOs at prices that create a favorable risk reward scenario with limited extension. We also purchased tax free municipal bonds in anticipation of the additional taxable income as a result of the OABC merger. During the third quarter, due to a continued steep yield curve, we sold CMBS, and CMOs with durations of three to six years and replaced them with longer duration CMBS while freeing up $20 million to fund loan growth during the quarter. We also sold low yielding long duration nonbank qualified municipal securities and partially replaced them with mostly bank qualified municipal securities with a net result of freeing up an additional $50 million to fund loan growth during the quarter. During the fourth quarter we sold longer duration nonbank qualified municipal securities, U.S. Treasuries and CMBS. In addition we also sold approximately $57 million of U.S. Agency low coupon MBS from the OABC acquired securities portfolio as a part of a restructuring of that portfolio. These were low coupon MBS with longer payment windows. We purchased bank qualified municipal securities, premium CMOs with favorable expected returns in relation to risk, CMBS and treasury securities. Our investment securities and U.S. Agency MBS increased from $1.83 billion at December 31, 2013, to $2.09 billion at December 31, 2014. At December 31, 2014, securities as a percentage of assets decreased to 43.5%, when compared to 53.5% at December 31, 2013 as a result of the acquisition of OABC and OABC's large percentage of loans to assets. Our balance sheet management strategy is dynamic and will be continually reevaluated as market conditions warrant. As interest rates, yield curves, MBS prepayments, funding costs, security spreads and loan and deposit portfolios change, our determination of the proper types and maturities of securities to own, proper amount of securities to own and funding needs and funding sources will continue to be reevaluated. Should the economics of purchasing securities remain the same or decrease, we will likely allow this part of the balance sheet to shrink through run-off or security sales. However, should the economics become more attractive, we might strategically increase the securities portfolio and the balance sheet.

With respect to liabilities, we will continue to utilize a combination of FHLB advances and deposits to achieve our strategy of minimizing cost while achieving overall interest rate risk objectives as well as the liability management objectives of the ALCO. FHLB funding is the primary wholesale funding source we are currently utilizing. Our FHLB borrowings at December 31, 2014 increased 56.7%, or $324.6 million, to $897.4 million from $572.8 million at December 31, 2013 primarily as a result of the acquisition of OABC. In December 2014 we prepaid $39.2 million of FHLB advances with an average rate of 2.63%. This represented all of our higher priced advances maturing through December 2015. We paid prepayment fees of $539,000 associated with prepaying these advances. We will continue to purchase long-term FHLB advances as a hedge against future potential high interest rates. Our brokered CDs decreased to $23.4 million at December 31, 2014 from $54.4 million at December 31, 2013. As of December 31, 2014, all but $5.0 million of our brokered CDs were long-term. All of the long-term brokered CDs, except for one $5.0 million CD, have short-term calls that we control. We utilized long-term callable brokered CDs because the brokered CDs at the time of issuance better matched overall ALCO objectives by protecting us with fixed rates should interest rates increase, while providing us options to call the funding should interest rates decrease. We are actively evaluating the callable brokered CDs and may exercise the call option if there is an economic benefit. Our wholesale funding policy currently allows maximum brokered CDs of $180 million; however, this amount could be increased to match changes in ALCO objectives. The potential higher interest expense and lack of customer loyalty are risks associated with the use of brokered CDs. During 2014, an increase in FHLB advances, resulted in an increase in wholesale funding as a percentage of deposits, not including brokered CDs, to 27.5% at December 31, 2014, from 25.4% at December 31, 2013.

RESULTS OF OPERATIONS

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

NET INTEREST INCOME

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

	Years ended December 31,		
	2014	2013	2012
	(in thousands)		
Interest income			
Loans	$70,598	$72,910	$69,462
Investment securities – taxable	615	799	519
Investment securities – tax-exempt	24,038	25,483	13,644
Mortgage-backed securities	28,207	20,085	32,118
FHLB stock and other investments	181	182	240
Other interest earning assets	139	143	37
Total interest income	123,778	119,602	116,020
Interest expense			
Deposits	7,953	8,179	10,841
Short-term obligations	624	1,875	6,340
Long-term obligations	8,379	7,914	9,714
Total interest expense	16,956	17,968	26,895
Net interest income	$106,822	$101,634	$89,125

Net interest income for the year ended December 31, 2014 increased $5.2 million, or 5.1%, compared to the same period in 2013 and increased $12.5 million, or 14.0%, for the year ended December 31, 2013 compared to the same period in 2012. The overall increase in net interest income during 2014 was primarily the result of an increase in interest income from MBS and a decrease in short-term obligation interest expense coupled with a decrease in deposit interest expense, partially offset by a decrease in loan and investment securities - tax exempt interest income and an increase in long-term obligation interest expense. The overall increase in net interest income during 2013 was primarily the result of a decrease in short-term and long-term obligation interest expense coupled with a decrease in deposit interest expense and an increase in total interest income. In the fourth quarter of 2013 we recorded the immaterial cumulative effect of an error relating to prior years, which increased interest income $1.4 million.

During the year ended December 31, 2014, total interest income increased $4.2 million, or 3.5%, when compared to the same period in 2013, and during the year ended December 31, 2013, increased $3.6 million, or 3.1%, when compared to same period in 2012. The increase in total interest income for the year ended December 31, 2014 was the result of an increase in the average yield on average interest earning assets from 4.25% for the year ended December 31, 2013 to 4.29% for the year ended December 31, 2014 and an increase in average interest earning assets of $81.2 million, or 2.6%, from $3.18 billion to $3.26 billion from 2013 to 2014. The increase in the yield on interest earning assets during the year ended December 31, 2014 is reflective of an increase in the average yields of MBS, and taxable investment securities.

The increase in total interest income for the year ended December 31, 2013 was the result of an increase in the average yield on interest earning assets from 4.13% for the year ended December 31, 2012 to 4.25% for the year ended December 31, 2013 and an increase in the average interest earning assets of $109.8 million, or 3.6%, from $3.07 billion to $3.18 billion from 2012 to 2013. The increase in the yield on interest earning assets during the year ended December 31, 2013 is reflective of the shift in asset mix out of the lower yielding MBS and into higher yielding loans and tax-exempt investment securities and an immaterial cumulative prior period interest income error of $1.4 million recorded during the fourth quarter of 2013.

Total interest expense decreased $1.0 million, or 5.6%, during the year ended December 31, 2014. The decrease was attributable to a decrease in the average yield on interest bearing liabilities for the year ended December 31, 2014, to 0.66% from 0.71% for the same period in 2013 which more than offset the increase in average interest bearing liabilities of $61.2 million, or 2.4%, from $2.52 billion to $2.59 billion. The decrease in the average yield on interest bearing liabilities of five basis points was a result of continued low short-term interest rates during the year ended December 31, 2014. Total interest expense decreased $8.9 million, or 33.2%, during the year ended December 31, 2013, as compared to 2012. The decrease was attributable to a decrease in the average yield on interest bearing liabilities for the year ended December 31, 2013, to 0.71% from 1.11% for the same period in 2012 which more than offset the increase in average interest bearing liabilities of $96.3 million, or 4.0%, from $2.43 billion to $2.52 billion. The decrease in the average yield on interest bearing liabilities of 40 basis points is a result of overall lower interest rates. For the year ended December 31, 2014, our net interest spread increased to 3.63% from 3.54%, and our net interest margin increased to 3.77% from 3.69% when compared to the same period in 2013. For the year ended December 31, 2013, our net interest spread increased to 3.54% from 3.02%, and our net interest margin increased to 3.69% from 3.26% when compared to the same period in 2012.

During the year ended December 31, 2014, average loans increased $124.4 million, or 9.6%, to $1.42 billion from $1.30 billion, compared to the same period in 2013. During the year ended December 31, 2013, average loans increased $116.3 million, or 9.9%, from $1.18 billion to $1.30 billion, compared to the same period in 2012. Residential 1-4 family loans, commercial real estate loans, and municipal loans represent a large part of this increase for both years. The average yield on loans decreased from 5.92% for the year ended December 31, 2013 to 5.24% for the year ended December 31, 2014. Interest income on loans decreased $2.3 million, or 3.2%, for the year ended December 31, 2014 compared to the same period in 2013 as a result of a decrease in the average yield which more than offset the increase in average balance. The average yield on loans decreased from 6.23% for the year ended December 31, 2012 to 5.92% for the year ended December 31, 2013. Interest income on loans increased $3.4 million, or 5.0%, for the year ended December 31, 2013 compared to the same period in 2012 as a result of an increase in the average balance which more than offset the decrease in the average yield. The decrease in the yield on loans for 2014 and 2013 was due to selling the higher yielding SFG subprime automobile loans and competition and the overall low interest rate environment.

Average investment and MBS decreased $50.0 million, or 2.8%, to $1.75 billion from $1.80 billion for the year ended December 31, 2014 when compared to the same period in 2013 and decreased $37.5 million, or 2.0%, from $1.84 billion to $1.80 billion for the year ended December 31, 2013 when compared to the same period in 2012. At December 31, 2014, most of our MBS were fixed rate securities and less than one percent were variable rate MBS compared to approximately two percent in 2013. The overall yield on average investment and MBS increased to 3.72% during the year ended December 31, 2014 from 3.24% during the same period in 2013 and increased to 3.24% during the year ended December 31, 2013 from 2.90% during the same period in 2012. The increase in the average yield during 2014 primarily reflects an increase in the yield of MBS securities. The increase in the average yield during 2013 reflects the shift in the portfolio mix of less MBS and more tax exempt investment securities. Interest income on investment and MBS increased $6.5 million in 2014, or 14.0%, as the increase in the average yield more than offset the decrease in the average balance. A decrease in long-term interest rate levels combined with lower credit spreads could negatively impact our net interest margin in the future due to increased prepayments. Interest income on investment and MBS increased $86,000 in 2013, or 0.2%, due to an increase in the average yield which more than offset the decrease in the average balance.

Average FHLB stock and other investments decreased $2.7 million, or 8.6%, to $28.7 million, for the year ended December 31, 2014, when compared to $31.4 million for 2013 due to the decrease in average FHLB advances during 2014 and the corresponding requirement to hold stock associated with those advances. Average FHLB stock and other investments decreased $2.8 million, or 8.2%, to $31.4 million, for the year ended December 31, 2013, when compared to $34.2 million for 2012 due to the decrease in average FHLB advances during 2013 and the corresponding requirement to hold stock associated with those advances. Interest income from our FHLB stock and other investments decreased $1,000, or 0.5%, during 2014, due to a decrease in the average balance partially offset by an increase in the average yield from 0.58% for the year ended December 31, 2013 compared to 0.63% for the same period in 2014. Interest income from our FHLB stock and other investments decreased $58,000, or 24.2%, during 2013, due to a decrease in the average balance and the average yield from 0.70% for the year ended December 31, 2012 compared to 0.58% for the same period in 2013. The FHLB stock is a variable instrument with the rate typically tied to the federal funds rate. We are required as a member of FHLB to own a specific amount of stock that changes as the level of our FHLB advances and asset size change.

Average interest earning deposits decreased $274,000, or 0.5%, to $54.9 million, for the year ended December 31, 2014, when compared to $55.1 million for 2013. Interest income from interest earning deposits decreased $4,000 in 2014, or 2.8%, as a result of a decrease in average balance and average yield as compared to 2013. Average interest earning deposits increased $34.3 million, or 164.9%, to $55.1 million, for the year ended December 31, 2013, when compared to $20.8 million for 2012. Interest income from interest earning deposits increased $106,000, or 286.5%, for the year ended December 31, 2013, when compared to 2012, as a result of the increase in the average balance and average yield.

During the years ended December 31, 2014 and 2013, our average loans increased while our average securities decreased. As a result, the mix of our average interest earning assets changed as our average total securities as a percentage of total average interest earning assets averaged 54.5% during 2014 compared to 57.5% during 2013 and 60.9% during 2012. Average loans were 43.9% of average total interest earning assets during 2014 compared to 40.8% during 2013 and 38.5% during 2012. Other interest earning asset categories averaged 1.7% of average interest earning assets during 2014 compared to 1.7% during 2013 and 0.7% during 2012.

Total interest expense decreased $1.0 million, or 5.6%, during the year ended December 31, 2014 and $8.9 million, or 33.2%, during the year ended December 31, 2013. The decrease was primarily attributable to funding costs as the average yield on interest bearing liabilities decreased from 1.11% for 2012 to 0.71% for 2013 to 0.66% for the year ended December 31, 2014, which more than offset increases in average interest bearing liabilities in 2014 and 2013. The increase in average interest bearing liabilities included an increase in long-term FHLB advances of $61.4 million, or 14.1%, and an increase in interest bearing deposits of $133.2 million, or 7.3%, which was partially offset by a decrease in short-term obligations of $133.3 million, or 67.5%, during 2014. The increase in average interest bearing liabilities during the year ended December 31, 2013 included an increase in long-term FHLB advances of $104.0 million, or 31.3%, a decrease in short-term obligations of $87.2 million, or 30.6%, and an increase in interest bearing deposits of $79.5 million, or 4.5%.

The following table sets forth our deposit averages by category for the years ended December 31, 2014, 2013 and 2012:

COMPOSITION OF DEPOSITS

	Years Ended December 31,								
	2014			2013			2012		
	Average Balance	Average Yield		Average Balance	Average Yield		Average Balance	Average Yield	
	(dollars in thousands)								
Interest Bearing Demand Deposits	$1,231,711	0.29	%	$1,081,475	0.31	%	$892,798	0.39	%
Savings Deposits	121,453	0.11	%	108,097	0.13	%	96,854	0.15	%
Time Deposits	610,178	0.70	%	640,608	0.73	%	761,030	0.95	%
Total Interest Bearing Deposits	1,963,342	0.41	%	1,830,180	0.45	%	1,750,682	0.62	%
Noninterest Bearing Demand Deposits	576,770	N/A		560,762	N/A		564,007	N/A	
Total Deposits	$2,540,112	0.31	%	$2,390,942	0.34	%	$2,314,689	0.47	%

Average interest bearing deposits increased $133.2 million, or 7.3%, while the average rate paid decreased from 0.45% for the year ended December 31, 2013 to 0.41% for the year ended December 31, 2014. For the year ended December 31, 2013 average interest bearing deposits increased $79.5 million, or 4.5%, while the average rate paid decreased from 0.62% for the year ended December 31, 2012 to 0.45% . Average time deposits decreased $30.4 million, or 4.8%, and the average rate paid decreased three basis points for the year ended December 31, 2014. Average time deposits decreased $120.4 million, or 15.8%, and the average rate paid decreased 22 basis points for the year ended December 31, 2013. Average interest bearing demand deposits increased $150.2 million, or 13.9%, while the average rate paid decreased two basis points for the year ended December 31, 2014. Average interest bearing demand deposits increased $188.7 million, or 21.1%, while the average rate paid decreased eight basis points for the year ended December 31, 2013. Average savings deposits increased $13.4 million, or 12.4%, while the average rate paid decreased two basis points for the year ended December 31, 2014. Average savings deposits increased $11.2 million, or 11.6%, while the average rate paid decreased two basis points for the year ended December 31, 2013. Average noninterest bearing demand deposits increased $16.0 million, or 2.9%, during 2014 and decreased $3.2 million, or 0.6%, during 2013. Interest expense for interest bearing deposits for the year ended December 31, 2014 decreased $226,000, or 2.8%, when compared to the same period in 2013 due to the decrease in the average yield which more than offset the increase in the average balance. Interest expense for interest bearing deposits for the year ended December 31, 2013, decreased $2.7 million, or 24.6%, when compared to the same period in 2012 due to the decrease in the average yield which more than offset the increase in the average balance. The latter three categories, which are considered the lowest cost deposits, comprised 76.0% of total average deposits during the year ended December 31, 2014 compared to 73.2% during 2013 and 67.1% during 2012. The increase in our average total deposits during 2014 and 2013 is primarily the result of an increase in deposits from municipalities and to a lesser extent, deposit growth due to branch expansion, and continued market penetration.

At December 31, 2014, total brokered CDs issued were $23.4 million compared to $54.4 million at December 31, 2013. This represented a decrease of $31.0 million, or 56.9%, from 2013. Total brokered CDs increased $34.9 million, or 179.4%, from $19.5 million at December 31, 2012, when compared to 2013. At December 31, 2014, all of the brokered CDs had maturities of less than five years, with $5.0 million due after one year. All of the brokered CDs, except for one $5.0 million CD, are long-term with short-term calls that we control. We utilize long-term callable brokered CDs because the brokered CDs better match overall ALCO objectives at the time of issuance by protecting us with fixed rates should interest rates increase, while providing us options to call the funding should interest rates decrease. At December 31, 2014, brokered CDs represented 0.8% of deposits compared to 2.2% of deposits at December 31, 2013 and 0.8% at December 31, 2012. Our wholesale funding policy currently allows maximum

brokered CDs of $180 million; however, this amount could be increased to match changes in ALCO objectives. The potential higher interest cost and lack of customer loyalty are risks associated with the use of brokered CDs.
Average short-term interest bearing liabilities, consisting primarily of FHLB advances and federal funds purchased and repurchase agreements, were $64.2 million, a decrease of $133.3 million, or 67.5%, for the year ended December 31, 2014 when compared to the same period in 2013. The decrease in average short-term interest bearing liabilities was more than offset by the increase in long-term FHLB advances purchased during 2013. For the year ended December 31, 2013, the decrease was $87.2

million, or 30.6%, to $197.5 million when compared to the same period in 2012. Interest expense associated with short-term interest bearing liabilities decreased $1.3 million, or 66.7%, while the average rate paid increased two basis points to 0.97% for the year ended December 31, 2014, when compared to 0.95% for the same period in 2013. Interest expense associated with short-term interest bearing liabilities decreased $4.5 million, or 70.4%, and the average rate paid decreased 128 basis points to 0.95% for the year ended December 31, 2013, when compared to 2.23% for the same period in 2012. The decrease in the interest expense during 2014 was due to the decrease in the average balance which more than offset the increase in the average rate paid. The decrease in the interest expense during 2013 was due to the decrease in the average balance and average rate.

Average long-term interest bearing liabilities consisting of FHLB advances increased $61.4 million, or 14.1%, during the year ended December 31, 2014 to $497.3 million as compared to $435.9 million at December 31, 2013. The increase in the average long-term FHLB advances is due to the purchase of long-term advances during 2014 for asset liability risk management purposes. Average long-term interest bearing liabilities consisting of FHLB advances increased $104.0 million, or 31.3%, during the year ended December 31, 2013 from $331.9 million at December 31, 2012. In the first quarter of 2013, as $50 million of the $200 million par in long-term advance commitments from the FHLB expired, we obtained long-term advances at rates below the advance commitment rates that expired. Interest expense associated with long-term FHLB advances increased $490,000, or 7.6%, and the average rate paid decreased eight basis points to 1.40% for the year ended December 31, 2014 when compared to 1.48% for the same period in 2013. The increase in interest expense was due to the increase in the average balance which more than offset the decrease in the average rate paid. Interest expense associated with long-term FHLB advances decreased $164,000, or 2.5%, and the average rate paid decreased 52 basis points to 1.48% for the year ended December 31, 2013 when compared to 2.00% for the same period in 2012. The decrease in interest expense was due to the decrease in the average rate paid which more than offset the increase in the average balance. FHLB advances are collateralized by FHLB stock, securities and nonspecific real estate loans.

Average long-term debt, consisting of our junior subordinated debentures, was $60.3 million for the three years ended December 31, 2014, 2013, and 2012. Interest expense associated with long-term debt decreased $25,000, or 1.7%, to $1.4 million for the year ended December 31, 2014 when compared to $1.4 million for the same period in 2013 as a result of the decrease in the average yield of four basis points. Interest expense associated with long-term debt decreased $1.6 million, or 53.0%, to $1.4 million for the year ended December 31, 2013 when compared to $3.1 million for the same period in 2012 as a result of the decrease in the average yield of 272 basis points. The interest rate on the $20.6 million of long-term debentures issued to Southside Statutory Trust III adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points. The interest rate on the $23.2 million of long-term debentures issued to Southside Statutory Trust IV adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points. The interest rate on the $12.9 million of long-term debentures issued to Southside Statutory Trust V adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points. The interest rate on the $3.6 million of long-term debentures issued to Magnolia Trust Company I adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

AVERAGE BALANCES AND YIELDS

The following table presents average balance sheet amounts and average yields for the years ended December 31, 2014, 2013 and 2012. The information should be reviewed in conjunction with the consolidated financial statements for the same years then ended. Two major components affecting our earnings are the interest earning assets and interest bearing liabilities. A summary of average interest earning assets and interest bearing liabilities is set forth below, together with the average yield on the interest earning assets and the average cost of the interest bearing liabilities.

AVERAGE BALANCES AND YIELDS
(dollars in thousands)
Years Ended

	December 31, 2014			December 31, 2013			December 31, 2012		
	Average Balance	Interest	Avg. Yield	Average Balance	Interest	Avg. Yield	Average Balance	Interest	Avg. Yield
ASSETS									
INTEREST EARNING ASSETS:									
Loans[1][2]	$1,420,802	$74,450	5.24 %	$1,296,440	$76,728	5.92 %	$1,180,095	$73,498	6.23 %
Loans Held For Sale	11,012	47	0.43 %	1,137	38	3.34 %	1,694	59	3.48 %
Securities:									
Inv. Sec. (Taxable)[4]	33,168	615	1.85 %	47,914	799	1.67 %	35,217	519	1.47 %
Inv. Sec. (Tax Exempt)[3][4]	659,219	36,263	5.50 %	678,000	37,310	5.50 %	387,284	20,552	5.31 %
Mortgage-backed Sec.[4]	1,056,095	28,207	2.67 %	1,072,601	20,085	1.87 %	1,413,554	32,118	2.27 %
Total Securities	1,748,482	65,085	3.72 %	1,798,515	58,194	3.24 %	1,836,055	53,189	2.90 %
FHLB stock and other investments, at cost	28,684	181	0.63 %	31,378	182	0.58 %	34,191	240	0.70 %
Interest Earning Deposits	54,853	139	0.25 %	55,127	143	0.26 %	20,809	37	0.18 %
Total Interest Earning Assets	3,263,833	139,902	4.29 %	3,182,597	135,285	4.25 %	3,072,844	127,023	4.13 %
NONINTEREST EARNING ASSETS:									
Cash and Due From Banks	43,342			44,013			42,938		
Bank Premises and Equipment	55,680			50,766			50,392		
Other Assets	133,641			120,725			163,402		
Less: Allowance for Loan Losses	(17,177)			(19,007)			(19,922)		
Total Assets	$3,479,319			$3,379,094			$3,309,654		

(1) Interest on loans includes net fees on loans that are not material in amount.
(2) Interest income includes taxable-equivalent adjustments of $3,899, $3,856 and $4,095 for the years ended December 31, 2014, 2013, and 2012, respectively.

(3) Interest income includes taxable-equivalent adjustments of $12,225, $11,827 and $6,908 for the years ended December 31, 2014, 2013, and 2012, respectively.

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

Note: As of December 31, 2014, 2013 and 2012, loans totaling $4,096, $8,088 and $10,314, respectively, were on nonaccrual status. Our policy is to reverse previously accrued but unpaid interest on nonaccrual loans; thereafter, interest income is recorded to the extent received when appropriate.

AVERAGE BALANCES AND YIELDS
(dollars in thousands)
Years Ended

	December 31, 2014			December 31, 2013			December 31, 2012		
	Average Balance	Interest	Avg. Yield	Average Balance	Interest	Avg. Yield	Average Balance	Interest	Avg. Yield
LIABILITIES AND SHAREHOLDERS' EQUITY									
INTEREST BEARING LIABILITIES:									
Savings Deposits	$121,453	$136	0.11 %	$108,097	$142	0.13 %	$96,854	$145	0.15 %
Time Deposits	610,178	4,287	0.70 %	640,608	4,700	0.73 %	761,030	7,256	0.95 %
Interest Bearing Demand Deposits	1,231,711	3,530	0.29 %	1,081,475	3,337	0.31 %	892,798	3,440	0.39 %
Total Interest Bearing Deposits	1,963,342	7,953	0.41 %	1,830,180	8,179	0.45 %	1,750,682	10,841	0.62 %
Short-term Interest Bearing Liabilities	64,160	624	0.97 %	197,506	1,875	0.95 %	284,730	6,340	2.23 %
Long-term Interest Bearing Liabilities-FHLB Dallas	497,296	6,955	1.40 %	435,941	6,465	1.48 %	331,898	6,629	2.00 %
Long-term Debt (5)	60,311	1,424	2.36 %	60,311	1,449	2.40 %	60,311	3,085	5.12 %
Total Interest Bearing Liabilities	2,585,109	16,956	0.66 %	2,523,938	17,968	0.71 %	2,427,621	26,895	1.11 %
NONINTEREST BEARING LIABILITIES:									
Demand Deposits	576,770			560,762			564,007		
Other Liabilities	29,672			44,685			47,668		
Total Liabilities	3,191,551			3,129,385			3,039,296		
SHAREHOLDERS' EQUITY	287,768			249,709			270,358		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$3,479,319			$3,379,094			$3,309,654		
NET INTEREST INCOME		$122,946			$117,317			$100,128	
NET INTEREST MARGIN ON AVERAGE EARNING ASSETS			3.77 %			3.69 %			3.26 %
NET INTEREST SPREAD			3.63 %			3.54 %			3.02 %

(5) Represents issuance of junior subordinated debentures.

ANALYSIS OF CHANGES IN INTEREST INCOME AND INTEREST EXPENSE

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

	Years Ended December 31, 2014 Compared to 2013		
	Average Volume	Average Yield	Increase (Decrease)
INTEREST INCOME:			
Loans [1]	$6,976	$(9,254)	$(2,278)
Loans Held For Sale	68	(59)	9
Investment Securities (Taxable)	(266)	82	(184)
Investment Securities (Tax Exempt) [1]	(1,033)	(14)	(1,047)
Mortgage-backed Securities	(314)	8,436	8,122
FHLB stock and other investments	(16)	15	(1)
Interest Earning Deposits	(1)	(3)	(4)
Total Interest Income	5,414	(797)	4,617
INTEREST EXPENSE:			
Savings Deposits	16	(22)	(6)
Time Deposits	(218)	(195)	(413)
Interest Bearing Demand Deposits	442	(249)	193
Short-term Interest Bearing Liabilities	(1,296)	45	(1,251)
Long-term FHLB Advances	873	(383)	490
Long-term Debt	—	(25)	(25)
Total Interest Expense	(183)	(829)	(1,012)
Net Interest Income	$5,597	$32	$5,629

	Years Ended December 31, 2013 Compared to 2012		
	Average Volume	Average Yield	Increase (Decrease)
INTEREST INCOME:			
Loans [1]	$7,007	$(3,777)	$3,230
Loans Held For Sale	(19)	(2)	(21)
Investment Securities (Taxable)	205	75	280
Investment Securities (Tax Exempt) [1]	15,971	787	16,758
Mortgage-backed Securities	(6,959)	(5,074)	(12,033)
FHLB stock and other investments	(19)	(39)	(58)
Interest Earning Deposits	83	23	106
Total Interest Income	16,269	(8,007)	8,262
INTEREST EXPENSE:			
Savings Deposits	16	(19)	(3)
Time Deposits	(1,040)	(1,516)	(2,556)
Interest Bearing Demand Deposits	652	(755)	(103)
Short-term Interest Bearing Liabilities	(1,554)	(2,911)	(4,465)
Long-term FHLB Advances	1,784	(1,948)	(164)
Long-term Debt	—	(1,636)	(1,636)

Total Interest Expense	(142)	(8,785)	(8,927)
Net Interest Income	$16,411	$778	$17,189

(1) Interest yields on loans and securities that are nontaxable for federal income tax purposes are presented on a taxable equivalent basis.

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

PROVISION FOR LOAN LOSSES

During 2014 our asset quality improved as reflected in the decrease in the nonperforming asset to total asset ratio to 0.26% at December 31, 2014 from 0.39% in 2013. This decrease is primarily due to the sale of subprime automobile loans purchased by SFG during the fourth quarter of 2014. In addition, the mix of the loan portfolio has continued to shift over the last two years to the loan categories that have had lower levels of charge-offs and nonperforming assets, 1-4 family residential loans, municipal loans and commercial real estate loans. The provision for loan losses for the year ended December 31, 2014 was $14.9 million compared to $8.9 million for the year ended December 31, 2013 and $10.7 million for the year ended December 31, 2012. For the year ended December 31, 2014, net charge-offs of loans increased $9.9 million, to $20.5 million when compared to $10.6 million for the same period in 2013 and increased $1.9 million from $8.7 million during 2013 when compared to 2012.

The increase in net charge-offs for 2014 was a result of an increase in total charge-offs of $9.0 million and a decrease in total recoveries of $947,000. Net charge-offs for loans to individuals increased 99.8%, to $20.8 million for the year ended December 31, 2014 compared to the same period in 2013. This increase was due to an increase in charge-offs on SFG loans and a write down of the SFG loans to fair value in connection with the sale of the subprime automobile loans. Net charge-offs for 1-4 family residential loans decreased $287,000, resulting in net recoveries of $59,000 for the year ended December 31, 2014 compared to the same period in 2013. Net charge-offs for commercial loans decreased $384,000, resulting in net recoveries of $105,000, net recoveries of construction loans increased $65,000 to $142,000, and net recoveries of other real estate loans decreased $264,000 to $8,000 for the year ended December 31, 2014 compared to the same period in 2013.

The increase in net charge-offs for 2013 was a result of an increase in total charge-offs of $2.5 million which were slightly offset by an increase in total recoveries of $649,000. Net charge-offs for 1-4 family residential loans increased $161,000, to $228,000 for the year ended December 31, 2013 compared to the same period in 2012. Net charge-offs for loans to individuals increased 23.3%, to $10.4 million and net charge-offs for commercial loans increased $189,000, to $279,000 for the year ended December 31, 2013 compared to the same period in 2012. Net recoveries of construction loans decreased $3,000, resulting in net recoveries of $77,000, and net charge-offs of other real estate loans decreased $425,000, resulting in net recoveries of $272,000 for the year ended December 31, 2013 compared to the same period in 2012.

As of December 31, 2014, and 2013, our reviews of the loan portfolio indicated that loan loss allowances of $13.3 million and $18.9 million, respectively, were appropriate to cover probable losses in the portfolio.

NONINTEREST INCOME

Noninterest income consists of revenues generated from a broad range of financial services and activities including deposit related fee based services. The following schedule lists the accounts from which noninterest income was derived and gives totals for these accounts for the year ended December 31, 2014 and the comparable years ended December 31, 2013, and 2012:

	Years Ended December 31,		
	2014	2013	2012
	(in thousands)		
Deposit services	$15,280	$15,560	$15,433
Gain on sale of securities available for sale	2,830	8,472	17,966
(Loss) gain on sale of securities carried at fair value through income	—	—	(498)
FHLB advance option impairment charges	—	—	(2,031)
Impairment of equity method investment	(2,755)	—	—
Gain on sale of loans	323	770	1,119
Trust income	3,145	3,024	2,794
Bank owned life insurance income	1,334	3,122	1,110
Other	4,332	4,297	4,128
Total noninterest income	$24,489	$35,245	$40,021

Total noninterest income for the year ended December 31, 2014 decreased 30.5%, or $10.8 million, compared to 2013 and decreased 11.9%, or $4.8 million, during the year ended December 31, 2013, when compared to the same period in 2012. The decrease in noninterest income during 2014 was primarily due to a $5.6 million decrease in the gain on sale of AFS securities and a $2.8 million impairment of equity related to our investment in SFG related to sale of the loans purchased by SFG and the repossessed assets. During the years ended December 31, 2014, 2013 and 2012, we had gain on sale of AFS securities of $2.8 million, $8.5 million, and $18.0 million, respectively. The fair value of the AFS securities portfolio at December 31, 2014 was $1.45 billion with a net unrealized gain on that date of $20.7 million. The net unrealized gain is comprised of $22.6 million in unrealized gains and $1.9 million in unrealized losses. The fair value of the AFS securities portfolio at December 31, 2013 was

$1.18 billion with a net unrealized loss on that date of $1.1 million. The net unrealized loss is comprised of $19.9 million in unrealized gains and $20.9 million in unrealized losses. The fair value of HTM securities portfolio at December 31, 2014 was $661.6 million with a net unrealized gain on that date of $8.2 million. The net unrealized gain is comprised of $25.7 million in unrealized gains and $17.5 million in unrealized losses. The fair value of HTM securities portfolio at December 31, 2013 was $649.2 million with a net unrealized loss on that date of $30.1 million. The net unrealized loss is comprised of $11.1 million in unrealized gains and $41.2 million in unrealized losses. There can be no assurance that the level of security gains reported during the year ended December 31, 2014, will continue in future periods.

During the quarter ended December 31, 2014, the size of the securities portfolio decreased due to sale of non bank qualified municipal securities, U.S. Treasuries, CMBS and U.S. Agency MBS from the OABC acquired securities portfolio as part of restructuring that portfolio which was partially offset by additional purchases of both residential and commercial MBS bank qualified municipal securities and U.S. Treasuries. The decrease in the securities portfolio was connected to our cash management strategy in anticipation of our merger with OABC and to fund loan growth. During the quarter ended December 31, 2013, as interest rates began to increase, we sold some of our longer maturity general market tax-free municipal securities when the market pricing for these securities caused the economics of holding this sector to become less attractive. We also sold some of our MBS with more volatile prepays and some low yielding long duration agency debentures. During the year ended December 31, 2013, the size of the securities portfolio increased due to additional purchases of both residential and commercial MBS as well as Texas municipals. During 2012, the size of the securities portfolio decreased due to increased prepayments on our MBS, sales of prepayment volatile MBS and the significantly reduced attractiveness of purchasing additional fixed rate MBS. Also during 2012, we sold all of our securities carried at fair value through income. The sale of these securities resulted in a loss on sale of securities carried at fair value through income of $498,000.

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

Deposit services income decreased $280,000, or 1.8%, for the year ended December 31, 2014, as compared to the same period in 2013 and increased $127,000, or 0.8%, for the year ended December 31, 2013, as compared to the same period in 2012. The decrease in 2014 was primarily due to a decrease in overdraft income partially offset by an increase in ATM and debit card income.

Gain on sale of loans decreased $447,000, or 58.1%, for the year ended December 31, 2014, when compared to the same period in 2013. Gain on sale of loans decreased $349,000, or 31.2%, for the year ended December 31, 2013, when compared to the same period in 2012. This decrease was primarily a result of a decrease in the dollar amount of loans sold and the related servicing release and secondary market fees. The decrease in loans sold was due to a greater emphasis on retaining loans for our own portfolio and the overall reduction in mortgage refinancing.

Bank owned life insurance ("BOLI") income decreased $1.8 million, or 57.3%, for the year ended December 31, 2014, when compared to the same period in 2013. BOLI income increased $2.0 million, or 181.3%, for the year ended December 31, 2013, when compared to the same period in 2012. The changes for each year were primarily as a result of two death benefits received, one for a retired covered officer and one for an active covered officer in 2013.

NONINTEREST EXPENSE

The following schedule lists the accounts which comprise noninterest expense for the years ended December 31, 2014, 2013 and 2012:

	Years Ended December 31,		
	2014	2013	2012
	(in thousands)		
Salaries and employee benefits	$60,821	$52,054	$48,084
Occupancy expense	7,259	7,539	7,498
Advertising, travel & entertainment	2,219	2,642	2,463
ATM and debit card expense	1,331	1,328	1,063
Professional fees	7,827	2,782	2,928
Software and data processing expense	4,629	2,018	519
Telephone and communications	1,222	1,529	1,665
FDIC insurance	1,765	1,713	1,744
FHLB prepayment fees	539	1,048	—
Other	10,092	9,060	10,143
Total noninterest expense	$97,704	$81,713	$76,107

Noninterest expense for the year ended December 31, 2014 increased $16.0 million, or 19.6%, when compared to the year ended December 31, 2013 and increased $5.6 million, or 7.4% for the year ended December 31, 2013, when compared to the year ended December 31, 2012.

Salaries and employee benefits expense increased $8.8 million, or 16.8%, during the year ended December 31, 2014, when compared to the same period in 2013 and increased $4.0 million, or 8.3%, during the year ended December 31, 2013, when compared to the same period in 2012. During 2014 we recorded in salaries and employee benefits $8.9 million of post combination expenses for the acceleration of unvested OABC stock options and restricted stock related to the acquisition of OABC in addition to $150,000 in a one time payment to certain OABC officers. The increases were partially offset by a decrease in retirement expense. Direct salary expense and payroll taxes increased $2.3 million, or 5.5%, for the year ended December 31, 2014, when compared to the same period in 2013 and increased $3.3 million, or 8.3%, for the year ended December 31, 2013, when compared to the same period in 2012.

Retirement expense, included in salary and benefits, decreased $3.0 million, or 59.8%, for the year ended December 31, 2014, when compared to the same period in 2013 and increased $755,000, or 17.4%, for the year ended December 31, 2013, when compared to the same period in 2012. The decrease was primarily related to the decrease in the defined benefit and restoration plans. The defined benefit and restoration plans decreased primarily due to the changes in the actuarial assumptions used to determine net periodic pension costs for 2014 when compared to 2013 and for 2013 when compared to 2012. Specifically, the assumed long-term rate of return was 7.25% for 2014, 2013 and 2012 and the assumed discount rate was increased to 5.06% for 2014 compared to 4.08% for 2013 and 4.84% for 2012. We will continue to evaluate the assumed long-term rate of return and the discount rate to determine if either should be changed in the future. If either of these assumptions decreased, the cost and funding required for the retirement plan could increase.

Health and life insurance expense, included in salary and benefits, increased $604,000, or 14.4%, for the year ended December 31, 2014, when compared to the same period in 2013 due to increases in claims expense and plan administrative cost. Health and life insurance expense decreased $62,000, or 1.5%, for the year ended December 31, 2013, when compared to the same period in 2012 due to decreased health claims expense and plan administrative cost during 2013. We have a self-insured health plan which is supplemented with stop loss insurance policies. Health insurance costs are rising nationwide and these costs may increase during 2015.

Advertising, travel and entertainment decreased $423,000, or 16.0%, for the year ended December 31, 2014, when compared to the same period in 2013 and increased $179,000, or 7.3%, for the year ended December 31, 2013, when compared to the same period in 2012. The decrease in 2014 was primarily a result of decreased travel expenses related to SFG Finance.

Professional fees increased $5.0 million, or 181.3%, for the year ended December 31, 2014, compared to the same period in 2013. Professional fees decreased $146,000, or 5.0%, for year ended December 31, 2013, compared to the same period in 2012. The increase during 2014 was due to professional fees incurred in connection with the OABC merger that included primarily investment banking fees, legal fees and accounting fees.

Software and data processing expense increased $2.6 million, or 129.4%, for the year ended December 31, 2014, as compared to the same period in 2013 and increased $1.5 million, or 288.8%, for the year ended December 31, 2013, as compared to the same period in 2012. The increase in 2014 was related to software contracts canceled related to the OABC merger.

Telephone and communications decreased $307,000, or 20.1%, for the year ended December 31, 2014, as compared to the same period in 2013 and decreased $136,000, or 8.2%, for the year ended December 31, 2013, as compared to the same period in 2012. The decrease in 2014 was due to continued savings from renegotiated contracts. The decrease during 2013 was due to moving to a consolidated system and vendor changes.

FHLB prepayment fees decreased $509,000, or 48.6%, for the year ended December 31, 2014 as a result of the prepayment of fewer FHLB advances of $39.2 million during 2014. FHLB prepayment fees were $1.0 million for the year ended December 31, 2013 as a result of the prepayment of FHLB advances of $94.3 million.

Other expenses increased $1.0 million, or 11.4%, for the year ended December 31, 2014, as compared to the same period in 2013 and decreased $1.0 million, or 10.7%, for the year ended December 31, 2013, as compared to the same period in 2012. The increase in 2014 was primarily due to a reserve established associated with the sale of the subprime automobile loans, and other expenses related to overall growth.

INCOME TAXES

Pre-tax income for the year ended December 31, 2014 was $18.7 million compared to $46.3 million for the year ended December 31, 2013, and $42.3 million for the year ended December 31, 2012.

Income tax benefit was $2.2 million for the year ended December 31, 2014 and represented a decrease of $7.3 million, or 142.5%, when compared to the year ended December 31, 2013, and decreased $2.5 million, or 33.0%, to $5.1 million for the year ended December 31, 2013, when compared to the year ended December 31, 2012. The effective benefit rate as a percentage of pre-tax income was 11.6% in 2014, as compared to an effective tax rate of 11.0% in 2013 and 18.0% in 2012. The decrease in the income tax expense and effective tax rate for the year ended December 31, 2014 and 2013 was due to an increase in tax-exempt income as a percentage of taxable income as compared to the prior year. The increase in tax-exempt income as a percentage of taxable income was primarily due to the significant increase in our average tax-exempt securities portfolio for 2014 as compared to 2013. The net deferred tax asset totaled $12.7 million at December 31, 2014 as compared to $18.4 million in 2013.

LENDING ACTIVITIES

One of our main objectives is to seek attractive lending opportunities in Texas, primarily in the counties in which we operate. Substantially all of our loan originations are made to borrowers who live in and conduct business in the counties in Texas in which we operate, with the exception of municipal loans which are made almost entirely in Texas. Municipal loans are made to municipalities, counties, school districts, and colleges primarily throughout the state of Texas. During the fourth quarter, we completed the sale of all of the subprime automobile pools held by SFG. These were high yield loans representing existing subprime automobile loans with payment histories that were collateralized by new and used automobiles.

Total loans as of December 31, 2014 increased $829.9 million, or 61.4%, and the average loan balance outstanding for the year increased $124.4 million, or 9.6%, when compared to 2013. The increase in total loans is primarily due to the acquisition of OABC.

Our market areas did not experience the level of downturn in the economy and real estate prices that some of the harder hit areas of the country experienced during 2008 to 2011. However, we did experience weakening conditions associated with the real estate led downturn during 2008 through 2011 and strengthened our underwriting standards, especially related to all aspects of real estate lending. Our real estate loan portfolio does not have Alt-A or subprime mortgage exposure.

Construction loans increased $118.3 million, or 94.4%, from December 31, 2013 to December 31, 2014 and other real estate loans increased $222.7 million, or 84.8%, respectively. 1-4 family residential loans increased $298.8 million, or 76.5%, from December 31, 2013 to December 31, 2014. Loans to individuals increased $100.5 million, or 59.2%, from December 31, 2013 to December 31, 2014. Commercial loans increased $77.7 million, or 49.3%, from December 31, 2013 to December 31, 2014. Municipal loans as of December 31, 2014 increased $11.9 million, or 4.9%, from December 31, 2013.

The increase in 1-4 family residential loans, construction loans, other real estate loans, loans to individuals and commercial loans was due primarily to the acquisition of OABC. In our loan portfolio, loans dependent upon private household income represent a significant concentration. Due to the number of customers involved who work in all sectors of the numerous local, state and national economies, we believe the risk in this portion of the portfolio is adequately spread throughout the economic communities we serve, which assists in mitigating this concentration.

A significant portion of our loan portfolio is dependent on the medical community. Medical loan types include commercial loans and commercial real estate loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations. The medical community represents a concentration of risk in our Commercial loan and Commercial Real Estate loan portfolio. See “Item 1. Business – Market Area.” We believe that risk in the medical community is mitigated because it is spread among multiple practice types and multiple specialties. Should the government change the amount it pays the medical community through the various government health insurance programs or if new government regulation impacts the profitability of the medical community, the medical community could be adversely impacted which in turn could result in higher default rates by borrowers in the medical industry.

The aggregate amount of loans that we are permitted to make under applicable bank regulations to any one borrower, including non-affiliate related entities is 25% of Tier 1 capital. Our legal lending limit at December 31, 2014, was approximately $96.0 million. Our largest loan relationship at December 31, 2014 was approximately $25.6 million.

The average yield on loans for the year ended December 31, 2014, decreased to 5.24% from 5.92% for the year ended December 31, 2013. This decrease was reflective of the sale of the higher yielding SFG subprime automobile loans and to a lesser extent the overall lower interest rate environment during 2014 and the lower rates associated with the new loans added and repriced during 2014.

LOAN PORTFOLIO COMPOSITION AND ASSOCIATED RISK

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

	December 31,				
	2014	2013	2012	2011	2010
Real Estate Loans:					
Construction	$243,486	$125,219	$113,744	$111,361	$115,094
1-4 Family Residential	689,288	390,499	368,845	247,479	219,031
Other	485,226	262,536	236,760	206,519	200,723
Commercial Loans	235,356	157,655	160,058	143,552	148,761
Municipal Loans	257,492	245,550	220,947	207,261	196,594
Loans to Individuals	270,285	169,814	162,623	171,058	197,717
Total Loans	$2,181,133	$1,351,273	$1,262,977	$1,087,230	$1,077,920

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

REAL ESTATE LOANS

Real estate loans represent our greatest concentration of loans. We attempt to mitigate the amount of risk associated with this group of loans through the type of loans originated and geographic distribution. At December 31, 2014, the majority of our real estate loans were collateralized by properties located in our market areas. Of the $1.42 billion in real estate loans, $689.3 million, or 48.6%, represent loans collateralized by residential dwellings that are primarily owner-occupied. Historically, the amount of losses suffered on this type of loan has been significantly less than those on other properties. Our loan policy requires an appraisal or evaluation on the property, based on the size and complexity of the transaction, prior to funding any real estate loan and also outlines the requirements for appraisals on renewals.

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

Real estate loans are divided into 1-4 Family Residential Mortgage Loans, Construction Loans and Other. The Other real estate consists of $460.4 million of commercial real estate loans, $21.0 million of loans secured by multi-family properties and $3.8 million of loans secured by farm land. The Commercial Real Estate portion of Other is discussed in more detail below.

1-4 Family Residential Mortgage Loans

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

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

We review information concerning the income, financial condition, employment and credit history when evaluating the creditworthiness of the applicant.

We also make home equity loans, which are included as part of the 1-4 family residential mortgage loans, and at December 31, 2014, these loans totaled $77.6 million. Under Texas law, these loans, when combined with all other mortgage indebtedness for the property, are capped at 80% of appraised value.

Construction Loans

Our commercial construction loans and construction loans to individuals are collateralized by property located primarily in the market areas we serve. A majority of our construction loans are directed toward properties that will be owner-occupied. Construction loans for projects built on speculation are financed, but these typically have secondary sources of repayment and collateral. Our construction loans have both adjustable and fixed interest rates during the construction period. Construction loans to individuals are typically priced and made with the intention of granting the permanent loan on the property.

Commercial Real Estate Loans

Commercial real estate loans primarily include commercial office buildings, retail, medical facilities and offices, warehouse facilities, hotels and churches. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Commercial real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years.

COMMERCIAL LOANS

Our commercial loans are diversified to meet most business needs. Loan types include short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type, other than the medical industry. Loans to borrowers in the medical industry include all loan types listed above for commercial loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations.

In our commercial loan underwriting, we assess the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

MUNICIPAL LOANS

We have a specific lending department that primarily makes loans to municipalities and school districts throughout the state of Texas. A small percentage are made in adjoining states. The majority of the loans to municipalities and school districts have tax or revenue pledges and in some cases are additionally supported by collateral. Municipal loans made without a direct pledge of taxes or revenues are usually made based on some type of collateral that represents an essential service. Lending money directly to these municipalities allows us to earn a higher yield for similar durations than we could if we purchased municipal securities. Total loans to municipalities and school districts as of December 31, 2014 increased $11.9 million when compared to 2013. At December 31, 2014, we had total loans to municipalities and school districts of $257.5 million.

LOANS TO INDIVIDUALS

Substantially all of our consumer loan originations are made to consumers in our market areas. The majority of loans to individuals outstanding are collateralized by titled equipment, which are primarily vehicles. At December 31, 2014, these types of loans accounted for approximately $207.1 million, or 76.6%, of total loans to individuals.

Loan pools purchased through SFG were subjected to a modeling system that considered credit scores and estimated collateral values to determine expected defaults in each pool. For the year ended December 31, 2013, SFG purchased loan pools of approximately $73.0 million, net of discount, respectively.

During the fourth quarter of 2014, the sale of all of the subprime automobile loans and repossessed assets held by SFG was completed. As a result, the carrying amount of SFG loans totaling $70.3 million were sold and are therefore not included in our loan portfolio as of December 31, 2014.

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

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

LOAN MATURITIES AND SENSITIVITY TO CHANGES IN INTEREST RATES

The following table represents loan maturities and sensitivity to changes in interest rates for our real estate construction, commercial and municipal loans. The amounts of these loans outstanding at December 31, 2014, which, based on remaining scheduled repayments of principal, are due in (1) one year or less, (2) more than one year but less than five years, and (3) more than five years, are shown in the following table. The amounts due after one year are classified according to the sensitivity to changes in interest rates.

	Due in One Year or Less(1)	After One but Within Five Years	After Five Years
	(in thousands)		
Real Estate Loans – Construction	$125,829	$91,619	$26,038
Commercial Loans	122,447	98,648	14,261
Municipal Loans	27,296	85,146	145,050
Total	$275,572	$275,413	$185,349

Loans with Maturities After One Year for Which:	Interest Rates are Fixed or Predetermined	$171,386
	Interest Rates are Floating or Adjustable	$289,376

(1) The volume of commercial loans due within one year reflects our general policy of attempting to limit these loans to a short-term maturity. Nonaccrual loans totaling $1.1 million are reflected in the due after five years column.

LOANS TO AFFILIATED PARTIES

In the normal course of business, we make loans to certain of our own executive officers and directors and their related interests. As of December 31, 2014 and 2013, these loans totaled $7.1 million and $5.5 million, respectively. These loans represented 1.7% and 2.1% of shareholders' equity as of December 31, 2014 and 2013, respectively. Such loans are made in the normal course of business at normal credit terms, including interest rate and collateral requirements and do not represent more than normal credit risks contained in the rest of the loan portfolio for loans of similar types.

LOAN LOSS EXPERIENCE AND ALLOWANCE FOR LOAN LOSSES

Our allowance for loan losses was $13.3 million at December 31, 2014, or 0.6% of loans, a decrease of $5.6 million, or 29.6%, compared to $18.9 million at December 31, 2013. The decrease in the allowance for loan losses is due primarily to the write down of SFG loans to fair value in connection with their sale during the fourth quarter 2014. Loans increased during 2014 as a result of the acquisition of OABC. The loans acquired were measured at fair value at the acquisition date with no carryover in allowance for loan loss.

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

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $50,000 or more is updated on a quarterly basis in order to properly determine necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

For loans to individuals, the methodology associated with determining the appropriate allowance for losses on loans primarily consists of an evaluation of individual payment histories, remaining term to maturity and underlying collateral support.

Prior to September 30, 2014, SFG loans included in loans to individuals that experienced past due status or extension of maturity characteristics were reserved for at higher levels based on the circumstances associated with each specific loan. In general, the reserves for SFG were calculated based on the past due status of the loan. For reserve purposes, the portfolio was segregated by past due status and by the remaining term variance from the original contract. During repayment, loans that paid late took longer to repay than the original contract. Additionally, some loans may have been granted extensions for extenuating payment circumstances and evaluated for troubled debt classification. The remaining term extensions increased the risk of collateral deterioration and, accordingly, reserves were increased to recognize this risk.

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

After all of the data in the loan portfolio is accumulated the reserve allocations are separated into various loan classes detailed in the table below.

As of December 31, 2014, our review of the loan portfolio indicated that a loan loss allowance of $13.3 million was appropriate to cover probable losses in the portfolio. Changes in economic and other conditions may require future adjustments to the allowance for loan losses.

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

LOAN LOSS EXPERIENCE AND ALLOWANCE FOR LOAN LOSSES

	Years Ended December 31,				
	2014	2013	2012	2011	2010
Average Net Loans Outstanding	$1,420,802	$1,296,440	$1,180,095	$1,054,882	$1,031,858
Balance of Allowance for Loan Losses at Beginning of Period	$18,877	$20,585	$18,540	$20,711	$19,896
Loan Charge-Offs:					
Real Estate-Construction	(14)	—	(41)	(46)	(873)
Real Estate-1-4 Family Residential	(22)	(319)	(239)	(675)	(288)
Real Estate-Other	—	(67)	(159)	(271)	(577)
Commercial Loans	(66)	(512)	(402)	(1,254)	(2,603)
Loans to Individuals	(22,461)	(12,676)	(10,188)	(10,231)	(12,072)
Total Loan Charge-Offs	(22,563)	(13,574)	(11,029)	(12,477)	(16,413)
Recovery of Loans Previously Charged-off:					
Real Estate-Construction	156	77	121	61	165
Real Estate-1-4 Family Residential	81	91	172	98	13
Real Estate-Other	8	339	6	275	—
Commercial Loans	171	233	312	449	854
Loans to Individuals	1,624	2,247	1,727	1,927	2,459
Total Recovery of Loans Previously Charged-Off	2,040	2,987	2,338	2,810	3,491
Net Loan Charge-Offs	(20,523)	(10,587)	(8,691)	(9,667)	(12,922)
Provision for Loan Losses	14,938	8,879	10,736	7,496	13,737
Balance of Allowance for Loan Losses at End of Period	$13,292	$18,877	$20,585	$18,540	$20,711
Net Charge-Offs to Average Net Loans Outstanding	1.44%	0.82%	0.74%	0.92%	1.25%
Allowance for Loan Losses to Nonaccruing Loans	324.51	233.40	199.58	180.02	142.60
Allowance for Loan Losses to Nonperforming Assets	108.27	138.74	139.87	140.58	116.95
Allowance for Loan Losses to Total Loans	0.61	1.40	1.63	1.71	1.92

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

	Years Ended December 31, 2014			2013			2012			2011			2010		
	Amount	Percent of Loans To Total Loans		Amount	Percent of Loans To Total Loans		Amount	Percent of Loans To Total Loans		Amount	Percent of Loans To Total Loans		Amount	Percent of Loans To Total Loans	
Real Estate															
Construction	$2,456	11.2	%	$2,142	9.3	%	$2,355	9.0	%	$2,620	10.2	%	$2,585	10.7	%
1-4 Family Residential	2,822	31.6	%	3,277	28.9	%	3,545	29.2	%	1,957	22.8	%	1,988	20.3	%
Other	3,025	22.2	%	2,572	19.4	%	2,290	18.7	%	3,051	19.0	%	3,354	18.6	%
Commercial Loans	3,279	10.8	%	1,970	11.7	%	3,158	12.7	%	2,877	13.2	%	3,746	13.8	%
Municipal Loans	716	11.8	%	668	18.2	%	633	17.5	%	619	19.1	%	607	18.3	%
Loans to Individuals	994	12.4	%	8,248	12.5	%	7,373	12.9	%	6,244	15.7	%	7,978	18.3	%
Other	—	0.0	%	—	0.0	%	1,231	0.0	%	1,172	0.0	%	453	0.0	%
Ending Balance	$13,292	100.0	%	$18,877	100.0	%	$20,585	100.0	%	$18,540	100.0	%	$20,711	100.0	%

See "Consolidated Financial Statements - Note 6 – Loans and Allowance for Probable Loan Losses."

NONPERFORMING ASSETS

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

Total nonperforming assets at December 31, 2014 were $12.3 million representing a decrease of $1.3 million, or 9.8%, from $13.6 million at December 31, 2013. From December 31, 2013 to December 31, 2014, nonaccrual loans decreased $4.0 million, or 49.4%, to $4.1 million. Of this total, 49.2% are residential real estate loans, 17.5% are construction loans, 16.5% are commercial real estate loans, 10.2% are commercial loans, and 6.6% are loans to individuals. OREO increased $1.0 million, or 139.4%, to $1.7 million from December 31, 2013 to December 31,

2014. We are actively marketing all properties and none are being held for investment purposes. Restructured loans increased $2.0 million, or 51.1%, to $5.9 million. Repossessed assets decreased $336,000, or 37.3%, to $565,000 at December 31, 2014 from $901,000 at December 31, 2013. Included in total nonperforming assets are $7.2 million of loans classified as troubled debt restructurings at December 31, 2014 and $5.3 million at December 31, 2013.

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

NONPERFORMING ASSETS

	Years Ended December 31,				
	2014 [1]	2013	2012	2011	2010
Accruing Loans Past Due More Than 90 Days:					
Real Estate	$—	$—	$—	$—	$—
Loans to Individuals	4	3	15	5	7
Commercial	—	—	—	—	—
	4	3	15	5	7
Loans on Nonaccrual:					
Real Estate	3,408	3,506	5,774	7,037	8,511
Loans to Individuals	272	3,520	2,728	1,909	4,214
Commercial	416	1,062	1,812	1,353	1,799
	4,096	8,088	10,314	10,299	14,524
Restructured Loans:					
Real Estate	4,542	2,399	2,135	762	36
Loans to Individuals	38	423	632	1,206	2,243
Commercial	595	307	231	141	41
Municipal	699	759	—	—	—
	5,874	3,888	2,998	2,109	2,320
Total Nonperforming Loans	9,974	11,979	13,327	12,413	16,851
Other Real Estate Owned	1,738	726	686	453	220
Repossessed Assets	565	901	704	322	638
Total Nonperforming Assets	$12,277	$13,606	$14,717	$13,188	$17,709
Nonperforming Assets to Total Assets	0.26 %	0.39 %	0.45 %	0.40 %	0.59 %
Nonperforming Assets to Total Loans	0.56	1.01	1.17	1.21	1.64
Nonaccrual Loans to Total Loans	0.19	0.60	0.82	0.95	1.35
Loans 90 Days Past Due to Total Loans	—	—	—	—	—

(1) Excludes purchased credit impaired loans measured at fair value at acquisition of OABC.

Nonperforming assets at December 31, 2014, as a percentage of total assets decreased to 0.26% from the previous year and as a percentage of loans decreased to 0.56%. Nonperforming assets hinder our ability to earn money. Decreases in earnings can result from both the loss of interest income and the costs associated with maintaining the OREO, for taxes, insurance and other operating expenses. In addition to the nonperforming assets, at December 31, 2014, in the opinion of management, we had $1.1 million of loans identified as potential problem loans. A potential problem loan is a loan where information about possible credit problems of the borrower is known, causing management to have serious doubts about the ability of the borrower to comply with the present loan repayment terms and which may result in a future classification of the loan in one of the nonperforming asset categories.

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

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The following is a summary of our recorded investment in loans (primarily nonaccrual loans) for which impairment has been recognized (in thousands):

	December 31, 2014		
	Total	Valuation Allowance	Carrying Value
Real Estate Loans	$7,920	$177	$7,743
Commercial Loans	1,011	242	769
Municipal Loans	699	14	685
Loans to Individuals	310	103	207
Total	$9,940	$536	$9,404

	December 31, 2013		
	Total	Valuation Allowance	Carrying Value
Real Estate Loans	$5,874	$337	$5,537
Commercial Loans	1,369	240	1,129
Municipal Loans	759	15	744
Loans to Individuals	3,943	1,950	1,993
Total	$11,945	$2,542	$9,403

At December 31, 2014 and 2013, there were no impaired loans included above without a valuation allowance.

For the years ended December 31, 2014 and 2013, the average recorded investment in impaired loans was approximately $11.0 million and $12.0 million, respectively.

The amount of interest recognized on loans that were nonaccruing or restructured during the year was $365,000, $642,000 and $572,000 for the years ended December 31, 2014, 2013 and 2012, respectively. If these loans had been accruing interest at their original contracted rates, related income would have been $663,000 for the year ended December 31, 2014 and $1.3 million for both years ended December 31, 2013 and 2012.

SECURITIES ACTIVITY

Our securities portfolio plays a primary role in management of our interest rate sensitivity and, therefore, is managed in the context of the overall balance sheet. The securities portfolio generates a substantial percentage of our interest income and serves as a necessary source of liquidity.
We account for debt and equity securities as follows:
•Held to Maturity ("HTM"). Debt securities that management has the current intent and ability to hold until maturity are classified as HTM and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts.
•Available for Sale ("AFS"). Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as AFS. These assets are carried at fair value. Fair value is determined using quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services. Unrealized gains and losses on AFS securities are excluded from earnings and reported net of tax as a separate component of shareholders' equity until realized.
Premiums are amortized and discounts are accreted to maturity, or in the case of MBS, over the estimated life of the security, using the level yield interest method. Declines in the fair value of HTM and AFS securities below their cost

that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) our intent and ability to retain our investment in the issuer for a period of time

sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.
Securities with limited marketability, such as FHLB stock and other investments, are carried at cost, which approximates its fair value and assessed for other-than-temporary impairment.
Management attempts to deploy investable funds into instruments that are expected to provide a reasonable overall return on the portfolio given the current assessment of economic and financial conditions, while maintaining acceptable levels of capital, interest rate and liquidity risk. At December 31, 2014, the securities portfolio as a percentage of total assets was 44.4% which was slightly less than loans, which were 45.4% of total assets. For a discussion of our strategy in relation to the securities portfolio, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Balance Sheet Strategy.”
The following tables set forth the carrying amount of investment securities and MBS at December 31, 2014, 2013 and 2012 (in thousands):

	December 31,		
Available for Sale:	2014	2013	2012
Investment Securities:			
U.S. Treasury	$14,906	$—	$—
U.S. Government Agency Debentures	4,828	10,129	60,863
State and Political Subdivisions	267,684	314,074	545,688
Other Stocks and Bonds	13,239	13,226	11,156
Other Equity Securities	6,049	—	—
Mortgage-backed Securities: (1)			
Residential	964,298	772,085	806,360
Commercial	177,704	68,173	—
Total	$1,448,708	$1,177,687	$1,424,067

	December 31,		
Held to Maturity:	2014	2013	2012
Investment Securities:			
State and Political Subdivisions	$388,823	$391,552	$1,009
Mortgage-backed Securities: (1)			
Residential	52,217	74,030	245,538
Commercial	201,279	201,539	—
Total	$642,319	$667,121	$246,547

(1) All mortgage-backed securities issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.
We invest in MBS, including mortgage participation certificates, which are insured or guaranteed by U.S. Government agencies and GSEs and Collateralized Mortgage Obligation (“CMOs”) and real estate mortgage investment conduits (“REMICs”). MBS (which also are known as mortgage participation certificates or pass-through certificates) represent a participation interest in a pool of single-family or multi-family mortgages, the principal and interest payments on which are passed from the mortgage originators, through intermediaries (generally U.S. Government agencies and GSEs) that pool and re-package the participation interests in the form of securities, to investors such as ourselves. U.S. Government agencies, primarily Government National Mortgage Association (“GNMA”) and GSEs, primarily Freddie Mac, and Fannie Mae guarantee the payment of principal and interest to investors. GSEs are not backed by the full faith and credit of the U.S. Government. Freddie Mac, Fannie Mae and FHLB are the primary GSEs from which we purchase securities. At December 31, 2014, all of our MBS were collateralized by U.S. Government agencies or GSEs.
MBS typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or

adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

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

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

During 2014, as interest rates remained low, we continued to sell primarily lower yielding, longer duration municipal securities and more prepayment volatile MBS and replaced them with primarily shorter duration municipal securities. The sale of these securities resulted in a gain on the sale of available for sale securities of $2.8 million. There can be no assurance that the level of security gains reported during the year ended December 31, 2014, will continue in future periods.

The combined investment securities, MBS, and FHLB stock and other investments portfolio increased to $2.13 billion at December 31, 2014, compared to $1.88 billion at December 31, 2013, an increase of $254.0 million, or 13.5%. This increase is primarily a result of an increase in MBS of $279.7 million, or 25.1% due to the acquisition of OABC which was partially offset by a $34.2 million, or 4.8%, decrease in our ownership of securities issued by US Treasuries and state and political subdivisions during 2014 when compared to 2013.

During 2013, the interest rate yield curve gradually became steeper during the second half of the year while at the same time credit and volatility spreads continued to tighten. We used this environment to reposition a portion of our securities portfolio. MBS increased during 2013 because, as long-term interest rates began to increase during May 2013, we began to purchase certain lower dollar MBS with limited extension risk that would perform favorably if prepayments slowed. As interest rates continued to increase prepayments on MBS continued to slow providing additional opportunities to purchase MBS during the later half of 2013. We also increased our tax-free municipal security portfolio during 2013. All of our municipal security purchases were Texas credits. As we increased the municipal portfolio we purchased higher coupon municipal securities and we sold many of our lower coupon longer duration municipal securities to lower the overall duration of this portfolio and increase the overall coupon.

The combined fair value of the AFS and HTM securities portfolio at December 31, 2014 was $2.11 billion, which represented a net unrealized gain as of that date of $28.9 million. The net unrealized gain was comprised of $48.3 million in unrealized gains and $19.4 million of unrealized losses. The fair value of the AFS securities portfolio at December 31, 2014 was $1.45 billion, which represented a net unrealized gain as of that date of $20.7 million. The net unrealized gain was comprised of $22.6 million of unrealized gains and $1.9 million of unrealized losses. The $1.9 million of unrealized losses is primarily resulting from our investment securities issued by state and political subdivisions and residential MBS. Net unrealized gains and losses on securities transferred to HTM from AFS are included as a component of shareholder's equity on the consolidated balance sheet. Net unrealized gains and losses on AFS securities, which is also a component of shareholders' equity on the consolidated balance sheet, can fluctuate significantly as a result of changes in interest rates. Because management cannot predict the future direction of interest rates, the effect on shareholders' equity in the future cannot be determined; however, this risk is monitored through the use of shock tests on the AFS securities portfolio using an array of interest rate assumptions.

During the second quarter of 2013, the Company transferred CMBS with a fair value of $57.9 million and state and political subdivision securities with a fair value of $232.2 million from AFS to HTM. The unrealized gain on the securities transferred from AFS to HTM was $3.2 million ($2.1 million, net of tax) at the date of transfer based on the fair value of the securities on the transfer date. During the third quarter of 2013, the Company transferred additional CMBS with a fair value of $72.9 million and state and political subdivision securities with a fair value of $89.8 million from AFS to HTM. The net unrealized loss on the securities transferred from AFS to HTM in the third quarter was $15.2 million ($9.8 million, net of tax) at the date of transfer based on the fair value of the securities on the transfer date. There were no securities transferred from AFS to HTM during 2014 or 2012. There were no sales from the HTM portfolio during the years ended December 31, 2014, 2013 or 2012. There were $642.3 million and $667.1 million of securities classified as HTM at December 31, 2014 and 2013, respectively.

The maturities classified according to the sensitivity to changes in interest rates of the December 31, 2014 securities portfolio and the weighted yields are presented below. Tax-exempt obligations are shown on a taxable equivalent basis. Mortgage-backed securities are included in maturity categories based on their stated maturity date. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	MATURING											
	Within 1 Year			After 1 But Within 5 Years			After 5 But Within 10 Years			After 10 Years		
Available For Sale:	Amount	Yield		Amount	Yield		Amount	Yield		Amount	Yield	
	(dollars in thousands)											
Investment Securities:												
U.S. Treasuries	$—	—		$9,935	1.64	%	$4,971	2.03	%	$—	—	
U.S. Government Agency Debentures	—	—		—	—		4,828	2.66	%	—	—	
State and Political Subdivisions	4,053	5.94	%	9,894	5.02	%	34,991	4.80	%	218,746	5.42	%
Other Stocks and Bonds	326	1.82	%	9,892	1.65	%	3,021	1.23	%	—	—	
Other Equity Securities	6,049	2.19	%	—	—		—	—		—	—	
Mortgage-backed Securities:												
Residential	19	3.00	%	5,048	2.88	%	85,540	2.15	%	873,691	2.25	%
Commercial	—	—		5,460	1.83	%	172,244	2.69	%	—	—	
Total	$10,447	3.63	%	$40,229	2.66	%	$305,595	2.75	%	$1,092,437	2.88	%

	MATURING											
	Within 1 Year			After 1 But Within 5 Years			After 5 But Within 10 Years			After 10 Years		
Held to Maturity:	Amount	Yield		Amount	Yield		Amount	Yield		Amount	Yield	
	(dollars in thousands)											
Investment Securities:												
State and Political Subdivisions	$—	—		$2,889	0.46	%	$33,351	4.11	%	$352,583	5.63	%
Mortgage-backed Securities:												
Residential	56	3.38	%	3,671	4.47	%	22,346	3.32	%	26,144	5.00	%
Commercial	—	—		—	—		195,485	2.94	%	5,794	3.00	%
Total	$56	3.38	%	$6,560	2.72	%	$251,182	3.13	%	$384,521	5.55	%

At December 31, 2014, there were no holdings of any one issuer, other than the U.S. Government, its agencies and its GSEs, in an amount greater than 10% of our shareholders' equity.

DEPOSITS AND BORROWED FUNDS

Deposits provide us with our primary source of funds. The increase of $846.6 million, or 33.5%, in total deposits during 2014 contributed to the increase in the loans portfolio. Deposits increased during 2014 primarily due to the OABC merger and to a lesser extent branch expansion and increased market penetration. During 2014, our public fund deposits decreased $815,000 to $861.9 million at December 31, 2014 from $862.8 million at December 31, 2013. At December 31, 2014, brokered CDs reflected a decrease of approximately $31.0 million when compared to December 31, 2013. Deposits, net of brokered deposits, at December 31, 2014, increased $877.6 million, or 35.5%, when compared to December 31, 2013. Time deposits, including brokered CDs, increased a total of $181.8 million, or 27.6%, during 2014 when compared to 2013. Noninterest bearing demand deposits increased $131.1 million, or 24.7%, during 2014. Interest bearing demand deposits increased $417.3 million, or 34.0%, and saving deposits increased $116.4 million, or 105.9%, during 2014. The latter three categories, which are considered the lowest cost deposits, comprised 75.1% of total deposits at December 31, 2014 compared to 73.9% at December 31, 2013.

The following table sets forth deposits by category at December 31, 2014, 2013, and 2012 (in thousands):

	Years Ended December 31,		
	2014	2013	2012
Noninterest Bearing Demand Deposits	$661,014	$529,897	$595,093
Interest Bearing Demand Deposits	1,646,155	1,228,841	1,008,348
Savings Deposits	226,276	109,873	103,839
Time Deposits	840,972	659,197	644,617
Total Deposits	$3,374,417	$2,527,808	$2,351,897

During the year ended December 31, 2014, total time deposits of $100,000 or more increased $104.8 million, or 22.0%, to $581.4 million from $476.6 million at December 31, 2013.

The table below sets forth the maturity distribution of time deposits of $100,000 or more at December 31, 2014 and 2013 (in thousands):

	December 31, 2014			December 31, 2013		
	Time Certificates Of Deposit	Other Time Deposits	Total	Time Certificates Of Deposit	Other Time Deposits	Total
Three months or less	$81,471	$28,000	$109,471	$63,279	$25,000	$88,279
Over three to six months	67,504	21,000	88,504	71,399	19,500	90,899
Over six to twelve months	173,765	7,000	180,765	151,773	7,000	158,773
Over twelve months	202,630	—	202,630	138,631	—	138,631
Total	$525,370	$56,000	$581,370	$425,082	$51,500	$476,582

At December 31, 2014, we had $23.4 million in brokered CDs that represented 0.7% of our deposits. Our brokered CDs at December 31, 2014 have maturities of less than five years and are reflected in the CDs under $100,000 category. At December 31, 2013, we had $54.4 million in brokered CDs and at December 31, 2012, we had $19.5 million in brokered CDs. Our current policy allows for a maximum of $180 million in brokered CDs. The potential higher interest cost and lack of customer loyalty are risks associated with the use of brokered CDs.

Short-term obligations, consisting primarily of FHLB advances and federal funds purchased and repurchase agreements, increased $227.3 million, or 305.9%, during 2014 when compared to 2013 primarily due to the acquisition of OABC. FHLB advances are collateralized by FHLB stock, nonspecified loans and securities. Short-term obligations are summarized as follows (dollars in thousands):

	Years Ended December 31,		
	2014	2013	2012
Federal funds purchased and repurchase agreements			
Balance at end of period	$4,237	$859	$984
Average amount outstanding during the period (1)	1,886	861	1,770
Maximum amount outstanding during the period (2)	4,237	859	2,704
Weighted average interest rate during the period (3)	0.2 %	0.4 %	1.4 %
Interest rate at end of period	1.4 %	0.4 %	0.4 %
FHLB advances			
Balance at end of period	$297,368	$73,445	$150,985
Average amount outstanding during the period (1)	62,240	196,426	282,741
Maximum amount outstanding during the period (2)	297,368	310,070	440,246
Weighted average interest rate during the period (3)	0.9 %	0.9 %	2.2 %
Interest rate at end of period	0.4 %	0.2 %	3.7 %
Other obligations			
Balance at end of period	$—	$—	$219
Average amount outstanding during the period (1)	—	219	219
Maximum amount outstanding during the period (2)	—	219	219
Weighted average interest rate during the period (3)	—	7.6 %	8.0 %
Interest rate at end of period	—	—	8.0 %

(1) The average amount outstanding during the period was computed by dividing the total daily outstanding principal balances by the number of days in the period.

(2) The maximum amount outstanding at any month-end during the period.

(3) The weighted average interest rate during the period was computed by dividing the actual interest expense by the average balance outstanding during the period.

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

	December 31, 2014	December 31, 2013
FHLB Advances [1]		
Varying maturities to 2028	$600,052	$499,349
Long-term Debt [2]		
Southside Statutory Trust III Due 2033 [3]	20,619	20,619
Southside Statutory Trust IV Due 2037 [4]	23,196	23,196
Southside Statutory Trust V Due 2037 [5]	12,887	12,887
Magnolia Trust Company I Due 2035 [6]	3,609	3,609
Total Long-term Debt	60,311	60,311
Total Long-term Obligations	$660,363	$559,660

(1) At December 31, 2014, the weighted average cost of these advances was 1.3%.

(2) This long-term debt consists of trust preferred securities that qualify under the risk-based capital guidelines as Tier 1 capital, subject to certain limitations.

(3) This debt carries an adjustable rate of 3.1951% through March 30, 2015 and adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points.

(4) This debt carries an adjustable rate of 1.5326% through January 29, 2015 and adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points.

(5) This debt carries an adjustable rate of 2.4906% through March 15, 2015 and adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points.

(6) This debt carries an adjustable rate of 2.0329% through February 22, 2015 and adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

Long-term FHLB advances increased $100.7 million, or 20.2%, during 2014 to $600.1 million when compared to $499.3 million in 2013. The increase was the result of the $127.1 million of long-term FHLB advances acquired in the merger with OABC during 2014.

During 2011 and 2010, we entered into the option to fund between one and a half years and two years forward from the advance commitment date, $200 million par in long-term advance commitments from the FHLB at the FHLB rates on the date the option was purchased. In order to obtain these commitments from the FHLB, we paid fees of $10.95 million. During 2011, the value of the FHLB advance option fees became impaired. During 2012, the FHLB advance option fees were fully impaired, and we recorded impairment charges of $2.0 million in our income statement. For the years ended December 31, 2014 and 2013, there were no impairment charges recorded in our income statement, and there was no remaining carrying value recorded in our balance sheet.

Long-term debt was $60.3 million at December 31, 2014 and 2013. Long-term debt consists of $56.7 million of our junior subordinated debentures issued in connection with the issuance of trust preferred securities by Southside Statutory Trusts III, IV, V and $3.6 million of junior subordinated debentures issued to Magnolia Trust Company I.

CAPITAL RESOURCES

Our total shareholders' equity at December 31, 2014 of $425.2 million increased 63.9%, or $165.7 million, from December 31, 2013 and represented 8.8% of total assets at December 31, 2014 compared to 7.5% at December 31, 2013.

The increase in shareholders' equity at December 31, 2014 was primarily the result of the issuance of $151.3 million in common stock (5,168,138 shares) in connection with the OABC acquisition and to a lesser extent, $20.8 million of net income for 2014, $1.2 million in common stock (40,142 shares) through our dividend reinvestment plan, a decrease of $5.5 million in accumulated other comprehensive loss, which was partially offset by $17.9 million in cash dividends paid. The decrease in accumulated other comprehensive loss is composed of an increase of $14.9 million, net of tax, in the unrealized gain on securities, net of reclassification adjustment (see “Note 4 – Accumulated Other Comprehensive (Loss) Income”) and a decrease of $9.4 million, net of tax, related to the change in the funded status of our defined benefit plans. Our dividend policy requires that any cash dividend payments may not exceed consolidated earnings for that year. Shareholders should not anticipate a continuation of the cash dividend simply because of the existence of a dividend reinvestment program. The payment of dividends will depend upon future earnings, our financial condition, and other related factors including the discretion of the board of directors.

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

Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 Capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 Capital (as defined) to average assets (as defined). Tier 1 Capital is defined as the sum of shareholders’ equity and qualifying subordinated debt, excluding unrealized gains or losses on debt securities available for sale, unrealized gains on equity securities available for sale and unrealized gains or losses on cash flow hedges, net of deferred income taxes; plus certain mandatorily redeemable capital securities, less nonqualifying intangible assets net of applicable deferred income taxes, and certain nonfinancial equity investments. Total capital is defined as the sum of Tier 1 Capital, a qualifying portion of the allowance for loan losses, and qualifying subordinated debt. Management believes, as of December 31, 2014, that we meet all capital adequacy requirements to which we are subject.

In addition, for a depository institution to be considered “well capitalized” under the regulatory framework for prompt corrective action, its Tier 1 and Total Capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively and its leverage ratio must be at least 5.0%.

	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
As of December 31, 2014:	(dollars in thousands)								
Total Capital (to Risk Weighted Assets)									
Consolidated	$412,893	16.69	%	$197,863	8.00	%	N/A	N/A	
Bank Only	$398,104	16.13	%	$197,503	8.00	%	$246,878	10.00	%
Tier 1 Capital (to Risk Weighted Assets)									
Consolidated	$398,798	16.12	%	$98,932	4.00	%	N/A	N/A	
Bank Only	$384,009	15.55	%	$98,751	4.00	%	$148,127	6.00	%
Tier 1 Capital (to Average Assets) (1)									
Consolidated	$398,798	11.35	%	$140,492	4.00	%	N/A	N/A	
Bank Only	$384,009	10.95	%	$140,329	4.00	%	$175,412	5.00	%
As of December 31, 2013:									
Total Capital (to Risk Weighted Assets)									
Consolidated	$335,944	21.71	%	$123,776	8.00	%	N/A	N/A	
Bank Only	$332,069	21.46	%	$123,775	8.00	%	$154,719	10.00	%
Tier 1 Capital (to Risk Weighted Assets)									
Consolidated	$316,754	20.47	%	$61,888	4.00	%	N/A	N/A	
Bank Only	$312,879	20.22	%	$61,888	4.00	%	$92,831	6.00	%
Tier 1 Capital (to Average Assets) (1)									
Consolidated	$316,754	9.07	%	$139,665	4.00	%	N/A	N/A	
Bank Only	$312,879	8.97	%	$139,559	4.00	%	$174,449	5.00	%

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

The capital requirements applicable to the Company and Southside Bank are subject to change because, over the coming years, the regulatory capital framework will change as a result of the Dodd-Frank Act and as a result of a separate international regulatory capital initiative known as “Basel III.”

The table below summarizes our key equity ratios for the years ended December 31, 2014, 2013 and 2012:

	Years Ended December 31,					
	2014		2013		2012	
Return on Average Assets	0.60	%	1.22	%	1.05	%
Return on Average Shareholders' Equity	7.24	%	16.50	%	12.83	%
Dividend Payout Ratio – Basic	88.07	%	41.55	%	60.99	%
Dividend Payout Ratio – Diluted	88.07	%	41.55	%	60.99	%
Average Shareholders' Equity to Average Total Assets	8.27	%	7.39	%	8.17	%

ACCOUNTING PRONOUNCEMENTS

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

EFFECTS OF INFLATION

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

MANAGEMENT OF LIQUIDITY

Liquidity management involves our ability to convert assets to cash with a minimum risk of loss to enable us to meet our obligations to our customers at any time. This means addressing (1) the immediate cash withdrawal requirements of depositors and other funds providers; (2) the funding requirements of all lines and letters of credit; and (3) the short-term credit needs of customers. Liquidity is provided by short-term investments that can be readily liquidated with a minimum risk of loss. Cash, interest earning deposits, federal funds sold and short-term investments with maturities or repricing characteristics of one year or less continue to be a substantial percentage of total assets. At December 31, 2014, these investments were 12.9% of total assets, as compared with 14.1% for December 31, 2013, and 18.6% for December 31, 2012. The decrease to 12.9% at December 31, 2014 is primarily reflective of changes in the investment portfolio. Liquidity is further provided through the matching, by time period, of rate sensitive interest earning assets with rate sensitive interest bearing liabilities. Southside Bank has three lines of credit for the purchase of overnight federal funds at prevailing rates. One $30.0 million and two $15.0 million unsecured lines of credit have been established with Frost Bank, Comerica Bank and TIB -The Independent Bankers Bank, respectively. There were no federal funds purchased at December 31, 2014. Southside Bank has a $5.0 million line of credit with Frost Bank to be used to issue letters of credit. At December 31, 2014, the amount of additional funding Southside Bank could obtain from FHLB using unpledged securities at FHLB was approximately $756.7 million, net of FHLB stock purchases required. Southside Bank obtained no letters of credit from FHLB as collateral for a portion of its public fund deposits.

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

OFF-BALANCE-SHEET ARRANGEMENTS

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

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

We had outstanding unused commitments to extend credit of $373.3 million and $156.2 million at December 31, 2014 and 2013, respectively. Each commitment has a maturity date and the commitment expires on that date with the exception of credit card and ready reserve commitments, which have no stated maturity date. Unused commitments for credit card and ready reserve at December 31, 2014 and 2013 were $14.4 million and $13.8 million, respectively, and are reflected in the due after one year category. We had outstanding standby letters of credit of $6.2 million and $5.9 million at December 31, 2014 and 2013, respectively.

The scheduled maturities of unused commitments as of December 31, 2014 and 2013 were as follows (in thousands):

	December 31,	
	2014	2013
Unused commitments:		
Due in one year or less	$168,208	$110,210
Due after one year	205,047	46,032
Total	$373,255	$156,242

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

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The following summarizes our contractual cash obligations and commercial commitments at December 31, 2014, and the effect such obligations are expected to have on liquidity and cash flow in future periods. Payments reflected in the table below do not include interest.

	Payments Due By Period				
	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	Total
	(in thousands)				
Contractual obligations:					
Long-term debt, including current maturities (1)	$—	$—	$—	$60,311	$60,311
FHLB advances (2)	298,416	419,615	117,645	61,744	897,420
Operating leases (3)	2,038	2,981	1,760	770	7,549
Deferred compensation agreements (4)	591	941	641	4,431	6,604
Time deposits (5)	531,203	211,803	93,915	4,051	840,972
Securities purchased not paid for	5,982	—	—	—	5,982
Capital lease obligations	—	—	—	—	—
Purchase obligations	—	—	—	—	—
Total contractual obligations	$838,230	$635,340	$213,961	$131,307	$1,818,838

(1) The total balance of long-term debt was $60.3 million at December 31, 2014. The scheduled maturities and interest rates were as follows:

•Floating rate debt of $20.6 million with a scheduled maturity of 2033, was indexed to three-month LIBOR plus 294 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 3.1951% through March 30, 2015.
•Floating rate debt of $23.2 million with a scheduled maturity of 2037, was indexed to three-month LIBOR plus 130 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 1.5326% through January 29, 2015.
•Floating rate debt of $12.9 million with a scheduled maturity of 2037, was indexed to three-month LIBOR plus 225 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 2.4906% through March 15, 2015.
•Floating rate debt of $3.6 million with a scheduled maturity of 2035, was indexed to three-month LIBOR plus 180 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 2.0329% through February 22, 2015.

(2) We had fixed rate FHLB advances with maturity dates ranging from 2015 through 2028, with interest rates ranging from 0.1% to 6.8% with a total balance of $897.4 million at December 31, 2014.

(3) We had various operating leases for our office machines that total $256,000 and expire on or before the end of 2018. In addition, we have operating leases totaling $7.3 million on our retail branch locations, loan production offices and full service branch locations which have future commitments of up to nine years and additional options, which we control, beyond the commitment period.

(4) We have deferred compensation agreements (the “agreements”) with 18 officers totaling $6.6 million. Payments from the agreements are to commence at the time of retirement or death. As of December 31, 2014, $2.0 million in payments had been made from such agreements. Of the 18 officers included in the agreements, payments have

commenced to six executives and/or their beneficiaries. In addition, one active officer was eligible for retirement at December 31, 2014. Three officers become eligible in the years 2015 through 2019. The remaining eight officers are eligible at various dates after five years. The totals reflected under five years assume the retirement of the eligible officer at December 31, 2014 and the retirement of the eligible officers in years 2015 through 2019. Additional information regarding executive compensation is incorporated into “Item 11. Executive Compensation” of this Annual Report on Form 10-K.

(5) We had $23.4 million of brokered CDs at December 31, 2014 with maturity dates ranging from 2015 through 2019 and coupons ranging from 0.9% to 1.5%.

We do not expect to make a contribution to our defined benefit plan during 2015. We do expect to contribute to our defined benefit plan in future years, however, those amounts are indeterminable at this time.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

In an attempt to manage our exposure to changes in interest rates, management closely monitors our exposure to interest rate risk through our ALCO. Our ALCO meets regularly and reviews our interest rate risk position and makes recommendations to our board for adjusting this position. In addition, our board reviews our asset/liability position on a monthly basis. We primarily use two methods for measuring and analyzing interest rate risk: net income simulation analysis and MVPE modeling. We utilize the net income simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of various interest rate scenarios on projected net interest income and net income over the next 12 months. The model was used to measure the impact on net interest income relative to a base case scenario of rates increasing 100 and 200 basis points or decreasing 100 and 200 basis points over the next 12 months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet. The impact of interest rate-related risks such as prepayment, basis and option risk are also considered. Due to the low level of interest rates many of the current interest rates cannot decline 100 or 200 basis points. The model has floors for each of those interest rates and none are assumed to go negative. As of December 31, 2014, the model simulations projected that 100 and 200 basis point immediate increases in interest rates would result in negative variances on net interest income of 2.34% and 2.29%, respectively, relative to the base case over the next 12 months, while an immediate decrease in interest rates of 100 and 200 basis points would result in a negative variance in net interest income of 3.43% and 3.25%, respectively, relative to the base case over the next 12 months. As of December 31, 2013, the model simulations projected that 100 and 200 basis point increases in interest rates would result in negative variances on net interest income of 5.86% and 8.42%, respectively, relative to the base case over 12 months, while decreases in interest rates of 100 and 200 basis points would result in negative variances in net interest income of 2.69% and 4.15%, respectively, relative to the base case over the next 12 months. As part of the overall assumptions, certain assets and liabilities have been given reasonable floors. This type of simulation analysis requires numerous assumptions including but not limited to changes in balance sheet mix, prepayment rates on mortgage-related assets and fixed rate loans, cash flows and repricings of all financial instruments, changes in volumes and pricing, future shapes of the yield curve, relationship of market interest rates to each other (basis risk), credit spread and deposit sensitivity. Assumptions are based on management’s best estimates but may not accurately reflect actual results under certain changes in interest rates.

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer (“CEO”) and our Chief Financial Officer (“CFO”), undertook an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act of 1934, as amended (the “Exchange Act”)) as of December 31, 2014 and, based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of that date in recording, processing, summarizing and reporting in a timely manner the information that the Company is required to disclose in its reports under the Exchange Act and in accumulating and communicating to the Company's management, including the Company's CEO and CFO, such information as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

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

Management’s Report on Internal Control Over Financial Reporting

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

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control-Integrated Framework (“2013 framework”).

Management’s assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of OmniAmerican Bancorp, Inc. OmniAmerican Bancorp, Inc. was acquired in a purchase business combination on December 17, 2014 and is included in the 2014 consolidated financial statements of Southside Bancshares, Inc. and subsidiaries. OmniAmerican Bancorp, Inc. constituted $1.4 billion and $298.3 million of total and net assets, respectively, as of December 31, 2014.

Based on this assessment, management concluded that we maintained effective internal control over financial reporting as of December 31, 2014.

The effectiveness of our internal control over financial reporting as of December 31, 2014 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which appears in this Item under the heading "Attestation Report of Independent Registered Public Accounting Firm."

Southside Bancshares, Inc.
March 12, 2015

Attestation Report of Independent Registered Public Accounting Firm

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Southside Bancshares, Inc.

We have audited Southside Bancshares, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Southside Bancshares, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

As indicated in the accompanying Management's Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of OmniAmerican Bancorp, Inc. OmniAmerican Bancorp, Inc. was acquired in a purchase business combination on December 17, 2014 and is included in the 2014 consolidated financial statements of Southside Bancshares, Inc. and subsidiaries. OmniAmerican Bancorp, Inc. constituted $1.4 billion and $298.3 million of total and net assets, respectively, as of December 31, 2014. Our audit of internal control over financial reporting of Southside Bancshares, Inc. and subsidiaries also did not include an evaluation of the internal control over financial reporting of OmniAmerican Bancorp, Inc.

In our opinion, Southside Bancshares, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2014 consolidated financial statements of Southside Bancshares, Inc. and subsidiaries and our reported dated March 12, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas
March 12, 2015

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2015 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2015 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

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

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2015 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

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

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2015 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2015 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

1. Financial Statements

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

- Consolidated Balance Sheets as of December 31, 2014 and 2013.
- Consolidated Statements of Income for the years ended December 31, 2014, 2013 and 2012.
- Consolidated Statements of Comprehensive Income for the years ended December 31, 2014, 2013 and 2012.
- Consolidated Statements of Changes in Equity for the years ended December 31, 2014, 2013 and 2012.
- Consolidated Statements of Cash Flow for the years ended December 31, 2014, 2013 and 2012.
- Notes to Consolidated Financial Statements.

2. Financial Statement Schedules

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

3. Exhibits

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

SIGNATURES

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

	SOUTHSIDE BANCSHARES, INC.
DATE: March 12, 2015	BY: /s/ Sam Dawson Sam Dawson, President and Chief Executive Officer (Principal Executive Officer)
DATE: March 12, 2015	BY: /s/ Lee R. Gibson Lee R. Gibson, CPA, Senior Executive Vice President and Chief Financial Officer (Principal Financial Officer)
DATE: March 12, 2015	BY: /s/ Julie N. Shamburger Julie N. Shamburger, CPA, Executive Vice President and Chief Accounting Officer (Principal Accounting Officer)

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

Signature	Title	Date
(Joe Norton)	Chairman of the Board and Director	March 12, 2015
/s/ John (Bob) Garrett John (Bob) Garrett	Vice Chairman of the Board and Director	March 12, 2015
/s/ B.G. Hartley (B. G. Hartley)	Chairman Emeritus and Director	March 12, 2015
/s/ Sam Dawson (Sam Dawson)	President, Chief Executive Officer and Director	March 12, 2015
/s/ Lawrence Anderson (Lawrence Anderson)	Director	March 12, 2015
/s/ S. Elaine Anderson (S. Elaine Anderson)	Director	March 12, 2015
/s/ Herbert C. Buie (Herbert C. Buie)	Director	March 12, 2015
/s/ Alton Cade (Alton Cade)	Director	March 12, 2015
/s/ Patricia A. Callan (Patricia A. Callan)	Director	March 12, 2015
/s/ Pierre de Wet (Pierre de Wet)	Director	March 12, 2015
/s/ Melvin B. Lovelady (Melvin B. Lovelady)	Director	March 12, 2015
/s/ Paul W. Powell (Paul W. Powell)	Director	March 12, 2015
/s/ William Sheehy (William Sheehy)	Director	March 12, 2015
/s/ Preston L. Smith (Preston L. Smith)	Director	March 12, 2015
/s/ Don W. Thedford (Don W. Thedford)	Director	March 12, 2015

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Southside Bancshares, Inc.

We have audited the accompanying consolidated balance sheets of Southside Bancshares, Inc. and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southside Bancshares, Inc. and subsidiaries at December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Southside Bancshares, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 12, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas
March 12, 2015

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

	December 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$64,001	$45,624
Interest bearing deposits	20,654	8,807
Total cash and cash equivalents	84,655	54,431
Investment securities:		
Available for sale, at estimated fair value	306,706	337,429
Held to maturity, at carrying value (estimated fair value of $400,248 and $377,383, respectively)	388,823	391,552
Mortgage-backed securities:		
Available for sale, at estimated fair value	1,142,002	840,258
Held to maturity, at carrying value (estimated fair value of $261,339 and $271,836, respectively)	253,496	275,569
FHLB stock, at cost	39,942	34,065
Other investments, at cost	3,929	2,065
Loans held for sale	2,899	151
Loans:		
Loans	2,181,133	1,351,273
Less: Allowance for loan losses	(13,292)	(18,877)
Net loans	2,167,841	1,332,396
Premises and equipment, net	112,860	52,060
Goodwill	91,372	22,034
Other intangible assets, net	8,844	178
Interest receivable	22,436	21,973
Deferred tax asset, net	12,707	18,415
Unsettled trades to sell securities	57,202	3,933
Bank owned life insurance	92,384	46,008
Other assets	19,163	13,146
TOTAL ASSETS	$4,807,261	$3,445,663
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Deposits:		
Noninterest bearing	$661,014	$529,897
Interest bearing	2,713,403	1,997,911
Total deposits	3,374,417	2,527,808
Short-term obligations:		
Federal funds purchased and repurchase agreements	4,237	859
FHLB advances	297,368	73,445
Total short-term obligations	301,605	74,304
Long-term obligations:		
FHLB advances	600,052	499,349
Long-term debt	60,311	60,311
Total long-term obligations	660,363	559,660
Unsettled trades to purchase securities	5,982	973

Other liabilities	39,651	23,400
TOTAL LIABILITIES	4,382,018	3,186,145
Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 16)		
Shareholders' equity:		
Common stock: ($1.25 par, 40,000,000 shares authorized, 26,578,127 shares issued in 2014 and 20,386,221 shares issued in 2013)	33,223	25,483
Paid-in capital	389,886	214,091
Retained earnings	55,396	78,673
Treasury stock (2,469,638 shares at cost)	(37,692)	(37,692)
Accumulated other comprehensive loss	(15,570)	(21,037)
TOTAL SHAREHOLDERS' EQUITY	425,243	259,518
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$4,807,261	$3,445,663

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

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

	Years Ended December 31,		
	2014	2013	2012
Interest income			
Loans	$70,598	$72,910	$69,462
Investment securities – taxable	615	799	519
Investment securities – tax-exempt	24,038	25,483	13,644
Mortgage-backed securities	28,207	20,085	32,118
FHLB stock and other investments	181	182	240
Other interest earning assets	139	143	37
Total interest income	123,778	119,602	116,020
Interest expense			
Deposits	7,953	8,179	10,841
Short-term obligations	624	1,875	6,340
Long-term obligations	8,379	7,914	9,714
Total interest expense	16,956	17,968	26,895
Net interest income	106,822	101,634	89,125
Provision for loan losses	14,938	8,879	10,736
Net interest income after provision for loan losses	91,884	92,755	78,389
Noninterest income			
Deposit services	15,280	15,560	15,433
Net gain on sale of securities available for sale	2,830	8,472	17,966
Loss on sale of securities carried at fair value through income	—	—	(498)
FHLB advance option impairment charges	—	—	(2,031)
Impairment of investment in SFG Finance, LLC	(2,755)	—	—
Gain on sale of loans	323	770	1,119
Trust income	3,145	3,024	2,794
Bank owned life insurance income	1,334	3,122	1,110
Other	4,332	4,297	4,128
Total noninterest income	24,489	35,245	40,021
Noninterest expense			
Salaries and employee benefits	60,821	52,054	48,084
Occupancy expense	7,259	7,539	7,498
Advertising, travel & entertainment	2,219	2,642	2,463
ATM and debit card expense	1,331	1,328	1,063
Professional fees	7,827	2,782	2,928
Software and data processing expense	4,629	2,018	519
Telephone and communications	1,222	1,529	1,665
FDIC insurance	1,765	1,713	1,744
FHLB prepayment fees	539	1,048	—
Other	10,092	9,060	10,143
Total noninterest expense	97,704	81,713	76,107
Income before income tax expense	18,669	46,287	42,303
Income tax (benefit) expense	(2,164)	5,097	7,608
Net income	$20,833	$41,190	$34,695

Earnings per common share – basic	$1.09	$2.19	$1.82
Earnings per common share – diluted	$1.09	$2.19	$1.82
Dividends paid per common share	$0.96	$0.91	$1.11

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

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

	Years ended December 31,		
	2014	2013	2012
Net income	$20,833	$41,190	$34,695
Other comprehensive income (loss):			
Net unrealized holding gains (losses) on available for sale securities during the period	24,338	(50,518)	7,859
Change in net unrealized loss on securities transferred to held to maturity	1,405	471	—
Noncredit portion of other-than-temporary impairment losses on the AFS securities	—	(10)	181
Reclassification adjustment for gain on sale of available for sale securities, included in net income	(2,830)	(8,472)	(17,966)
Reclassification of other-than-temporary impairment charges on available for sale securities, included in net income	—	42	181
Amortization of net actuarial loss, included in net periodic benefit cost	1,042	2,787	2,022
Amortization of prior service credit, included in net periodic benefit cost	(14)	(43)	(43)
Prior service cost adjustment due to plan amendments	43	(357)	—
Change in net actuarial (loss) gain	(15,574)	19,215	(10,362)
Other comprehensive income (loss), before tax	8,410	(36,885)	(18,128)
Income tax (expense) benefit related to other items of comprehensive income	(2,943)	12,910	6,345
Other comprehensive income (loss), net of tax	5,467	(23,975)	(11,783)
Comprehensive income	$26,300	$17,215	$22,912

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

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

	Common Stock	Paid In Capital	Retained Earnings	Treasury Stock	Accu-mulated-Other Compre-hensive Income (Loss)	Total Equity
Balance at December 31, 2011	$23,146	$176,791	$72,646	$(28,377)	$14,721	$258,927
Net Income			34,695			34,695
Other comprehensive loss					(11,783)	(11,783)
Issuance of common stock (94,134 shares)	118	1,756				1,874
Purchase of common stock (355,500 shares)				(7,416)		(7,416)
Stock compensation expense		511				511
Tax benefit related to stock awards		44				44
Net issuance of common stock under employee stock plans	10	75	(90)			(5)
Cash dividends paid on common stock ($1.11 per share)			(19,084)			(19,084)
Stock dividend declared	1,034	16,425	(17,459)			—
Balance at December 31, 2012	24,308	195,602	70,708	(35,793)	2,938	257,763
Net Income			41,190			41,190
Other comprehensive loss					(23,975)	(23,975)
Issuance of common stock (57,675 shares)	72	1,324				1,396
Purchase of common stock (90,300 shares)				(1,899)		(1,899)
Stock compensation expense		911				911
Tax benefit related to stock awards		65				65
Net issuance of common stock under employee stock plans	38	194	(77)			155
Cash dividends paid on common stock ($0.91 per share)			(16,088)			(16,088)
Stock dividend declared	1,065	15,995	(17,060)			—
Balance at December 31, 2013	25,483	214,091	78,673	(37,692)	(21,037)	259,518
Net Income			20,833			20,833
Other comprehensive income					5,467	5,467
Issuance of common stock (40,142 shares)	50	1,163				1,213
Net issuance of common stock in connection with the acquisition of OmniAmerican Bancorp, Inc. (5,168,138 shares)	6,460	144,832				151,292
Stock compensation expense		1,086				1,086
Tax (expense) benefit related to stock awards		(76)				(76)
Net issuance of common stock under employee stock plans	106	1,094	(126)			1,074
Cash dividends paid on common stock ($0.96 per share)			(17,919)			(17,919)
Impairment of investment in SFG Finance, LLC.		2,755				2,755

Stock dividend declared	1,124	24,941	(26,065)			—
Balance at December 31, 2014	$33,223	$389,886	$55,396	$(37,692)	$(15,570)	$425,243

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

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

	Years Ended December 31,		
	2014	2013	2012
OPERATING ACTIVITIES:			
Net income	$20,833	$41,190	$34,695
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation	3,268	3,669	3,606
Amortization of premium	20,644	29,566	45,926
Accretion of discount and loan fees	(3,275)	(5,676)	(4,746)
Provision for loan losses	14,938	8,879	10,736
Stock compensation expense	1,086	911	511
Deferred tax benefit	(925)	(1,386)	(1,233)
Tax expense (benefit) related to stock awards	72	(65)	(11)
Loss on sale of securities carried at fair value through income	—	—	498
Net gain on sale of securities available for sale	(2,830)	(8,472)	(17,966)
Impairment of investment in SFG Finance, LLC.	2,755	—	—
FHLB advance option impairment charges	—	—	2,031
Loss (gain) on premises and equipment	14	8	(1)
Impairment on other real estate owned	—	100	28
Loss (gain) on other real estate owned	137	(59)	(19)
Net change in:			
Interest receivable	2,512	(3,037)	490
Other assets	(5,573)	(9,310)	(90)
Interest payable	(99)	(444)	(886)
Other liabilities	4,477	182	(3,952)
Loans originated for sale	(2,000)	3,450	(49)
Net cash provided by operating activities	56,034	59,506	69,568
INVESTING ACTIVITIES:			
Securities held to maturity:			
Purchases	—	(140,861)	—
Maturities, calls and principal repayments	21,889	168,673	113,086
Securities available for sale:			
Purchases	(803,163)	(1,499,307)	(1,807,157)
Sales	650,391	826,735	1,004,315
Maturities, calls and principal repayments	272,073	379,661	362,887
Securities carried at fair value through income:			
Purchases	—	—	(57,606)
Sales	—	—	675,255
Maturities, calls and principal repayments	—	—	25,279
Proceeds from redemption of FHLB stock	12,872	5,819	18,572
Purchases of FHLB stock and other investments	(4,915)	(11,995)	(12,592)
Net loans originated	(158,572)	(99,446)	(186,814)
Proceeds from sale of SFG loans	67,575	—	—
Net cash paid in acquisition	(127,020)	—	—
Purchases of premises and equipment	(5,162)	(5,662)	(3,109)
Proceeds from sales of premises and equipment	8	—	24

Proceeds on bank owned life insurance	—	4,165	—
Proceeds from sales of other real estate owned	535	480	567
Proceeds from sales of repossessed assets	6,199	3,935	4,453
Net cash (used in) provided by investing activities	(67,290)	(367,803)	137,160

(continued)

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

	Years Ended December 31,		
	2014	2013	2012
FINANCING ACTIVITIES:			
Net increase in demand and savings accounts	$105,971	$161,331	$267,513
Net (decrease) increase in certificates of deposit	(60,718)	14,551	(237,848)
Net increase (decrease) in federal funds purchased and repurchase agreements	1,378	(125)	(1,961)
Proceeds from FHLB advances	7,102,277	20,739,951	16,010,884
Repayment of FHLB advances	(7,091,125)	(20,687,239)	(16,113,337)
Tax (expense) benefit related to stock awards	(72)	65	44
Net issuance of common stock under employee stock plan	1,074	155	(5)
Purchase of common stock	—	(1,899)	(7,416)
Proceeds from the issuance of common stock	1,213	1,396	1,874
Cash dividends paid	(17,919)	(16,088)	(19,084)
Payments for other financing activities	(599)	—	—
Net cash provided by (used in) financing activities	41,480	212,098	(99,336)
Net increase (decrease) in cash and cash equivalents	30,224	(96,199)	107,392
Cash and cash equivalents at beginning of period	54,431	150,630	43,238
Cash and cash equivalents at end of period	$84,655	$54,431	$150,630
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:			
Interest paid	$17,055	$18,412	$27,781
Income taxes paid	$4,300	$4,000	$11,200
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Loans transferred to other repossessed assets and real estate through foreclosure	$5,211	$5,793	$5,659
Transfer of available for sale securities to held to maturity securities	$—	$452,884	$—
Adjustment to pension liability	$14,503	$(21,602)	$8,383
5% stock dividend	$26,065	$17,060	$17,459
Unsettled trades to purchase securities	$(5,982)	$(973)	$(10,047)
Unsettled trades to sell securities	$57,202	$3,933	$—
Common stock issued in acquisition	$151,891	$—	$—

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Southside Bancshares, Inc. and Subsidiaries

1. SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

The significant accounting and reporting policies of Southside Bancshares, Inc. (the "Company"), and its wholly-owned subsidiaries, Southside Delaware Financial Corporation, Southside Bank ("Southside Bank"), and our nonbank subsidiaries, are summarized below.

Organization and Basis of Presentation. The consolidated financial statements include the accounts of Southside Bancshares, Inc., Southside Bank, SFG Finance, LLC (formerly Southside Financial Group) and the nonbank subsidiaries. On July 15, 2011, Southside Bank acquired the remaining 50% interest in SFG increasing our ownership to 100%. The purchase price was $4.8 million and resulted in a decrease to shareholders' equity of approximately $2.8 million and the elimination of the noncontrolling interest. SFG is consolidated in our financial statements. Effective February 14, 2012, Southside Bank became a direct wholly-owned subsidiary of Southside Bancshares, Inc. as a result of the merger of Southside Delaware Financial Corporation with and into Southside Bancshares, Inc.

On March 20, 2014 our board of directors declared a 5% stock dividend to common stock shareholders of record as of April 10, 2014, payable on May 1, 2014. On March 28, 2013 our board of directors declared a 5% stock dividend to common stock shareholders of record as of April 18, 2013, payable on May 9, 2013. All share data for all periods presented has been adjusted to give retroactive recognition to stock dividends.

We offer a full range of financial services to commercial, industrial, financial and individual customers. All significant intercompany accounts and transactions are eliminated in consolidation. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires the use of management's estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates. Certain prior-period amounts have been reclassified to conform to the current period presentation.

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

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

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

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

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

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

Cash on hand or on deposit with the Federal Reserve Bank of $13.4 million and $14.6 million was required to meet regulatory reserves and clearing requirements at December 31, 2014 and 2013, respectively.

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

Comprehensive Income. Comprehensive income includes all changes in shareholders’ equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of comprehensive income include the after tax effect of changes in the fair value of securities available for sale, changes in the funded status of defined benefit retirement plans and the noncredit portion of other-than-temporary impairment. Comprehensive income is reported in the accompanying consolidated statements of changes in shareholders’ equity and in “Note 4 - Accumulated Other Comprehensive (Loss) Income.”

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

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

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

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

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

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

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

Securities. We use the specific identification method to determine the basis for computing realized gain or loss. We account for debt and equity securities as follows:

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

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

Unrealized gains and losses on AFS securities are excluded from earnings and reported net of tax in Accumulated Other Comprehensive Income until realized. Declines in the fair value of securities below their cost are reflected in earnings as realized losses to the extent the impairment is deemed to be other-than-temporary credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income unless there is no ability or intent to hold to recovery.

Premiums are amortized and discounts are accreted to maturity, or in the case of mortgage-backed securities ("MBS"), over the estimated life of the security, using the level yield interest method. Declines in the fair value of HTM and AFS securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, we consider (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded in the month of the trade date and are determined using the specific identification method.

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

Fair Value Option. We elect the fair value option for MBS purchased at a significant premium.

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

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

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

We measured our goodwill for impairment at December 31, 2014. At December 31, 2014, the fair value of the reporting unit was greater than the carrying value of the reporting unit. As a result, we did not record any goodwill impairment for the year ended December 31, 2014 and we had no cumulative goodwill impairment.

For the years ended December 31, 2014, 2013 and 2012, amortization expense related to our core deposit intangible was $187,000, $146,000, and $198,000, respectively.

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

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

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

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

Advertising Costs. Advertising costs are expensed as incurred. Advertising expense was $983,000 for the year ended December 31, 2014. Advertising expense for the years ended December 31, 2013 and 2012 was $1.3 million and $1.1 million, respectively.

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

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

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

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

Defined Benefit Pension Plan. Defined benefit pension plan costs are charged to retirement expense and included in "salaries and employee benefits" on the consolidated statements of income. Defined benefit pension obligations and the annual pension costs are determined by independent actuaries and through the use of a number of assumptions that are reviewed by management. These assumptions include a compensation rate increase, a discount rate used to determine the current benefit obligation and a long-term expected rate of return on plan assets. Net periodic defined benefit pension expense includes service cost, interest cost based on the assumed discount rate, an expected return on plan assets, amortization of prior service cost and amortization of net actuarial gains or losses. Prior service costs include the impact of plan amendments on the liabilities and are amortized over the future service periods of active employees expected to receive benefits under the plan. Actuarial gains and losses result from experience different from that assumed and from changes in assumptions. Amortization of actuarial gains and losses is included as a component of net periodic defined benefit pension cost. The plan obligations and related assets of our defined benefit pension plan are presented in "Note 11 – Employee Benefits" to our consolidated financial statements included in this report.

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

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

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

Segment Information. We have determined that our business is conducted in one reportable segment.

Accounting Pronouncements:

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-04, "Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." This update clarifies that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of the residential real estate property collateralizing a consumer mortgage loan, upon either: (i) the creditor obtaining legal title to the property upon completion of the foreclosure; or (ii) the borrower conveying all interest in the property to the creditor to satisfy the loan through completion of a deed-in-lieu of foreclosure or through a similar legal agreement. ASU 2014-04 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." Under the new guidance, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on the entity's operations and financial results when any of the following occurs: (i) the component of an entity or group of components of an entity meets the criteria in paragraph 205-20-45-1E to be classified as held for sale; (ii) the component of an entity or group of components of an entity is disposed of by sale; or (iii) the component of an entity or group of components of an entity is disposed of other than by sale (for example, by abandonment or in a distribution to owners in a spin-off). ASU 2014-08 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014 with early adoption permitted. We early adopted ASU 2014-08 in the third quarter of 2014.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." This update states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update affects entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. ASU 2014-09 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is not permitted. We are in the process of reviewing the potential impact the adoption of this guidance will have on our consolidated financial statements.

In June 2014, the FASB issued ASU 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." This update aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements by accounting for these transactions as secured borrowings. This update also requires a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return of the transferred financial assets throughout the term of the transaction. ASU 2014-11 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. Early adoption is not permitted. The adoption of this guidance is not expected to have a significant impact on our consolidated financial statements.

In August 2014, the FASB issued ASU 2014-14, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure." This update affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD), and the U.S. Department of Veterans Affairs (VA). The update requires that, upon foreclosure, a guaranteed mortgage loan be derecognized and a separate other receivable be recognized when specific criteria are met. ASU 2014-14 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014 with early adoption permitted under certain circumstances. The adoption of this guidance is not expected to have a significant impact on our consolidated financial statements.

2. ACQUISITION

On December 17, 2014, we acquired 100% of the outstanding stock of OmniAmerican Bancorp, Inc. and its wholly-owned subsidiary OmniAmerican Bank (collectively, Omni) headquartered in Fort Worth, Texas. Omni operated 14 banking offices in Fort Worth, Texas and surrounding areas. We acquired Omni to further expand our presence in the growing Fort Worth market. The operations of Omni were merged into the Company as of the date of the acquisition. The results of Omni's operations for December 17 - December 31, 2014 are included in the consolidated financial statements and are not separately quantifiable subsequent to the business combination.

Pursuant to the merger agreement and our closing stock price on December 17, 2014 of $29.39, we issued 5.2 million shares of our common stock and paid $157.4 million in cash for all outstanding shares of OmniAmerican Bancorp stock and outstanding stock options. In accordance with the merger agreement, each outstanding share of common stock of OmniAmerican Bancorp, Inc. was converted into (a) 0.4459 of a share of common stock of the Company and (b) $13.125 in cash (the "Per Share Merger Consideration"). Each Omni restricted stock award and stock option, whether vested or unvested, that was outstanding immediately prior to the effective time of the merger, was cancelled and converted to the right to receive the Per Share Merger Consideration in the case of the restricted stock awards or, in the case of the stock options, the excess, if any, of the Per Share Merger Consideration over the exercise price of such stock option. The consideration associated with the non-vested restricted awards and the unvested stock options is excluded from the total purchase consideration. The total merger consideration for the Omni merger was $298.3 million.

The fair value of assets acquired, excluding goodwill, totaled $1.36 billion, including total loans of $763.3 million and total investment securities of $428.4 million. Total fair value of the liabilities assumed totaled $1.13 billion, including deposits of $801.3 million. Goodwill represents consideration transferred in excess of the fair value of the net assets acquired. As of December 31, 2014, the Company recognized $69.3 million in initial goodwill associated with the Omni merger. The goodwill resulting from the acquisition represents the value expected from the opportunities to strategically grow our franchise in the greater Fort Worth market area and to enhance our operations through customer synergies and efficiencies, thereby providing enhanced customer service. Goodwill is not expected to be deductible for tax purposes.

The Omni merger was accounted for using the purchase method of accounting and accordingly, purchased assets, including identifiable intangible assets, and assumed liabilities were recorded at their respective acquisition date fair values. The purchase price allocation is preliminary and is subject to final determination and valuation of the fair value of assets acquired and liabilities assumed. The components of the consideration paid are shown in the following table (in thousands).

Fair value of consideration transferred:	
Common stock issued	$151,891
Cash	157,408
Less: Post-combination share-based compensation expense (1)	8,874
Reimbursement of contract cancellation fees	1,815
Non-compete agreements	300
Total consideration transferred	$298,310

(1) In connection with the merger, we recorded the unvested stock options and the non-vested restricted stock awards as a post-combination expense.

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Estimated fair values of the assets acquired and liabilities assumed in the transaction as of the closing date of the transaction are shown in the following table (in thousands).

Cash, cash equivalents, and amounts due from banks	$21,214
Other investments	15,698
Securities available for sale	428,447
Loans held for sale	748
Loans	763,327
Property and equipment	58,928
Bank owned life insurance	44,964
Other assets	13,409
Core deposit intangible	8,570
Goodwill	69,338
Deposits	(801,327)
Short-term borrowings	(7,000)
Federal Home Loan Bank advances	(308,516)
Deferred tax liability, net	(3,244)
Other liabilities	(6,246)
	$298,310

The determination of estimated fair values of the acquired loans required the Company to make certain estimates about discount rates, future expected cash flows, market conditions and other future events that are highly subjective in nature. Based on such factors as past due status, nonaccrual status, bankruptcy status, and credit risk ratings, the acquired loans were divided into loans with evidence of credit quality deterioration, which are accounted for under ASC 310-30 (purchased credit impaired "PCI"), and loans that do not meet this criteria, which are accounted for under ASC 310-20 (purchased non-impaired). Expected cash flows, both principal and interest, were estimated based on key assumptions covering such factors as prepayments, default rates and severity of loss given default. These assumptions were developed using both Omni’s historical experience and the portfolio characteristics as of the acquisition date as well as available market research. The fair value estimates for acquired loans were based on the amount and timing of expected principal, interest and other cash flows, including expected prepayments, discounted at prevailing market interest rates applicable to the types of acquired loans, which we considered to be level 3 fair value measurements.
Deposit liabilities assumed in the acquisition of Omni were segregated into two categories: time-deposits (i.e., deposit accounts with a stated maturity) and demand deposits, both using level 2 fair value measurements. In determining fair value of time deposits, the Company discounted the contractual cash flows of the deposit accounts using prevailing market interest rates for time deposit accounts of similar type and duration. For demand deposits, the acquisition date outstanding balance of the assumed demand deposit accounts approximates fair value. The acquisition date fair value assigned to FHLB advance borrowings was determined based on prepayment penalty quotes for these assumed FHLB advances, which we considered to be level 2 fair value measurements. Acquisition date fair values for securities available for sale were determined using Level 1 or Level 2 inputs consistent with the methods discussed further in “Note 12 - Fair Value Measurement”. The remaining acquisition date fair values represent either Level 2 fair value measurements (other investments, loans held for sale, and short term borrowings) or Level 3 fair value measurements (property and equipment and core deposit intangible).

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

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

of the vesting provisions of the underlying awards. The share-based compensation expense is a component of salaries and employee benefits in the consolidated statements of income.
We incurred cost of $599,000 directly related to the issuance of the shares related to the merger which were offset against additional paid-in-capital in the consolidated statements of changes in equity. We also recorded non-compete agreements for $300,000 that will be amortized using the straight-line method over three years in conjunction with the merger.
Loans acquired with Omni were measured at fair value at the acquisition date with no carryover of any allowance for loan losses. Loans were segregated into those loans considered to be performing and those considered purchased credit impaired ("PCI"). PCI

loans are loans acquired with evidence of deteriorated credit quality for which it was probable, at acquisition, that all contractually required cash flows would not be collected.
The table below details the PCI loan portfolio at acquisition date (in thousands):

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

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

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

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

Unaudited pro forma net income for the years ended December 31, 2014 and 2013 would have been $33.3 million and $38.8 million, respectively, and revenues would have been $209.0 million and $221.6 million for the same years, respectively, had the acquisition occurred as of January 1, 2013. We are still finalizing the integration plan and such costs related to integration are not
reflected in these pro formas. As these plans are finalized, we may identify integration charges that are required to be recognized.

3. EARNINGS PER SHARE

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

	Years Ended December 31,		
	2014	2013	2012
Basic and Diluted Earnings:			
Net Income	$20,833	$41,190	$34,695
Basic weighted-average shares outstanding:	19,072	18,768	19,105
Add: Stock options	94	40	13
Diluted weighted-average shares outstanding	19,166	18,808	19,118
Basic Earnings Per Share:			
Net Income	$1.09	$2.19	$1.82
Diluted Earnings Per Share:			
Net Income	$1.09	$2.19	$1.82

For the year ended December 31, 2014, there were approximately 9,000 antidilutive options. For the years ended December 31, 2013 and 2012 there were approximately 4,000 and 14,000 antidilutive options, respectfully.

4. ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

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

	Year Ended December 31, 2014				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$(8,656)	$—	$(12)	$(12,369)	$(21,037)
Other comprehensive income (loss):					
Other comprehensive income (loss) before reclassifications	25,743	—	43	(15,574)	10,212
Reclassified from accumulated other comprehensive income	(2,830)	—	(14)	1,042	(1,802)
Income tax (expense) benefit	(8,019)	—	(10)	5,086	(2,943)
Net current-period other comprehensive income (loss), net of tax	14,894	—	19	(9,446)	5,467
Ending balance, net of tax	$6,238	$—	$7	$(21,815)	$(15,570)

	Year Ended December 31, 2013				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$30,500	$(1,140)	$248	$(26,670)	$2,938
Other comprehensive (loss) income:					
Other comprehensive (loss) income before reclassifications	(50,810)	753	(357)	19,215	(31,199)
Reclassified from accumulated other comprehensive income	(9,431)	1,001	(43)	2,787	(5,686)
Income tax benefit (expense)	21,085	(614)	140	(7,701)	12,910
Net current-period other comprehensive (loss) income, net of tax	(39,156)	1,140	(260)	14,301	(23,975)
Ending balance, net of tax	$(8,656)	$—	$(12)	$(12,369)	$(21,037)

	Year Ended December 31, 2012				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$37,271	$(1,577)	$276	$(21,249)	$14,721
Other comprehensive (loss) income:					
Other comprehensive income (loss) before reclassifications	7,549	491	—	(10,362)	(2,322)
Reclassified from accumulated other comprehensive income	(17,966)	181	(43)	2,022	(15,806)
Income tax benefit (expense)	3,646	(235)	15	2,919	6,345
Net current-period other comprehensive income (loss), net of tax	(6,771)	437	(28)	(5,421)	(11,783)
Ending balance, net of tax	$30,500	$(1,140)	$248	$(26,670)	$2,938

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

	Year ended December 31,		
	2014	2013	2012
Unrealized gains and losses on available for sale securities:			
Realized gain on sale of securities [(1)]	$2,830	$8,472	$17,966
Impairment losses [(2)]	—	(42)	(181)
Total before tax	2,830	8,430	17,785
Tax expense	(991)	(2,951)	(6,225)
Net of tax	$1,839	$5,479	$11,560
Amortization of pension plan:			
Net loss [(3)]	$(1,042)	$(2,787)	$(2,022)
Prior service credit [(3)]	14	43	43
Total before tax	(1,028)	(2,744)	(1,979)
Tax benefit	359	960	693
Net of tax	$(669)	$(1,784)	$(1,286)
Total reclassifications for the period, net of tax	$1,170	$3,695	$10,274

(1) Listed as net gain on sale of securities available for sale on the consolidated statements of income.
(2) Included in other in noninterest income on the consolidated statements of income.
(3) These accumulated other comprehensive income components are included in the computation of net periodic pension cost presented in "Note 11 - Employee Benefits."

5. SECURITIES

The amortized cost, carrying value, and estimated fair value of investment and mortgage-backed securities as of December 31, 2014 and 2013, are reflected in the tables below (in thousands):

	December 31, 2014						
		Recognized in OCI			Not recognized in OCI		
	Amortized	Gross Unrealized	Gross Unrealized	Carrying	Gross Unrealized	Gross Unrealized	Estimated
AVAILABLE FOR SALE	Cost	Gains	Losses	Value	Gains	Losses	Fair Value
Investment Securities:							
U.S. Treasuries	$14,883	$30	$7	$14,906			$14,906
U.S. Government Agency Debentures	4,835	—	7	4,828			4,828
State and Political Subdivisions	260,535	8,055	906	267,684			267,684
Other Stocks and Bonds	13,086	153	—	13,239			13,239
Other Equity Securities	6,061	—	12	6,049			6,049
Mortgage-backed Securities: (1)							
Residential	952,481	12,624	807	964,298			964,298
Commercial	176,112	1,743	151	177,704			177,704
Total	$1,427,993	$22,605	$1,890	$1,448,708			$1,448,708
HELD TO MATURITY							
Investment Securities:							
State and Political Subdivisions	$393,525	$5,168	$9,870	$388,823	$12,181	$756	$400,248
Mortgage-backed Securities: (1)							
Residential	52,287	—	70	52,217	2,871	—	55,088
Commercial	207,624	—	6,345	201,279	5,461	489	206,251
Total	$653,436	$5,168	$16,285	$642,319	$20,513	$1,245	$661,587

	December 31, 2013						
		Recognized in OCI			Not recognized in OCI		
	Amortized	Gross Unrealized	Gross Unrealized	Carrying	Gross Unrealized	Gross Unrealized	Estimated
AVAILABLE FOR SALE	Cost	Gains	Losses	Value	Gains	Losses	Fair Value
Investment Securities:							
U.S. Government Agency Debentures	$11,612	$—	$1,483	$10,129			$10,129
State and Political Subdivisions	322,412	4,537	12,875	314,074			314,074
Other Stocks and Bonds	13,074	159	7	13,226			13,226
Mortgage-backed Securities: (1)							
Residential	760,418	14,940	3,273	772,085			772,085
Commercial	71,262	220	3,309	68,173			68,173
Total	$1,178,778	$19,856	$20,947	$1,177,687			$1,177,687
HELD TO MATURITY							
Investment Securities:							
State and Political Subdivisions	$396,549	$5,925	$10,922	$391,552	$1,207	$ 15,376	$377,383
Mortgage-backed Securities: (1)							
Residential	74,129	—	99	74,030	3,923	—	77,953
Commercial	208,667	—	7,128	201,539	—	7,656	193,883
Total	$679,345	$5,925	$18,149	$667,121	$5,130	$ 23,032	$649,219

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

During the second quarter of 2013, the Company transferred commercial mortgage-backed securities with a fair value of $57.9 million and state and political subdivision securities with a fair value of $232.2 million from AFS to HTM. The unrealized gain on the securities transferred from AFS to HTM was $3.2 million ($2.1 million, net of tax) at the date of transfer based on the fair value of the securities on the transfer date. During the third quarter of 2013, the Company transferred additional commercial mortgage-backed securities with a fair value of $72.9 million and state and political subdivision securities with a fair value of $89.8 million from AFS to HTM. The net unrealized loss on the securities transferred from AFS to HTM in the third quarter of 2013 was $15.2 million ($9.8 million, net of tax) at the date of transfer based on the fair value of the securities on the transfer date. We transferred these securities due to overall balance sheet strategies and our management has the current intent and ability to hold these securities until maturity. The net unrealized loss on the transferred securities included in accumulated other comprehensive income will be amortized over the remaining life of the underlying security as an adjustment of the yield on those securities. There were no securities transferred from AFS to HTM during 2014.

The following table represents the unrealized loss on securities for the years ended December 31, 2014 and 2013 (in thousands):

	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
As of December 31, 2014:						
AVAILABLE FOR SALE						
Investment Securities:						
U.S. Treasuries	$4,968	$7	$—	$—	$4,968	$7
U.S. Government Agency Debentures	4,828	7	—	—	4,828	7
State and Political Subdivisions	28,155	90	44,269	816	72,424	906
Other Equity Securities	6,049	12	—	—	6,049	12
Mortgage-backed Securities:						
Residential	347,777	573	27,632	234	375,409	807
Commercial	21,103	54	10,116	97	31,219	151
Total	$412,880	$743	$82,017	$1,147	$494,897	$1,890
HELD TO MATURITY						
Investment Securities:						
State and Political Subdivisions	$7,843	$31	$64,946	$725	$72,789	$756
Mortgage-backed Securities:						
Commercial	—	—	44,144	489	44,144	489
Total	$7,843	$31	$109,090	$1,214	$116,933	$1,245
As of December 31, 2013:						
AVAILABLE FOR SALE						
Investment Securities:						
U.S. Government Agency Debentures	$—	$—	$10,129	$1,483	$10,129	$1,483
State and Political Subdivisions	191,117	11,757	18,408	1,118	209,525	12,875
Other Stocks and Bonds	2,992	7	—	—	2,992	7
Mortgage-backed Securities:						
Residential	126,965	3,266	1,351	7	128,316	3,273
Commercial	65,406	3,309	—	—	65,406	3,309
Total	$386,480	$18,339	$29,888	$2,608	$416,368	$20,947
HELD TO MATURITY						
Investment Securities:						
State and Political Subdivisions	$283,667	$15,311	$1,705	$65	$285,372	$15,376
Mortgage-backed Securities:						
Commercial	193,883	7,656	—	—	193,883	7,656
Total	$477,550	$22,967	$1,705	$65	$479,255	$23,032

We review those securities in an unrealized loss position for significant differences between fair value and the cost basis to evaluate if a classification of other-than temporarily impaired is warranted. In estimating other-than-temporary impairment losses, management considers, among other things, the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. The Company considers an other-than-temporary impairment to have occurred when there is an adverse change in expected cash flows. The majority of the unrealized loss positions are comprised of U.S. Agency MBS and highly rated municipal securities where the unrealized loss is a direct result of the change in interest rates and spreads. Based upon the length of time and the extent to which fair value is less than cost, we believe the securities with an unrealized loss in AOCI are not other-than-temporarily impaired at December 31, 2014. To the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment and MBS portfolio with an other-than-temporary impairment at December 31, 2014.

When it is determined that a decline in fair value of HTM and AFS securities is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and the noncredit portion to other comprehensive income. The turmoil in the capital markets had a significant impact on our estimate of fair value for certain of our securities and resulted in an other-than-temporary impairment recorded on these securities since 2009. On December 13, 2013, management decided to sell AFS Other Stocks and Bonds, with a $2.7 million amortized cost basis in pooled trust preferred securities ("TRUPs") as a result of new guidance effective in 2014 as listed in Section 419 of the Dodd-Frank Act (Volcker Rule). Those securities were structured products with cash flows dependent upon securities issued by U.S. financial institutions, including banks and insurance companies. The sale of these securities resulted in a loss of approximately $959,000 in 2013. Until the final rules of the Volcker Rule were issued by the agencies on December 10, 2013 management did not intend to sell the securities and it was not more likely than not that we would be required to sell the security before the anticipated recovery of its amortized cost basis.

The following table presents a roll forward of the credit losses recognized in earnings on these AFS debt securities held at the end of each of the years presented (in thousands):

	Years Ended December 31,		
	2014	2013	2012
Balance, beginning of period	$—	$3,256	$3,075
Additions for credit losses recognized on debt securities that had previously incurred impairment losses	—	42	181
Sales of credit impaired securities	—	(3,298)	—
Balance, end of period	$—	$—	$3,256

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

	Years Ended December 31,		
	2014	2013	2012
U.S. Treasury	$264	$17	$—
U.S. Government Agency Debentures	104	440	372
State and Political Subdivisions	24,077	25,620	13,697
Other Stocks and Bonds	208	205	94
Mortgage-backed Securities	28,207	20,085	32,118
Total interest income on securities	$52,860	$46,367	$46,281

Of the $2.8 million in net securities gains from the AFS portfolio for the year ended December 31, 2014, there were $8.2 million in realized gains and approximately $5.4 million in realized losses. Of the $8.5 million in net securities gains from the AFS portfolio for the year ended December 31, 2013, there were $14.9 million in realized gains and approximately $6.4 million in realized losses. Of the $18.0 million in net securities gains from the AFS portfolio for the year ended December 31, 2012, there were $18.5 million in realized gains and $572,000 in realized losses. There were no sales from the HTM portfolio during the years ended December 31, 2014, 2013 or 2012.

The amortized cost, carrying value, and fair value of securities at December 31, 2014, are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. MBS are presented in total by category due to the fact that MBS typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

	December 31, 2014	
	Amortized Cost	Fair Value
Available for sale securities:	(in thousands)	
Investment Securities		
Due in one year or less	$4,363	$4,379
Due after one year through five years	29,284	29,721
Due after five years through ten years	47,094	47,811
Due after ten years	212,598	218,746
	293,339	300,657
Mortgage-backed securities and other equity securities	1,134,654	1,148,051
Total	$1,427,993	$1,448,708

	December 31, 2014	
	Carrying Value	Fair Value
Held to maturity securities:	(in thousands)	
Investment Securities		
Due in one year or less	$—	$—
Due after one year through five years	2,889	2,884
Due after five years through ten years	33,351	33,763
Due after ten years	352,583	363,601
	388,823	400,248
Mortgage-backed securities	253,496	261,339
Total	$642,319	$661,587

Investment and MBS with book values of $1.12 billion and $1.14 billion were pledged as of December 31, 2014 and 2013, respectively, to collateralize FHLB advances, repurchase agreements and public funds or for other purposes as required by law.

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

6. LOANS AND ALLOWANCE FOR PROBABLE LOAN LOSSES

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

	December 31, 2014	December 31, 2013
Real Estate Loans:		
Construction	$243,486	$125,219
1-4 Family Residential	689,288	390,499
Other	485,226	262,536
Commercial Loans	235,356	157,655
Municipal Loans	257,492	245,550
Loans to Individuals	270,285	169,814
Total Loans (1)	2,181,133	1,351,273
Less: Allowance for Loan Losses	13,292	18,877
Net Loans	$2,167,841	$1,332,396

(1) Includes $763.3 million of loans acquired with the OmniAmerican acquisition as of December 17, 2014. These loans were measured at fair value at the acquisition date with no carryover of allowance for loan loss. We have not allocated any incremental allowance to these loans as of December 31, 2014 as we do not believe these loans have experienced further material credit deterioration since the date of acquisition.

Loans to Affiliated Parties

In the normal course of business, we make loans to certain of our own executive officers and directors and their related interests. As of December 31, 2014 and 2013, these loans totaled $7.1 million and $5.5 million, respectively. These loans represented 1.7% and 2.1% of shareholders' equity as of December 31, 2014 and 2013, respectively. Such loans are made in the normal course of business at normal credit terms, including interest rate and collateral requirements and do not represent more than normal credit risks contained in the rest of the loan portfolio for loans of similar types.

Real Estate Construction Loans

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

Real Estate 1-4 Family Residential Loans

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

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

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

Other Real Estate

Other Real Estate loans primarily include loans collateralized by commercial office buildings, retail, medical facilities and offices, warehouse facilities, hotels and churches. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Other real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years.

Commercial Loans

Our commercial loans are diversified loan types including short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type, other than the medical industry. Loans to borrowers in the medical industry include all loan types listed above for commercial loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations.

In our commercial loan underwriting, we assess the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

Municipal Loans

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

Loans to Individuals

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

Loan pools purchased through SFG were subjected to a modeling system that considered credit scores and estimated collateral values to determine expected defaults in each pool.   SFG purchased loan pools of approximately $36.5 million, net of discount, during the nine months ended September 30, 2014. There have been no material loan pool purchases since August 2014 and there will be no additional loan pool purchases through SFG. For the year ended December 31, 2013, SFG purchased loan pools of approximately $73.0 million, net of discount.

On October 3, 2014, we announced that we intended to sell all of our subprime automobile loans purchased through SFG, as well as the repossessed assets held by SFG. During the fourth quarter of 2014, the sale of the subprime automobile loans and repossessed assets held by SFG was completed. As a result, the carrying amount of SFG loans totaling $70.3 million were sold and are therefore not included in our loan portfolio as of December 31, 2014.

Allowance for Loan Losses

The allowance for loan losses is based on the most current review of the loan portfolio and is a result of multiple processes. First, the bank utilizes historical data to establish general reserve amounts for each class of loans. The historical charge off figure is further adjusted through qualitative factors that include general trends in past dues, nonaccruals and classified loans to more effectively and promptly react to both positive and negative movements. Second, our lenders have the primary responsibility for identifying problem loans and estimating necessary reserves based on customer financial stress and underlying collateral. These recommendations are reviewed by senior loan administration, the Special Assets department, and the Loan Review department. Third, the Loan Review department independently reviews the portfolio on an annual basis. The Loan Review department follows a board-approved annual loan review scope. The loan review scope encompasses a number of considerations including the size of the loan, the type of credit extended, the seasoning of the loan and the performance of the loan. The Loan Review scope, as it relates to size, focuses more on larger dollar loan relationships, typically, for example, aggregate debt of

$500,000 or greater. The Loan Review officer also reviews specific reserves compared to general reserves to determine trends in comparative reserves as well as losses not reserved for prior to charge-off to determine the effectiveness of the specific reserve process.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $50,000 or more is updated on a quarterly basis in order to properly determine necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

For loans to individuals, the methodology associated with determining the appropriate allowance for losses on loans primarily consists of an evaluation of individual payment histories, remaining term to maturity and underlying collateral support.

Prior to September 30, 2014, SFG loans included in loans to individuals that experienced past due status or extension of maturity characteristics were reserved for at higher levels based on the circumstances associated with each specific loan. In general, the reserves for SFG were calculated based on the past due status of the loan. For reserve purposes, the portfolio was segregated by past due status and by the remaining term variance from the original contract. During repayment, loans that paid late took longer to repay than the original contract. Additionally, some loans may have been granted extensions for extenuating payment circumstances and evaluated for troubled debt classification. The remaining term extensions increased the risk of collateral deterioration and, accordingly, reserves were increased to recognize this risk.

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

Credit Quality Indicators

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

- Pass (Rating 1 – 4) – This rating is assigned to all satisfactory loans. This category, by definition, consists of acceptable credit. Credit and collateral exceptions should not be present, although their presence would not necessarily prohibit a loan from being rated Pass, if deficiencies are in process of correction. These loans are not included in the Watch List.
- Pass Watch (Rating 5) – Special Treatment Required – These loans require some degree of special treatment, but not due to credit quality. This category does not include loans specially mentioned or adversely classified; however, particular attention must be accorded such credits due to characteristics such as:
A lack of, or abnormally extended payment program;

A heavy degree of concentration of collateral without sufficient margin;
A vulnerability to competition through lesser or extensive financial leverage; and
A dependence on a single or few customers or sources of supply and materials without suitable substitutes or alternatives.

- Special Mention (Rating 6) – A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.
- Substandard (Rating 7) – Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

- Doubtful (Rating 8) – Loans classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation, in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loans that are accruing and not considered troubled debt restructurings ("TDR") are reserved for as a group of similar type credits and included in the general portion of the allowance for loan losses.

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

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

The following table details activity in the allowance for loan losses by portfolio segment for the periods presented (in thousands):

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

(1) Of the $22.5 million in charge-offs recorded in the Loans to Individuals category for the year ended December 31, 2014, approximately $7.1 million relate to the write-down of SFG loans to fair value in connection with the sale of the subprime automobile loans that was completed in the fourth quarter 2014.
(2) Loans acquired with the OmniAmerican acquisition were measured at fair value on December 17, 2014 and did not have an associated allowance as of December 31, 2014.

	Year Ended December 31, 2013							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Other	Total
Balance at beginning of period	$2,355	$ 3,545	$2,290	$3,158	$633	$7,373	$1,231	$20,585
Provision (reversal) for loan losses	(290)	(40)	10	(909)	35	10,073	—	8,879
Distribution of other allowance	—	—	—	—	—	1,231	(1,231)	—
Loans charged off	—	(319)	(67)	(512)	—	(12,676)	—	(13,574)
Recoveries of loans charged off	77	91	339	233	—	2,247	—	2,987
Balance at end of period	$2,142	$ 3,277	$2,572	$1,970	$668	$8,248	$—	$18,877

	Year Ended December 31, 2012							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Other	Total
Balance at beginning of period	$2,620	$1,957	$3,051	$2,877	$619	$6,244	$1,172	$18,540
Provision (reversal) for loan losses	(345)	1,655	(608)	371	14	9,590	59	10,736
Loans charged off	(41)	(239)	(159)	(402)	—	(10,188)	—	(11,029)

Recoveries of loans charged off	121	172	6	312	—	1,727	—	2,338
Balance at end of period	$2,355	$3,545	$2,290	$3,158	$633	$7,373	$1,231	$20,585

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

	As of December 31, 2014						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment	$43	$102	$26	$242	$14	$103	$530
Ending balance – collectively evaluated for impairment	2,413	2,720	2,999	3,037	702	891	12,762
Balance at end of period	$2,456	$2,822	$3,025	$3,279	$716	$994	$13,292

	As of December 31, 2013						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment	$103	$161	$73	$240	$15	$173	$765
Ending balance – collectively evaluated for impairment	2,039	3,116	2,499	1,730	653	8,075	18,112
Balance at end of period	$2,142	$3,277	$2,572	$1,970	$668	$8,248	$18,877

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

	December 31, 2014						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Individuals	Total
Loans individually evaluated for impairment	$2,461	$2,936	$1,605	$1,011	$699	$310	$9,022
Loans collectively evaluated for impairment (1)	240,240	679,051	480,619	225,168	256,793	268,894	2,150,765
Purchased credit impaired loans (2)	785	7,301	3,002	9,177	—	1,081	21,346
Total ending loans balance	$243,486	$689,288	$485,226	$235,356	$257,492	$270,285	$2,181,133

(1) Includes purchased non impaired loans which were measured at fair value at acquisition and did not have an associated allowance for loan loss as of December 31, 2014.

(2) Purchased credit impaired loans were measured at fair value at acquisition and did not have an associated allowance for loan loss as of December 31, 2014.

	December 31, 2013						
	Real Estate						
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$1,472	$2,624	$1,778	$1,369	$759	$559	$8,561
Loans collectively evaluated for impairment	123,747	387,875	260,758	156,286	244,791	169,255	1,342,712
Total ending loans balance	$125,219	$390,499	$262,536	$157,655	$245,550	$169,814	$1,351,273

The following table sets forth loans by credit quality indicator for the periods presented (in thousands):

	December 31, 2014					
	Pass	Pass Watch	Special Mention (1)	Substandard (1)	Doubtful	Total
Real Estate Loans:						
Construction	$235,839	$862	$1,394	$5,363	$28	$243,486
1-4 Family Residential	675,952	1,453	1,706	9,167	1,010	689,288
Other	472,449	2,416	2,569	7,792	—	485,226
Commercial Loans	208,202	781	1,044	25,102	227	235,356
Municipal Loans	256,543	—	—	949	—	257,492
Loans to Individuals	269,204					