TEXAS CAPITAL BANCSHARES INC/TX
Form 10-K
February 21, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the fiscal year ended December 31, 2013

¨ Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from ______ to ______

Commission file number 001-34657

TEXAS CAPITAL BANCSHARES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	75-2679109
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
2000 McKinney Avenue, Suite 700,	
Dallas, Texas, U.S.A.	75201
(Address of principal executive officers)	(Zip Code)

214/932-6600

(Registrant s telephone number,

including area code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Securities registered under Section 12(b) of the Exchange Act:

Common stock, par value $0.01 per share

(Title of class)

6.50% Non-Cumulative Perpetual Preferred Stock Series A, par value $0.01 per share

(Title of class)

6.50% Subordinated Notes due 2042

(Title of class)

Warrants to Purchase Common Stock (expiring January 16, 2019), par value $0.01 per share

(Title of class)

The Nasdaq Stock Market LLC

(Name of Exchange on Which Registered)

Securities registered under Section 12(g) of the Exchange Act: NONE

Indicate by check mark if the issuer is a well-known seasoned issuer pursuant to Section 13 or Section 15(d) of the Securities Act. Yes x No ¨

Indicate by check mark if the issuer is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act. Yes ¨ No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 x ¨ No

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

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

Large Accelerated Filer x	Accelerated Filer ¨	Non-Accelerated Filer ¨ (Do not check if a smaller reporting company)	Non-Accelerated Filer ¨

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

As of June 30, 2013, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the shares of common stock held by non-affiliates, based on the closing price per share of the registrant s common stock as reported on The Nasdaq Global Select Market, was approximately $1,758,352,000. There were 42,755,496 shares of the registrant s common stock outstanding on February 20, 2014.

Documents Incorporated by Reference

Portions of the registrant s Proxy Statement relating to the 2014 Annual Meeting of Stockholders, which will be filed no later than April 10, 2014, are incorporated by reference into Part III of this Form 10-K.

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ITEM 1. *BUSINESS*

Background

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

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

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

We serve the needs of commercial businesses and successful professionals and entrepreneurs located in Texas as well as operate several lines of business serving a regional or national clientele of commercial borrowers. We are primarily a secured lender, with our greatest concentration of loans in Texas. We have benefitted from the Texas economy since our inception, producing strong loan growth and favorable loss experience amidst the challenging environment for banking nationally.

Growth History

We have grown substantially in both size and profitability since our formation. The table below sets forth data regarding the growth of key areas of our business from 2009 through 2013 (in thousands):

	December 31				
	2013	2012	2011	2010	2009
Total loans[(1)]	11,270,574	9,960,807	7,652,452	5,905,539	5,150,797
Assets[(1)]	11,714,397	10,540,542	8,137,225	6,445,679	5,698,318
Demand deposits	3,347,567	2,535,375	1,751,944	1,451,307	899,492
Total deposits	9,257,379	7,440,804	5,556,257	5,455,401	4,120,725
Stockholders equity	1,096,350	836,242	616,331	528,319	481,360

(1) From continuing operations.

The following table provides information about the growth of our loan portfolio by type of loan from December 2009 to December 2013 (in thousands):

	December 31				
	2013	2012	2011	2010	2009
Commercial loans	$ 5,020,565	$ 4,106,419	$ 3,275,150	$ 2,592,924	$ 2,457,533
Total real estate loans	3,409,133	2,630,088	2,241,277	2,029,766	1,903,127
Construction loans	1,262,905	737,637	422,026	270,008	669,426
Real estate term loans	2,146,228	1,892,451	1,819,251	1,759,758	1,233,701
Mortgage finance loans	2,784,265	3,175,272	2,080,081	1,194,209	693,504
Loans held for sale from discontinued operations	294	302	393	490	586
Equipment leases	93,160	69,470	61,792	95,607	99,129
Consumer loans	15,350	19,493	24,822	21,470	25,065

The Texas Market

The Texas market for banking services is highly competitive. Texas largest banking organizations are headquartered outside of Texas and are controlled by out-of-state organizations. We also compete with other providers of financial services, such as savings and loan associations, credit unions, consumer finance

companies, securities firms, insurance companies, commercial finance and leasing companies, full service brokerage firms and discount brokerage firms. We believe that many middle market companies and successful professionals and entrepreneurs are interested in banking with a company headquartered in, and with decision-making authority based in, Texas and with established Texas bankers who have the expertise to act as trusted advisors to the customer with regard to its banking needs. Our banking centers in our target markets are served by experienced bankers with lending expertise in the specific industries found in their market areas and established community ties. We believe our bank can offer customers more responsive and personalized service. We believe that, if we service these customers properly, we will be able to establish long-term relationships and provide multiple products to our customers, thereby enhancing our profitability.

Business Strategy

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

- Targeting middle market business and successful professionals and entrepreneurs;
- Growing our loan and deposit base in our existing markets by hiring additional experienced Texas bankers;
- Continuing our emphasis on credit policy to maintain credit quality consistent with long-term objectives;
- Leveraging our existing infrastructure to support a larger volume of business;
- Maintaining stringent internal approval processes for capital and operating expenses;
- Continuing our extensive use of outsourcing to provide cost-effective operational support with service levels consistent with large-bank operations; and
- Extending our reach within our target markets of Austin, Dallas, Fort Worth, Houston and San Antonio through service innovation and service excellence.

Products and Services

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

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

- commercial loans for general corporate purposes including financing for working capital, internal growth, acquisitions and financing for business insurance premiums;
- real estate term and construction loans;

- mortgage finance lending;
- equipment leasing;
- treasury management services;
- wealth management and trust services; and
- letters of credit.

Individual Customers. We also provide complete banking services for our individual customers, including:

- personal wealth management and trust services;
- certificates of deposit;
- interest bearing and non-interest bearing checking accounts with optional features such as Visa® debit/ATM cards and overdraft protection;

- traditional money market and savings accounts;
- loans, both secured and unsecured; and
- internet banking.

Lending Activities

We target our lending to middle market businesses and successful professionals and entrepreneurs that meet our credit standards. The credit standards are set by our standing Credit Policy Committee with the assistance of our Bank s Chief Credit and Risk Officer, who is charged with ensuring that credit standards are met by loans in our portfolio. Our Credit Policy Committee is comprised of senior Bank officers including our Bank s Chief Executive Officer and President, our Texas President/Chief Lending Officer and our Bank s Chief Credit and Risk Officer. We believe we have maintained a diversified loan portfolio. Credit policies and underwriting guidelines are tailored to address the unique risks associated with each industry represented in the portfolio. Our credit standards for commercial borrowers reference numerous criteria with respect to the borrower, including historical and projected financial information, strength of management, acceptable collateral and associated advance rates, and market conditions and trends in the borrower s industry. In addition, prospective loans are also analyzed based on current industry concentrations in our loan portfolio to prevent an unacceptable concentration of loans in any particular industry. We believe our credit standards are consistent with achieving business objectives in the markets we serve and will generally mitigate risks. We believe that we differentiate our bank from its competitors by focusing on and aggressively marketing to our core customers and accommodating, to the extent permitted by our credit standards, their individual needs.

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

Deposit Products

We offer a variety of deposit products to our core customers at interest rates that are competitive with other banks. Our business deposit products include commercial checking accounts, lockbox accounts, cash concentration accounts, and other treasury management services, including an on-line system. Our treasury management on-line system offers information services, wire transfer initiation, ACH initiation, account transfer, and service integration. Our consumer deposit products include checking accounts, savings accounts, money market accounts and certificates of deposit. We also allow our consumer deposit customers to access their accounts, transfer funds, pay bills and perform other account functions over the Internet and through ATM machines.

Wealth Management and Trust

Our wealth management and trust services include investment management, personal trust and estate services, custodial services, retirement accounts and related services. Our investment management professionals work with our clients to define objectives, goals and strategies for their investment portfolios. We assist the customer with the selection of an investment manager and work with the client to tailor the investment program accordingly. We also offer retirement products such as individual retirement accounts and administrative services for retirement vehicles such as pension and profit sharing plans.

Cayman Islands Branch

We established a branch of our bank in the Cayman Islands in 2003. We believe that a Cayman Islands branch enables us to offer more competitive cash management and deposit products to our customers. All deposits in the Cayman Branch come from U.S. based customers of our bank. Deposits, all of which are in U.S dollars, do not originate from foreign sources, funds transfers neither come from nor go to facilities outside of the U.S. and there are no federal or state income tax benefits to our bank or our customers as a result of these operations. Foreign deposits maintained at our Cayman Islands branch at December 31, 2013 and 2012 were $330.3 million and $329.3 million, respectively.

Employees

As of December 31, 2013, we had 1,016 full-time employees. None of our employees is represented by a collective bargaining agreement and we consider our relations with our employees to be good.

Regulation and Supervision

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

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

The Company s activities are governed by the Bank Holding Company Act of 1956 (BHCA), as amended by the Financial Services Modernization Act of 1999 (Gramm-Leach-Bliley Act), and is subject to regular inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve). We file quarterly reports and other information with the Federal Reserve. We file reports with the Securities and Exchange Commission (SEC) and are subject to its regulation with respect to our securities, reporting and certain governance matters, including matters submitted for stockholder approval. Our securities are listed on the Nasdaq Global Select Market, and we are subject to Nasdaq rules for listed companies.

Our bank is organized as a national banking association under the National Bank Act, and is subject to regulation, supervision and examination by the Office of the Comptroller of the Currency (the OCC), the FDIC, the Federal Reserve, the Consumer Financial Protection Bureau (CFPB) and other federal and state regulatory agencies. The OCC has primary supervisory responsibility for our bank and performs periodic examinations concerning safety and soundness, the quality of management and directors, information technology and compliance with applicable regulations. Our bank files quarterly Call Reports and other information with the OCC.

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

We are not at this time exercising this authority at the parent company level and do not have any plans to do so. We and our bank engage in traditional banking activities that are deemed financial in nature. In order for us to undertake new activities permitted by the BHCA, we and our bank must be considered well capitalized and well managed, our bank must have received a rating of at least satisfactory in its most recent examination under the Community Reinvestment Act and we would be required to notify the Federal Reserve within thirty days of engaging in the new activity.

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

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

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

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

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

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

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

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We and our bank are currently required to maintain a minimum total risk-based capital ratio of 8% (of which at least 4% is required to consist of Tier 1 capital elements). Tier 1 and total capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively, for an institution to be considered well capitalized. Our bank s total risk-based capital ratio was 10.27% at December 31, 2013 and, as a result, it is currently classified as well capitalized for purposes of the OCC s prompt corrective action regulations. The bank s capital category of well capitalized is determined solely for the purposes of applying the prompt corrective action regulations. The regulatory capital category may not constitute an accurate representation of the bank s overall financial condition or prospects. Our regulatory capital status is addressed in more detail under the heading *Liquidity and Capital Resources* within *Management s Discussion and Analysis of Financial Condition and Results of Operations* and in Note 13 to our financial statements *Regulatory Restrictions*.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) sets forth five capital categories for insured depository institutions under the prompt corrective action regulations:

Well capitalized equals or exceeds a 10 percent total risk-based capital ratio, 6 percent tier 1 risk-based capital ratio, and 5 percent leverage ratio and is not subject to any written agreement, order or directive requiring it to maintain a specific level for any capital measure;

Adequately capitalized equals or exceeds an 8 percent total risk-based capital ratio, 4 percent tier 1 risk-based capital ratio, and 4 percent leverage ratio;

Undercapitalized total risk-based capital ratio of less than 8 percent, or a tier 1 risk-based ratio of less than 4 percent, or a leverage ratio of less than 4 percent (3 percent for institutions with a regulatory rating of 1 that do not evidence rapid growth or other heightened risk indicators);

Significantly undercapitalized total risk-based capital ratio of less than 6 percent, or a tier 1 risk-based capital ratio of less than 3 percent, or a leverage ratio of less than 3 percent; and

Critically undercapitalized a ratio of tangible equity to total assets equal to or less than 2 percent.

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

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

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

The OCC and the Federal Reserve also use a leverage ratio as an additional tool to evaluate the capital adequacy of banking organizations. The leverage ratio is a company s Tier 1 capital divided by its average

total consolidated assets. A minimum leverage ratio of 3.0% is required for banks and bank holding companies that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority s risk-adjusted measure for market risk. All other banks and bank holding companies are required to maintain a minimum leverage ratio of 4.0%, unless a different minimum is specified by an appropriate regulatory authority. In order to be considered well capitalized the leverage ratio must be at least 5.0%. Most organizations seek to maintain leverage ratios that are at least 100 to 200 basis points above the minimum ratio. Our bank s leverage ratio was 8.96% at December 31, 2013 and, as a result, it is currently classified as well capitalized for purposes of the OCC s prompt corrective action regulations.

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

Basel III. The Basel Committee in 2010 released a set of recommendations for strengthening international capital and liquidity regulation of banking organizations, known as Basel III. In June 2012, U.S. bank regulatory agencies, including the OCC, issued three proposals to implement the capital, liquidity and other requirements under Basel III, as well as certain other regulatory capital requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). In July 2013, the Federal Reserve published final rules for the adoption of the Basel III regulatory capital framework (the Basel III Capital Rules).

The Basel III Capital Rules, among other things, (i) introduce a new capital measure called Common Equity Tier 1, (ii) specify that Tier 1 capital consist of Common Equity Tier 1 and Additional Tier 1 Capital instruments meeting specified requirements, (iii) define Common Equity Tier 1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to Common Equity Tier 1 and not to the other components of capital and (iv) establish a 7% threshold for the tier 1 common equity ratio, consisting of a minimum level plus a capital conservation buffer, and (v) expand the scope of the deductions/adjustments as compared to existing regulations. The rule also changes both the Tier 1 risk-based capital requirements and the total risk-based requirements to a minimum of 6% and 8%, respectively, plus a capital conservation buffer of 2.5% totaling 8.5% and 10.5%, respectively. The leverage ratio requirement under the rule is 5%. In order to be well capitalized under the new rule, we must maintain a common equity Tier 1 capital ratio, Tier 1 capital ratio, and total capital ratio of greater than or equal to 6.5 percent, 8 percent and 10 percent, respectively.

Because we had less than $15 billion in total consolidated assets as of December 31, 2009, we are allowed to continue to classify our trust preferred securities, all of which were issued prior to May 19, 2010, as Tier 1 capital.

The Basel III Capital Rules will be effective for us on January 1, 2015 with certain transition provisions fully phased in on January 1 2019. Based on our initial assessment of the Basel III Capital Rules, we do not believe they will have a material impact, and we believe we would meet the capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis if such requirements were currently in effect. Regulators may change capital and liquidity requirements including previous interpretations of practices related to risk weights that could require an increase to the allocation of capital to assets held by the Bank, and they could require banks to make retroactive adjustments to financial statements to reflect such changes.

Proposed Liquidity Requirements. The Basel III proposal included a liquidity framework that would require banks and bank holding companies to measure their liquidity against specific liquidity tests. U.S. bank regulators did not include the liquidity framework in the proposed or adopted rules and have not determined to what extent it will apply to banks that are not large, internationally active banks. One of the liquidity tests proposed in Basel III, referred to as the liquidity coverage ratio (LCR), is designed to ensure that a banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity s expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio (NSFR), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements are predicted to encourage banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets, and also to increase the use of long-term debt as a funding source. Regulators may change capital and liquidity requirements including previous interpretations of practices related to risk weights that could require an increase to the allocation of capital to assets held by our bank, and they could require banks to make retroactive adjustments to financial statements to reflect such changes.

Restrictions on Dividends and Repurchases. The sole source of funding of our parent company financial obligations has consisted of proceeds of capital markets transactions and cash payments from our bank for debt service. We may in the future seek to rely upon receipt of dividends paid by our bank to meet our financial obligations. Our bank is subject to statutory dividend restrictions. Under such restrictions, national banks may not, without the prior approval of the OCC, declare dividends in excess of the sum of the current year s net profits plus the retained net profits from the prior two years, less any required transfers to surplus. The Basel III Capital Rules, effective for us on January 1, 2015, will further limit the amount of dividends that be paid by our bank. In addition, under the FDICIA, our bank may not pay any dividend if payment would cause it to become undercapitalized or if it is undercapitalized.

Stress Testing. Pursuant to the Dodd-Frank Act and regulations published by the Federal Reserve and OCC in October 2012, institutions with average total consolidated assets greater than $10 billion are required to conduct an annual stress test of capital and consolidated earnings and losses under a base case and at least two stress scenarios provided by bank regulatory agencies. Institutions with total consolidated assets between $10 billion and $50 billion are to use data as of September 30, 2013 to conduct the test, using scenarios released by the agencies in November 2013. The results for those institutions must be reported to the agencies in March 2014. Public disclosure of summary stress test results will begin in June 2014 for the stress tests commenced in 2013. Results of stress test calculations are anticipated to become an important factor considered by banking regulators in evaluating a range of banking practices. Because we only recently achieved more than $10 billion in assets for four consecutive quarters, we will not be subject to stress test reporting until March 2015 with public disclosure of results in June 2015.

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

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

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Gramm-Leach-Bliley Act of 1999. The Gramm-Leach-Bliley Act:

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

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

Community Reinvestment Act. The Community Reinvestment Act of 1977 (CRA) requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. In order for a financial holding company to commence new activity permitted by the BHCA, each insured depository institution subsidiary of the financial holding company must have received a rating of at least satisfactory in its most recent examination under the CRA.

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

The Volcker Rule. The Dodd-Frank Act amended the BHCA to require the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading in designated types of financial instruments and investing in and sponsoring certain unregistered investment companies. This statutory provision, commonly known as the Volcker Rule, defines unregistered investment companies as hedge funds and private equity funds. In December 2013, federal regulators finalized rules to implement the Volcker Rule. The final rule is highly complex, and many aspects of its application remain uncertain. We do not currently anticipate that the Volcker Rule will have a material effect on our operations since we do not engage in the businesses prohibited by the Volcker Rule. Unanticipated effect of the Volcker Rule s provisions or future interpretations may have an adverse effect on our business or services provided to our bank by other financial institutions.

Safe and Sound Banking Practices. Banks and bank holding companies are prohibited from engaging in unsafe and unsound banking practices. Bank regulators have broad authority to prohibit activities of bank holding companies and their subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and have considerable discretion in identifying what they deem to be unsafe and unsound practices. Regulators can assess civil money penalties for certain activities based upon finding unsafe and unsound conduct on a knowing and reckless basis, if those activities cause a substantial loss to a depository institution. The penalties can be as high as $1.0 million for each day the activity continues.

Consumer Financial Protection Bureau. The Dodd-Frank Act established the CFPB, which has supervisory authority over depository institutions with total assets of $10 billion or greater with respect to a long list of statutes protecting the interests of consumers of financial services. The CFPB has to date focused its supervision and regulatory efforts on (i) risks to consumers and compliance with the federal consumer financial laws, when it evaluates the policies and practices of a financial institution; (ii) the markets in which firms operate and risks to consumers posed by activities in those markets; and (iii) depository institutions that offer a wide variety of consumer financial products and services.

Limits on Compensation. The Federal Reserve, OCC and FDIC in 2010 issued comprehensive final guidance on incentive compensation policies for executive management of banks and bank holding companies. This guidance was intended to ensure that the incentive compensation policies of banking organizations do not undermine their safety and soundness by encouraging excessive risk-taking. The guidance implements seeks to assure that incentive compensation arrangements (i) provide incentives that do not encourage excessive risk-taking, (ii) are compatible with effective internal controls and risk management, and (iii) are supported by strong corporate governance, including oversight by the board of directors.

The Dodd-Frank Act. The Dodd-Frank Act became law in 2010. It has already had a broad impact on the financial services industry, imposing significant regulatory and compliance changes. A significant volume of financial services regulations required by the Dodd-Frank Act have not yet been proposed, or if proposed, have not yet been finalized by banking regulators, making it difficult to predict the ultimate effect of the Dodd-Frank Act. The following discussion provides a brief summary of certain provisions of the Dodd-Frank Act that may have an effect on us.

The Dodd-Frank Act significantly reduces the ability of national banks to rely upon federal preemption of state consumer financial laws. Although the OCC, as the primary regulator of national banks, will have the ability to make preemption determinations where certain conditions are met, the broad rollback of federal preemption has the potential to create a patchwork of federal and state compliance obligations and enforcement. This could, in turn, result in significant new regulatory requirements applicable to us and certain of our lending activities, with potentially significant changes in our operations and increases in our compliance costs.

The Dodd-Frank Act makes permanent the general $250,000 deposit insurance limit for insured deposits. Amendments to the FDIC Act also revised the assessment base against which an insured depository institution s deposit insurance premiums paid to the FDIC s deposit insurance fund (DIF) will be calculated. The assessment base now consists of average consolidated total assets less its average tangible equity. Additionally, the Dodd-Frank Act makes changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15 percent to 1.35 percent of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. Several of these provisions could increase the FDIC deposit insurance premiums paid by us.

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

The Dodd-Frank Act may create risks of secondary actor liability for lenders that provide financing to entities offering financial products to consumers. We may incur compliance and other costs in connection with administration of credit extended to entities engaged in activities covered by the Dodd-Frank Act.

The Dodd-Frank Act addresses many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies, including ours. The Dodd-Frank Act (1) grants stockholders of U.S. publicly traded companies an advisory vote on executive compensation; (2) enhances independence requirements for compensation committee members; (3) requires companies listed on national securities exchanges to adopt incentive-based compensation claw-back policies for executive officers; (4) provides the SEC with authority to adopt proxy access rules that would allow stockholders of publicly traded companies to nominate candidates for election as a director and have those nominees included in a company s proxy materials; (5) prohibits uninstructed broker votes on election of directors, executive compensation matters (including say on pay advisory votes), and other significant matters, and (6) requires disclosures regarding board leadership structure.

Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on our operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements.

Available Information

Under the Securities Exchange Act of 1934, we are required to file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (SEC). You may read and copy any document filed by us with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the public reference room. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. We file electronically with the SEC.

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

ITEM 1A. *RISK FACTORS*

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

Risk Factors Associated With Our Business

We must effectively manage our credit risk. The risk of non-payment of loans is inherent in commercial banking. Increased credit risk may result from several factors, including adverse changes in economic and industry conditions, declines in the value of collateral and risks related to individual borrowers. We rely heavily on information provided by third parties when originating and monitoring loans. If this information is intentionally or negligently misrepresented and we do not detect such misrepresentations, the credit risk associated with the transaction may be increased. Although we attempt to manage our credit risk by carefully monitoring the concentration of our loans within specific loan categories and industries and through prudent loan approval and monitoring practices in all categories of our lending, we cannot assure you that our approval and monitoring procedures will reduce these lending risks. If our credit administration personnel, policies and procedures are not able to adequately adapt to changes in economic or other conditions that affect customers and the quality of the loan portfolio, we may incur increased losses that could adversely affect our financial results.

A significant portion of our assets consists of commercial loans. We generally invest a greater proportion of our assets in commercial loans to business customers than other banking institutions of our size, and our business plan calls for continued efforts to increase our assets invested in these loans. At December 31, 2013, approximately 44% of our loan portfolio was comprised of commercial loans. Commercial loans may involve a higher degree of credit risk than other types of loans due, in part, to their larger average size, the effects of changing economic conditions on the businesses of our commercial loan customers, the dependence of borrowers on operating cash flow to service debt and our reliance upon collateral which may not be readily marketable. Due to the proportionate amount of these commercial loans in our portfolio, losses incurred on a relatively small number of commercial loans could have a materially adverse impact on our results of operations and financial condition.

A significant portion of our loans are secured by commercial and residential real estate. At December 31, 2013, approximately 30% of our loan portfolio was comprised of loans with real estate as the primary component of collateral. Our real estate lending activities, and our exposure to fluctuations in real estate collateral values, are significant and expected to increase as our assets increase. The market value of real estate can fluctuate significantly in a relatively short period of time as a result of market conditions in the geographic area in which the real estate is located. If the value of real estate serving as collateral for our loans declines materially, a significant part of our loan portfolio could become under-collateralized and losses incurred upon borrower defaults would increase. Conditions in certain segments of the real estate industry, including homebuilding, lot development and mortgage lending, may have an effect on values of real estate pledged as collateral for our loans. The inability of purchasers of real estate, including residential real estate, to obtain financing may weaken the financial condition of our borrowers who are dependent on the sale or refinancing of property to repay their loans.

We must maintain an adequate allowance for loan losses. Our experience in the banking industry indicates that some portion of our loans will become delinquent, and some may only be partially repaid or may never be repaid at all. We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense each quarter, that is consistent with management s assessment of the collectability of the loan portfolio in light of the amount of loans committed and outstanding and current economic conditions and market trends. When specific loan losses are identified, the amount of the expected loss is removed, or charged-off, from the allowance. Our methodology for establishing the adequacy of the allowance for loan losses depends on our subjective application of risk grades as indicators of each borrower s ability to repay the loan.

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

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We must effectively manage our interest rate risk. Our profitability is dependent to a large extent on our net interest income, which is the difference between the interest income paid to us on our loans and investments and the interest we pay to third parties such as our depositors, lenders and debtholders. Changes in interest rates can impact our profits and the fair values of certain of our assets and liabilities. Prolonged periods of unusually low interest rates may have an adverse effect on our earnings by reducing yields on loans and other earning assets. Increases in market interest rates may reduce our customers desire to borrow money from us or adversely affect their ability to repay their outstanding loans by increasing their debt service obligations through the periodic reset of adjustable interest rate loans. If our borrowers ability to pay their loans is impaired by increasing interest payment obligations, our level of non-performing assets would increase, producing an adverse effect on operating results. Increases in interest rates can have a material impact on the volume of mortgage originations and refinancings, adversely affecting the profitability of our mortgage finance business. Interest rate risk can also result from mismatches between the dollar amounts of repricing or maturing assets and liabilities and from mismatches in the timing and rates at which our assets and liabilities reprice. We actively monitor and manage the balances of our maturing and repricing assets and liabilities to reduce the adverse impact of changes in interest rates, but there can be no assurance that we will be able to avoid material adverse effects on our net interest margin in all market conditions.

Federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed in 2011 by the Dodd-Frank Act. This change has had limited impact to date due to the excess of commercial liquidity and the very low rate environment in recent years. There can be no assurance that we will not be materially adversely affected in the future if economic activity increases and interest rates rise, which may result in our interest expense increasing, and our net interest margin decreasing, if we must offer interest on demand deposits to attract or retain customer deposits.

We must effectively execute our business strategy in order to continue our asset and earnings growth. Our core strategy is to develop our business principally through organic growth. Our prospects for continued growth must be considered in light of the risks, expenses and difficulties frequently encountered by companies seeking to realize significant growth. In order to execute our growth strategy successfully, we must, among other things:

- continue to identify and expand into suitable markets and lines of business, in Texas, regionally and nationally;
- develop new products and services and execute our full range of products and services more efficiently and effectively;
- attract and retain qualified bankers in each of our targeted markets to build our customer base;
- expand our loan portfolio while maintaining credit quality;
- attract sufficient deposits and capital to fund our anticipated loan growth;
- control expenses; and
- maintain sufficient qualified staffing and infrastructure to support growth and compliance with increasing regulatory requirements.

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

Our future profitability depends, to a significant extent, upon our middle market business customers. Our future profitability depends, to a significant extent, upon revenue we receive from middle market business customers, and their ability to continue to meet their loan obligations. Adverse economic conditions or other factors affecting this market segment may have a greater adverse effect on us than on other financial institutions that have a more diversified customer base.

Our business is concentrated in Texas. A substantial majority of our customers are located in Texas. As a result, our financial condition and results of operations may be strongly affected by any prolonged period of economic recession or other adverse business, economic or regulatory conditions affecting Texas businesses and financial institutions.

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

We must effectively manage our liquidity risk. Our bank requires available funds (liquidity) to meet its deposit, debt and other obligations as they come due as well as unexpected demands for cash payments. Our bank s principal source of funding consists of customer deposits. A substantial majority of our bank s liabilities consist of demand, savings, interest checking and money market deposits, which are payable on demand or upon several days notice. By comparison, a substantial portion of our assets are loans, most of which, excluding our mortgage finance loans, cannot be collected or sold in so short a time frame, creating the potential for an imbalance in the availability of liquid assets to satisfy depositors and loan funding requirements. We hold smaller balances of marketable securities than many of our competitors, limiting our ability to increase our liquidity by completing market sales of these assets. An inability to raise funds through deposits, borrowings, the sale of securities and loans and other sources, including our access to capital market transactions, could have a substantial negative effect on our bank s liquidity. We actively manage our available sources of funds to meet our expected needs under normal and financially stressed conditions, but there is no assurance that our bank will be able to meet funding commitments to borrowers and replace maturing deposits and advances as necessary under all possible circumstances. Our bank s ability to obtain funding could be impaired by factors beyond its control, such as disruptions in financial markets, negative expectations regarding the financial services industry generally or in our markets or negative perceptions of our bank.

Our bank sources a significant volume of its demand deposits from financial services companies and other commercial sources, resulting in a smaller number of larger deposits than would be typical of other banks in our markets. In recent periods over half of our total deposits have been attributable to customers whose balances exceed the $250,000 FDIC insurance limit. Many of these customers actively monitor our financial condition and results of operations and could withdraw their deposits quickly upon the occurrence of a material adverse development affecting our bank. One potential source of liquidity for our bank consists of brokered deposits arranged by brokers acting as intermediaries, typically larger money-center financial institutions. We have significant balances of other deposits defined for regulatory purposes to be brokered deposits, including deposits provided by certain of our customers in connection with our delivery of other financial services to them or their customers. If we do not maintain our regulatory capital above the level required to be well capitalized FDIC consent would be required for us to continue to obtain deposits classified as brokered deposits. Our non-traditional deposits are subject to greater operational and reputational risk of unexpected withdrawal than traditional demand and time deposits, particularly those provided by consumers. See *Management s Discussion and Analysis of Financial Condition and Results of Operations* below for further discussion of our liquidity.

We must be effective in developing and executing new lines of business and new products and services while managing associated risks. Our business strategy requires that we develop and grow new lines of business and offer new products and services within existing lines of business in order to compete successfully and realize our growth objectives. Substantial costs, risks and uncertainties are associated with these efforts, particularly in instances where the markets are not fully developed. Developing and marketing new activities requires that we invest significant time and resources before revenues and profits can be realized. Timetables for the development and launch of new activities may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives and shifting market preferences, may also adversely impact the successful execution of new activities. New activities necessarily entail additional risks and may present additional risks to the effectiveness of our system of internal controls. All service offerings, including current offerings and new activities, may become more risky due to changes in economic, competitive and market conditions beyond our control. 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 must continue to attract and retain key personnel. Our success depends to a significant extent upon our ability to attract and retain experienced bankers in each of our markets. Competition for the best people in our industry can be intense, and there is no assurance that we will continue to have the same level of success in this effort that has supported our historical results. Factors that affect our ability to attract and retain key employees include our compensation and benefits programs, our profitability and our reputation for rewarding and promoting qualified employees. The cost of employee compensation is a significant portion of our operating expenses and can materially impact our results of operations. The unanticipated loss of the services of key personnel could have an adverse effect on our business. Although we have entered into employment agreements with certain key employees, we cannot assure you that we will be successful in retaining them.

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

- national, regional and local economic conditions;
- general economic consequences of international conditions, such as weakness in European sovereign debt and the impact of that weakness on the US and global economies;
- legislative and regulatory changes impacting our industry;
- the financial health of our customers and economic conditions affecting them and the value of our collateral, including changes in the price of energy and other commodities;
- the incidence of fraud, illegal payments, security breaches and other illegal acts among or impacting our bank and our customers;
- structural changes in the markets for origination, sale and servicing of residential mortgages;
- changes in governmental economic and regulatory policies generally, including the extent and timing of intervention in credit markets by the Federal Reserve Board or withdrawal from that intervention;
- changes in the availability of liquidity at a systemic level; and
- material inflation or deflation.

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

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

Our accounting estimates and risk management processes rely on management judgment, which may be supported by analytical and forecasting models. The processes we use to estimate probable credit losses for purposes of establishing the allowance for loan losses and to measure the fair value of financial instruments, as well as the processes we use to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depend upon management s judgment. Management s judgment and the data relied upon by management may be based on assumptions that prove to be inaccurate, particularly in times of market stress or other unforeseen circumstances. Even if the relevant factual assumptions are accurate, our decisions may prove to be inadequate or inaccurate because of other flaws in the design or use of analytical tools used by management. Any such failures in our processes for producing accounting estimates and managing risks could have a material adverse effect on our business, financial condition and results of operations.

We are dependent on funds obtained from capital transactions or from our bank to fund our obligations. We are a financial holding company engaged in the business of managing, controlling and operating our bank. We conduct no material business or other activity at the parent company level other than activities incidental to holding equity and debt investments in our bank. As a result, we rely on the proceeds of capital transactions and payments of interest and principal on loans made to our bank to pay our operating expenses, to satisfy our obligations to debtholders and to pay dividends on our preferred stock. We may in the future rely on dividends from our bank to satisfy all or part of our parent company financial obligations. Our bank s ability to pay dividends may be limited. The profitability of our bank is subject to fluctuation based upon, among other things, the cost and availability of funds, changes in interest rates and economic conditions in general. Our bank s ability to pay dividends to us is subject to regulatory limitations that can, under certain adverse circumstances, prohibit the payment of dividends to us by our bank. Our right to participate in any distribution from the sale or liquidation of our bank is subject to the prior claims of our bank s creditors. If we are unable to access funds from capital transactions or our bank we may be unable to satisfy our obligations to creditors or debtholders or pay dividends on our preferred stock.

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

We must effectively manage our information systems risk. We rely heavily on our communications and information systems to conduct our business. The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. Our ability to compete successfully depends in part upon our ability to use technology to provide products and

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services that will satisfy customer demands. Many of the Company s competitors invest substantially greater resources in technological improvements than we do. 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, which may negatively affect our business, results of operations or financial condition.

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

We collect and store sensitive data, including personally identifiable information of our customers and employees. Computer break-ins of our systems or our customers systems, thefts of data and other breaches and criminal activity may result in significant costs to respond, liability for customer losses if we are at fault, damage to our customer relationships, regulatory scrutiny and enforcement and loss of future business opportunities due to reputational damage. Although we, with the help of third-party service providers, will continue to implement security technology and establish operational procedures to protect sensitive data, there can be no assurance that these measures will be effective. We advise and provide training to our customers regarding protection of their systems, but there is no assurance that our advice and training will be appropriately acted upon by our customers or effective to prevent losses. In some cases we may elect to contribute to the cost of responding to cybercrime against our customers, even when we are not at fault, in order to maintain valuable customer relationships.

Our operations rely on external vendors. We rely on certain external vendors to provide products and services necessary to maintain our day-to-day operations, particularly in the areas of operations, treasury management systems, information technology and security, exposing us to the risk that these vendors will not perform as required by our agreements. An external vendor s failure to perform in accordance with our agreement could be disruptive to our operations, which could have a material adverse impact on our business, financial condition and results of operations.

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

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

Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. Recent material changes in regulation and requirements imposed on financial institutions, such as the Dodd-Frank Act and the Basel III Accord, result in additional costs, impose more stringent capital, liquidity and leverage requirements, limit the types of financial services and products we may offer and increase the ability of non-bank financial services providers to offer competing financial services and products, among other things. The Dodd-Frank Act has not yet been fully implemented and there are many additional regulations that have not been proposed, or if proposed, have not been adopted. The full impact of the Dodd-Frank Act on our business strategies is unknown at this time and cannot be predicted.

We receive inquiries from our regulators from time to time regarding, among other things, lending practices, reserve methodology, interest rate and operational risk management, regulatory and financial accounting practices and policies and related matters, which can divert management s time and attention from focusing on our business. Because our assets now exceed $10 billion we are subject to additional regulatory requirements and have increased the amount of management time and expense devoted to developing the infrastructure to support our compliance. Commencing in 2014 we are required to conduct enhanced stress testing to evaluate the adequacy of our capital and liquidity planning. Uncertainties regarding the conditions and risk factors that will be required to be included in stress tests and how the financial models of our business will respond subject us to risk as this new activity is implemented. Any change to our practices or policies requested or required by our regulators, or any changes in interpretation of regulatory policy applicable to our businesses, may have a material adverse effect on our business, results of operations or financial condition.

We expend substantial effort and incur costs to continually improve our systems, controls, accounting, operations, information security, compliance, audit effectiveness, analytical capabilities, staffing and training in order to satisfy regulatory requirements. We cannot offer assurance that these efforts will satisfy applicable legal and regulatory requirements. Failure to comply with relevant laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

The FDIC has imposed higher general and special assessments on deposits or assets based on general industry conditions and as a result of changes in specific programs, and there is no restriction on the amount by which the FDIC may increase deposit and asset assessments in the future. Increases in FDIC assessments, fees or taxes could affect our earnings. Reports from the Public Company Accounting Oversight Board s (PCAOB) inspections of public accounting firms continue to outline findings and recommendations which could require these firms to perform additional work as part of their financial statement audits, increasing our audit and internal audit costs to respond to these added requirements and exposure to adverse findings by the PCAOB of the work performed. As a result, we have experienced, and may continue to experience, greater internal and external compliance and audit costs to comply with these changes that could adversely affect our results of operations.

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

Failure to meet regulatory capital standards could have a material adverse effect on our business, including damaging the confidence of customers in us, adversely impacting our competitive position, limiting our ability to use brokered deposits, limiting our access to capital markets transactions, limiting our ability to pursue new activities and resulting in higher FDIC assessments on deposits or assets. Were we to fall below guidelines for being deemed adequately capitalized the OCC or Federal Reserve could impose further restrictions and requirements in order to effect prompt corrective action. The capital requirements applicable to us are in a process of continuous evaluation and revision in connection with Basel III and the requirements of the Dodd-Frank Act. We cannot predict the final form, or the effects, of

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these regulations on our business, but among the possible effects are requirements that we slow our rate of growth or obtain additional capital which could reduce our earnings or dilute our existing stockholders.

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

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact our business. Severe weather, natural disasters, 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. Hurricanes have caused extensive flooding and destruction along the coastal areas of Texas, including communities where we conduct business. Although management has established disaster recovery policies and procedures, the occurrence of any such events could have a material adverse effect on our business, financial condition and results of operations.

We are subject to claims and litigation in the ordinary course of our business, including claims that may not be covered by our insurers. Customers and other parties we engage with assert claims and take legal action against us on a regular basis and we regularly take legal action to collect unpaid borrower obligations, realize on collateral and assert our rights in commercial and other contexts. These actions frequently result in counter-claims against us. Litigation arises in a variety of contexts, including lending activities, employment practices, commercial agreements, fiduciary responsibility related to our wealth management services, intellectual property rights and other general business matters.

Claims and legal actions may result in significant legal costs to defend us or assert our rights and reputational damage that adversely affects existing and future customer relationships. If claims and legal actions are not resolved in a manner favorable to us we may suffer significant financial liability adverse effects upon our reputation, which could have a material adverse effect on our business, financial condition and results of operations. See *Legal Proceedings* below for additional disclosures regarding legal proceedings.

We purchase insurance coverage to mitigate a wide range of operating risks, including general liability, errors and omissions, professional liability, business interruption, cyber-crime and property loss, for events that may be materially detrimental to our bank or customers. There is no assurance that our insurance will be adequate to protect us against material losses in excess of our coverage limits or that insurers will perform their obligations under our policies without attempting to limit or exclude coverage. We could be required to pursue legal actions against insurers to obtain payment of amounts we are owed, and there is no assurance that such actions, if pursued, would be successful.

Our controls and procedures may fail or be circumvented. Management regularly reviews and updates our internal controls over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and 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.

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Risks Relating to Our Securities

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

- actual or anticipated variations in quarterly 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, including regulatory actions against other financial institutions;
- perceptions in the marketplace regarding us and/or our competitors;
- new technology used, or services offered, by competitors;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- changes in government regulations and interpretation of those regulations, changes in our practices requested or required by regulators and changes in regulatory enforcement focus; and
- geopolitical conditions such as acts or threats of terrorism or military conflicts.

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

The trading volume in our common stock is less than that of other larger financial services companies. Although our common stock is traded on the Nasdaq Global Select Market, the trading volume in our common stock is less than that of other larger financial services companies. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause our stock price to fall. In addition, a substantial majority of common stock outstanding is held by institutional shareholders, and trading activity involving large positions may increase volatility of the stock price. Concentration of ownership by institutional investors and inability to execute trades covering large numbers of shares can increase volatility of stock price. Changes in general economic outlook or perspectives on our business or prospects by our institutional investors, whether factual or speculative, can have a major impact on our stock price.

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

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

The holders of our indebtedness and preferred stock have rights that are senior to those of our common shareholders. As of December 31, 2013, we had $111.0 million in subordinated notes and $113.4 million in junior subordinated notes outstanding that are held by statutory trusts which issued trust preferred securities to investors. Our bank issued subordinated notes in an aggregate principal amount of $175.0 million on January 31, 2014. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us to the extent not paid by each trust, provided the trust has funds available for such obligations.

Our subordinated notes and junior subordinated notes are senior to our shares of preferred stock and common stock in right of payment of dividends and other distributions. We must be current on interest and principal payments on our indebtedness before any dividends can be paid on our preferred stock or our common stock. In the event of our bankruptcy, dissolution or liquidation, the holders of our indebtedness must be satisfied before any distributions can be made to our preferred or common shareholders. If certain conditions are met, we have the right to defer interest payments on the junior subordinated debentures (and the related trust preferred securities) at any time or from time to time for a period not to exceed 20 consecutive quarters in a deferral period, during which time no dividends may be paid to holders of our preferred stock or common stock. Because our bank s subordinated notes issued in January 2014 are obligations of the bank, the would in any sale or liquidation of our bank receive payment before any amounts would be payable to holders of our common stock, preferred stock or subordinated notes.

At December 31, 2013, we had issued and outstanding 6 million shares of our 6.50% Non-Cumulative Perpetual Preferred Stock, Series, A, having an aggregate liquidation preference of $150.0 million. Our preferred stock is senior to our shares of common stock in right of payment of dividends and other distributions. We must be current on dividends payable to holders of preferred stock before any dividends can be paid on our common stock. In the event of our bankruptcy, dissolution or liquidation, the holders of our preferred stock must be satisfied before any distributions can be made to our common shareholders.

We do not currently pay dividends on our common stock. We have not paid dividends on our common stock and we do not expect to do so for the foreseeable future. Our ability to pay dividends is limited by regulatory restrictions and the need to maintain sufficient consolidated capital. The ability of our bank to pay dividends to us is limited by its obligation to maintain sufficient capital and by other regulatory restrictions as discussed above at *We are dependent on funds obtained from capital transactions or from our bank to fund our obligations.*

Restrictions on Ownership. The ability of a third party to acquire us is limited under applicable U.S. banking laws and regulations. The Bank Holding Company Act of 1956, as amended (the BHCA), requires any bank holding company (as defined therein) to obtain the approval of the Board of Governors of the Federal Reserve System (Federal Reserve) prior to acquiring, directly or indirectly, more than 5% of our outstanding Common Stock. Any company (as defined in the BHCA) other than a bank holding company would be required to obtain Federal Reserve approval before acquiring control of us. Control generally means (i) the ownership or control of 25% or more of a class of voting securities, (ii) the ability to elect a majority of the directors or (iii) the ability otherwise to exercise a controlling influence over management and policies. A holder of 25% or more of our outstanding Common Stock, other than an individual, is subject to regulation and supervision as a bank holding company under the BHCA. In addition, under the Change in Bank Control Act of 1978, as amended, and the Federal Reserve s regulations thereunder, any person, either individually or acting through or in concert with one or more persons, is required to provide notice to the Federal Reserve prior to acquiring, directly or indirectly, 10% or more of our outstanding common stock.

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

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

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

ITEM 1B. *UNRESOLVED STAFF COMMENTS*
None.

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ITEM 2. *PROPERTIES*

As of December 31, 2013, we conducted business at thirteen full service banking locations and one operations center. Our operations center houses our loan and deposit operations and the customer service call center. We lease the space in which our banking centers and the operations call center are located. These leases expire between July 2019 and September 2024, not including any renewal options that may be available.

The following table sets forth the location of our executive offices, operations center and each of our banking centers.

Type of Location	Address
Executive offices, banking location	2000 McKinney Avenue *Banking Center* Suite 190 *Executive Offices* Suite 700 Dallas, Texas 75201
Operations center, banking location	2350 Lakeside Drive *Banking Center* Suite 105 *Operations Center* Suite 800 Richardson, Texas 75082
Banking location	14131 Midway Road Suite 100 Addison, Texas 75001
Banking location	5910 North Central Expressway Suite 150 Dallas, Texas 75206
Banking location	5800 Granite Parkway Suite 150 Plano, Texas 75024
Executive offices	500 Throckmorton Suite 300 Fort Worth, Texas 76102
Banking location	570 Throckmorton Fort Worth, Texas 76102
Executive offices, banking location	98 San Jacinto Boulevard *Banking center* Suite 150 *Executive offices* Suite 200 Austin, Texas 78701
Banking location	3818 Bee Caves Road Austin, Texas 78746
Banking location	One Chisholm Trail Suite 225 Round Rock, Texas 78681
Executive offices, banking location	745 East Mulberry Street *Banking center* Suite 150 *Executive offices* Suite 350 San Antonio, Texas 78212
Banking location	7373 Broadway

	Suite 100 San Antonio, Texas 78209
Executive offices, banking location	One Riverway *Banking center* Suite 150 *Executive offices* Suite 2100 Houston, Texas 77056
Banking location	Westway II 4424 West Sam Houston Parkway N. Suite 170 Houston, TX 77041

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ITEM 3. *LEGAL PROCEEDINGS*

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

ITEM 4. *MINE SAFETY DISCLOSURES*

Not applicable.

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

Our common stock is traded on The Nasdaq Global Select Market under the symbol TCBI . On February 20, 2014, there were approximately 238 holders of record of our common stock.

No cash dividends have ever been paid by us on our common stock, and we do not anticipate paying any cash dividends in the foreseeable future. Our principal source of funds to pay cash dividends on our common stock would be cash dividends from our bank. The payment of dividends by our bank is subject to certain restrictions imposed by federal banking laws, regulations and authorities.

The following table presents the range of high and low bid prices reported on The Nasdaq Global Select Market for each of the four quarters of 2012 and 2013.

	Price Per Share	
Quarter Ended	High	Low
March 31, 2012	$ 36.61	$ 30.57
June 30, 2012	42.08	32.55
September 30, 2012	49.96	39.50
December 31, 2012	52.17	41.50
March 31, 2013	$ 47.39	$ 39.87
June 30, 2013	45.22	36.75
September 30, 2013	50.15	43.43
December 31, 2013	62.25	44.53

Equity Compensation Plan Information

The following table presents certain information regarding our equity compensation plans as of December 31, 2013.

Plan category	Number of Securities To Be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by security holders	592,751	$ 28.69	262,315
Equity compensation plans not approvedby security holders			

Total	592,751	$ 28.69	262,315

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Stock Performance Graph

The following table and graph sets forth the cumulative total stockholder return for the Company s common stock for the five-year period ending on December 31, 2013, compared to an overall stock market index (Russell 2000 Index) and the Company s peer group index (Nasdaq Bank Index). The Russell 2000 Index and Nasdaq Bank Index are based on total returns assuming reinvestment of dividends. The graph assumes an investment of $100 on December 31, 2008. The performance graph represents past performance and should not be considered to be an indication of future performance.

	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
Texas Capital Bancshares, Inc.	$ 100.00	$ 104.49	$ 159.73	$ 229.12	$ 335.48	$ 465.57
Russell 2000 Index RTY	100.00	124.38	155.54	147.52	169.17	231.17
Nasdaq Bank Index CBNK	100.00	80.70	89.71	78.82	91.45	126.15

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ITEM 6. *SELECTED CONSOLIDATED FINANCIAL DATA*

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

	At or For the Year Ended December 31				
	2013	2012	2011	2010	2009
	(In thousands, except per share, average share and percentage data)				
Consolidated Operating Data(1)					
Interest income	$ 444,625	$ 398,457	$ 321,600	$ 279,810	$ 243,153
Interest expense	25,112	21,578	18,663	38,136	46,462
Net interest income	419,513	376,879	302,937	241,674	196,691
Provision for credit losses	19,000	11,500	28,500	53,500	43,500
Net interest income after provision for credit losses	400,513	365,379	274,437	188,174	153,191
Non-interest income	44,024	43,040	32,232	32,263	29,260
Non-interest expense	256,734	219,844	188,201	163,488	145,542
Income from continuing operations before income taxes	187,803	188,575	118,468	56,949	36,909
Income tax expense	66,757	67,866	42,366	19,626	12,522
Income from continuing operations	121,046	120,709	76,102	37,323	24,387
Income (loss) from discontinued operations (after-tax)	5	(37)	(126)	(136)	(235)
Net income	121,051	120,672	75,976	37,187	24,152
Preferred stock dividends	7,394				5,383
Net income available to common shareholders	$ 113,657	$ 120,672	$ 75,976	$ 37,187	$ 18,769
Consolidated Balance Sheet Data(1)					
Total assets(2)	$ 11,714,397	$ 10,540,542	$ 8,137,225	$ 6,445,679	$ 5,698,318
Loans held for investment	8,486,309	6,785,535	5,572,371	4,711,330	4,457,293
Loans held for investment, mortgage finance loans	2,784,265	3,175,272	2,080,081	1,194,209	693,504
Securities available-for-sale	63,214	100,195	143,710	185,424	266,128
Demand deposits	3,347,567	2,535,375	1,751,944	1,451,307	899,492
Total deposits	9,257,379	7,440,804	5,556,257	5,455,401	4,120,725
Federal funds purchased	148,650	273,179	412,249	283,781	580,519
Other borrowings	876,980	1,673,982	1,355,867	14,106	376,510
Subordinated notes	111,000	111,000			
Trust preferred subordinated debentures	113,406	113,406	113,406	113,406	113,406
Stockholders equity	1,096,350	836,242	616,331	528,319	481,360

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	At or For the Year Ended December 31				
	2013	2012	2011	2010	2009
	(In thousands, except per share, average share and percentage data)				
Other Financial Data					
Income per share					
Basic					
Income from continuing operations	$ 2.78	$ 3.09	$ 2.04	$ 1.02	$ 0.56
Net income	2.78	3.09	2.03	1.02	0.55
Diluted					
Income from continuing operations	$ 2.72	$ 3.01	$ 1.99	$ 1.00	$ 0.56
Net income	2.72	3.00	1.98	1.00	0.55
Tangible book value per share(3)	22.50	19.96	15.69	13.89	12.96
Book value per share(3)	23.02	20.45	16.24	14.15	13.23
Weighted average shares					
Basic	40,864,225	39,046,340	37,334,743	36,627,329	34,113,285
Diluted	41,779,881	40,165,847	38,333,077	37,346,028	34,410,454
Selected Financial Ratios					
Performance Ratios					
Net interest margin	4.22%	4.41%	4.68%	4.28%	3.89%
Return on average assets	1.17%	1.35%	1.12%	0.63%	0.46%
Return on average equity	12.82%	16.93%	13.39%	7.23%	5.15%
Efficiency ratio	55.39%	52.35%	56.15%	59.68%	64.41%
Non-interest expense to average earning assets	2.58%	2.57%	2.90%	2.88%	2.87%
Asset Quality Ratios					
Net charge-offs (recoveries) to average loans	0.05%	0.07%	0.47%	0.95%	0.41%
Net charge-offs (recoveries) to average loans excluding mortgage finance loans(5)	0.07%	0.10%	0.58%	1.14%	0.46%
Reserve for loan losses to loans	0.78%	0.75%	0.92%	1.21%	1.32%
Reserve for loan losses to loans excluding mortgage finance loans(5)	1.03%	1.10%	1.26%	1.52%	1.52%
Reserve for loan losses to non-accrual loans	2.7x	1.3x	1.3x	.6x	.7x
Non-accrual loans to loans	0.29%	0.56%	0.71%	1.90%	1.86%
Non-accrual loans to loans excluding mortgage finance loans(5)	0.38%	0.82%	0.98%	2.38%	2.15%
Total NPAs to loans plus OREO	0.33%	0.72%	1.17%	2.60%	2.38%
Total NPAs to loans excluding mortgage finance loans plus OREO(5)	0.44%	1.06%	1.61%	3.26%	2.74%
Capital and Liquidity Ratios					
Total capital ratio(4)	10.73%	9.97%	9.25%	11.83%	11.98%
Tier 1 capital ratio(4)	9.15%	8.27%	8.38%	10.58%	10.73%
Tier 1 leverage ratio	10.87%	9.41%	8.78%	9.36%	10.54%
Average equity/average assets	9.68%	7.95%	8.33%	8.67%	8.91%
Tangible common equity/total tangible assets(3)	7.87%	7.73%	7.29%	7.98%	8.18%
Average net loans/average deposits	116.25%	129.97%	115.68%	105.50%	128.43%

(1) The consolidated statement of operating data and consolidated balance sheet data presented above for the five most recent fiscal years ended December 31, have been derived from our audited consolidated financial statements. The historical results are not necessarily indicative of the results to be expected in any future period.

(2) From continuing operations.

(3) Excludes unrealized gains/losses on securities.

(4) In response to FFIEC Call Report instructions issued in early April 2013, we began using a 100% risk weight for the mortgage finance loans with our March 31, 2013 Form 10-Q. We were required to amend our 2012 and 2011 Call Reports for this change in risk weighting, as well as the previously reported risk-weighted capital ratios for December 31, 2012 and 2011. We were not required to amend the ratios for December 31, 2010 or 2009.

(5) Mortgage finance loans were previously classified as loans held for sale but have been reclassified as loans held for investment as described in Note 1 Operations and Summary of Significant Accounting Policies. The indicated ratios are presented excluding the mortgage finance loans because the risk profile of our mortgage finance loans is different than our other loans held for investment. No provision is allocated to these loans based on the internal risk grade assigned.

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

Forward-Looking Statements

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

Deterioration of the credit quality of our loan portfolio, increased default rates and loan losses or adverse changes in the industry concentrations of our loan portfolio.

Developments adversely affecting our commercial, entrepreneur and professional customers.

Changes in the value of commercial and residential real estate securing our loans or in the demand for credit to support the purchase and ownership of such assets.

The failure of assumptions supporting our allowance for loan losses causing it to become inadequate as loan quality decreases and losses and charge-offs increase.

A failure to effectively manage our interest rate risk resulting from unexpectedly large or sudden changes in interest rates or rate or maturity imbalances in our assets and liabilities.

Failure to execute our business strategy, including any inability to expand into new markets and lines of business in Texas, regionally and nationally.

Loss of access to capital market transactions and other sources of funding, or a failure to effectively balance our funding sources with cash demands by depositors and borrowers.

Failure to successfully develop and launch new lines of business and new products and services within the expected time frames and budgets, or failure to anticipate and appropriately manage the associated risks.

The failure to attract and retain key personnel or the loss of key individuals or groups of employees.

Changes in the U.S. economy in general or the Texas economy specifically resulting in deterioration of credit quality or reduced demand for credit or other financial services we offer.

Legislative and regulatory changes imposing further restrictions and costs on our business, a failure to remain well capitalized or regulatory enforcement actions against us.

An increase in the incidence or severity of fraud, illegal payments, security breaches and other illegal acts impacting our bank and our customers.

Structural changes in the markets for origination, sale and servicing of residential mortgages.

Increased or more effective competition from banks and other financial service providers in our markets.

Material failures of our accounting estimates and risk management processes based on management judgment, or the supporting analytical and forecasting models.

Unavailability of funds obtained from capital transactions or from our bank to fund our obligations.

Failures of counterparties or third party vendors to perform their obligations.

Failures or breaches of our information systems that are not effectively managed.

Severe weather, natural disasters, acts of war or terrorism and other external events.

Incurrence of material costs and liabilities associated with claims and litigation.

Failure of our risk management strategies and procedures, including failure or circumvention of our controls.

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

Overview of Our Business Operations

We commenced our banking operations in December 1998. An important aspect of our growth strategy has been our ability to service and effectively manage a large number of loans and deposit accounts in multiple markets in Texas. Accordingly, we have created an operations infrastructure sufficient to support state-wide lending and banking operations that we continue to build out as needed to serve a larger customer base and specialized industries.

The following discussion and analysis presents the significant factors affecting our financial condition as of December 31, 2013 and 2012 and results of operations for each of the three years in the periods ended December 31, 2013, 2012 and 2011. This discussion should be read in conjunction with our consolidated financial statements and notes to the financial statements appearing later in this report.

Except as otherwise noted, all amounts and disclosures throughout this document reflect continuing operations. See Part I, Item 1 herein for a discussion of discontinued operations and at Note 19 Discontinued Operations.

Year ended December 31, 2013 compared to year ended December 31, 2012

We reported net income of $121.0 million and net income available to common shareholders of $113.7 million, or $2.72 per diluted common share, for the year ended December 31, 2013, compared to net income and net income available to common shareholders of $120.7 million, or $3.01 per diluted common share, for the same period in 2012. Return on average equity was 12.82% and return on average assets was 1.17% for the year ended December 31, 2013, compared to 16.93% and 1.35%, respectively, for the same period in 2012.

Net income increased $337,000 for the year ended December 31, 2013 compared to 2012. The $337,000 increase was primarily the result of a $42.6 million increase in net interest income, a $984,000 increase in non-interest income and a $1.1 million decrease in income tax expense, offset by a $7.5 million increase in the provision for credit losses and a $36.9 million increase in non-interest expense.

Details of the changes in the various components of net income are further discussed below.

Year ended December 31, 2012 compared to year ended December 31, 2011

We reported net income of $120.7 million, or $3.01 per diluted common share, for the year ended December 31, 2012, compared to $76.1 million, or $1.99 per diluted common share, for the same period of 2011. Return on average equity was 16.93% and return on average assets was 1.35% for the year ended December 31, 2012, compared to 13.39% and 1.12%, respectively, for the same period of 2011.

Net income increased $44.6 million, or 59%, for the year ended December 31, 2012 compared to the same period of 2011. The $44.6 million increase was primarily the result of a $73.9 million increase in net interest income, a $17 million decrease in the provision for credit losses and a $10.8 million increase in non-interest income, offset by a $31.6 million increase in non-interest expense and a $25.5 million increase in income tax expense.

Details of the changes in the various components of net income are further discussed below.

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Net Interest Income

Net interest income was $419.5 million for the year ended December 31, 2013 compared to $376.9 million for the same period of 2012. The increase in net interest income was primarily due to an increase of $1.4 billion in average earning assets as compared to the same period of 2012. The increase in average earning assets from 2012 included a $1.4 billion increase in average net loans offset by a $40.2 million decrease in average securities. For the year ended December 31, 2013, average net loans and securities represented 98% and 1%, respectively, of average earning assets compared to 98% and 1%, respectively, in 2012.

Average interest bearing liabilities for the year ended December 31, 2013 increased $95.6 million from the year ended December 31, 2012, which included a $947.9 million increase in interest bearing deposits, a $932.4 million decrease in other borrowings and an $80.1 million increase in subordinated notes. For the same periods, the average balance of demand deposits increased to $3.0 billion from $2.0 billion. The average cost of interest bearing liabilities increased from 0.35% for the year ended December 31, 2012 to 0.40% in 2013 related to the subordinated notes issued in the third quarter of 2012.

Net interest income was $376.8 million for the year ended December 31, 2012 compared to $302.9 million for the same period of 2011. The increase in net interest income was primarily due to an increase of $2.1 billion in average earning assets as compared to the same period of 2011. The increase in average earning assets from 2011 included a $2.2 billion increase in average net loans offset by a $39.7 million decrease in average securities. For the year ended December 31, 2012, average net loans and securities represented 98% and 1%, respectively, of average earning assets compared to 96% and 2%, respectively, in 2011.

Average interest bearing liabilities for the year ended December 31, 2012 increased $1.5 billion from the year ended December 31, 2011, which included a $613.4 million increase in interest bearing deposits, an $862.6 million increase in other borrowings and a $30.9 million increase in subordinated notes. For the same periods, the average balance of demand deposits increased to $2.0 billion from $1.5 billion. The average cost of interest bearing liabilities decreased from 0.40% for the year ended December 31, 2011 to 0.35% in 2012, reflecting the continued low market interest rates, and our focus on reducing deposit rates.

Volume/Rate Analysis

	Years Ended December 31,					
	2013/2012			2012/2011		
	Net	Change Due To(1)		Net	Change Due To(1)	
(in thousands)	Change	Volume	Yield/Rate	Change	Volume	Yield/Rate
Interest income:						
Securities(2)	$ (1,845)	$ (1,780)	$ (65)	$ (1,912)	$ (1,788)	$ (124)
Loans held for investment, mortgage finance loans	(5,411)	1,765	(7,176)	39,335	48,450	(9,115)
Loans held for investment	53,177	64,598	(11,421)	39,460	56,178	(16,718)
Federal funds sold	52	49	3	(24)	(18)	(6)
Deposits in other banks	23	96	(73)	(144)	(152)	8
Total	45,996	64,728	(18,732)	76,715	102,670	(25,955)
Interest expense:						
Transaction deposits	(165)	172	(337)	634	180	454
Savings deposits	1,857	3,110	(1,253)	877	1,178	(301)
Time deposits	(1,146)	(698)	(448)	(2,456)	(296)	(2,160)
Deposits in foreign branches	(160)	(220)	60	(361)	(277)	(84)
Other borrowings	(1,922)	(1,847)	(75)	2,001	1,360	641
Long-term debt	5,070	5,272	(202)	2,220		2,220
Total	3,534	5,789	(2,255)	2,915	2,145	770
Net interest income	$ 42,462	$ 58,939	$ (16,477)	$ 73,800	$ 100,525	$ (26,725)

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(1) Changes attributable to both volume and yield/rate are allocated to both volume and yield/rate on an equal basis.

(2) Taxable equivalent rates used where applicable assuming a 35% tax rate.

Net interest margin from continuing operations, the ratio of net interest income to average earning assets, decreased from 4.41% in 2012 to 4.22% in 2013. This 19 basis point decrease was a result of a decrease in interest income as a percent of earning assets offset by a reduction in funding costs. Funding cost including demand deposits and borrowed funds decreased from .21% for 2012 to .17% for 2013. The cost of subordinated debt issued in September 2012 and the trust preferred as a percent of total earning assets was .10% for 2013 compared to .06% for 2012. Total cost of funding, including all deposits and stockholders equity remained consistent at .24% for 2013.

Net interest margin from continuing operations decreased from 4.68% in 2011 to 4.41% in 2012. This 27 basis point decrease was a result of a decrease in interest income as a percent of earning assets offset by a reduction in funding costs. Total cost of funding decreased from .27% for 2011 to .24% for 2012.

Consolidated Daily Average Balances, Average Yields and Rates

	Year ended December 31								
	2013			2012			2011		
	Average Balance	Revenue / Expense(1)	Yield / Rate	Average Balance	Revenue / Expense(1)	Yield / Rate	Average Balance	Revenue / Expense(1)	Yield / Rate
Assets									
Securities Taxable	$ 59,031	$ 2,325	3.94%	$ 90,796	$ 3,681	4.05%	$ 123,124	$ 5,186	4.21%
Securities Non-taxable(2)	18,147	1,061	5.85%	26,579	1,550	5.83%	33,996	1,957	5.76%
Federal funds sold	54,547	65	0.12%	11,497	13	0.11%	21,897	37	0.17%
Deposits in other banks	89,503	231	0.26%	61,192	208	0.34%	107,734	352	0.33%
Loans held for investment, mortgage finance loans	2,342,149	87,864	3.75%	2,298,651	93,275	4.06%	1,210,954	53,940	4.45%
Loans held for investment	7,471,676	353,450	4.73%	6,148,860	300,273	4.88%	5,059,134	260,813	5.16%
Less reserve for loan losses	78,282			72,087			67,888		
Loans, net	9,735,543	441,314	4.53%	8,375,424	393,548	4.70%	6,202,200	314,753	5.07%
Total earning assets	9,956,771	444,996	4.47%	8,565,488	399,000	4.66%	6,488,951	322,285	4.97%
Cash and other assets	391,633			400,472			330,137		
Total assets	$ 10,348,404			$ 8,965,960			$ 6,819,088		
Liabilities and stockholders equity									
Transaction deposits	$ 908,415	$ 664	0.07%	$ 752,040	$ 829	0.11%	$ 391,100	$ 195	0.05%
Savings deposits	3,756,560	10,531	0.28%	2,765,089	8,674	0.31%	2,401,997	7,797	0.32%
Time deposits	397,329	1,629	0.41%	530,816	2,775	0.52%	562,654	5,231	0.93%
Deposits in foreign branches	345,506	1,206	0.35%	411,891	1,366	0.33%	490,703	1,727	0.35%
Total interest bearing deposits	5,407,810	14,030	0.26%	4,459,836	13,644	0.31%	3,846,454	14,950	0.39%
Other borrowings	653,318	1,219	0.19%	1,585,723	3,141	0.20%	723,172	1,140	0.16%
Subordinated notes	111,000	7,327	6.60%	30,934	2,037	6.58%			
Trust preferred subordinated debentures	113,406	2,536	2.24%	113,406	2,756	2.43%	113,406	2,573	2.27%
Total interest bearing liabilities	6,285,534	25,112	0.40%	6,189,899	21,578	0.35%	4,683,032	18,663	0.40%
Demand deposits	2,967,063			1,984,171			1,515,021		
Other liabilities	94,592			78,700			52,888		
Stockholders equity	1,001,215			713,190			568,147		
Total liabilities and stockholders equity	$ 10,348,404			$ 8,965,960			$ 6,819,088		

equity			
Net interest income	$ 419,884	$ 377,422	$ 303,622
Net interest margin	4.22%	4.41%	4.68%
Net interest spread	4.07%	4.31%	4.57%

(1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income. Loan interest income includes loan fees totaling $33.8 million, $33.7 million and $27.5 million for the years ended December 31, 2013, 2012 and 2011, respectively.

(2) Taxable equivalent rates used where applicable assuming a 35% tax rate.

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Non-interest Income

	Year ended December 31		
	2013	2012	2011
		(in thousands)	
Service charges on deposit accounts	$ 6,783	$ 6,605	$ 6,480
Trust fee income	5,023	4,822	4,219
Bank owned life insurance (BOLI) income	1,917	2,168	2,095
Brokered loan fees	16,980	17,596	11,335
Swap fees	5,520	4,909	1,935
Other(1)	7,801	6,940	6,168
Total non-interest income	$ 44,024	$ 43,040	$ 32,232

(1) Other income includes such items as letter of credit fees and other general operating income, none of which account for 1% or more of total interest income and non-interest income.

Non-interest income increased by $1.0 million during the year ended December 31, 2013 to $44.0 million, compared to $43.0 million during the same period in 2012. The increase was primarily due to an $861,000 increase in other non-interest income.

Non-interest income increased by $10.8 million during the year ended December 31, 2012 to $43.0 million, compared to $32.2 million during the same period in 2011. The increase was primarily due to a $6.3 million increase in brokered loan fees due to an increase in our mortgage finance lending volume. Swap fee income increased $3.0 million during the year ended December 31, 2012 due to an increase in swap transactions during 2012. Swap fees are fees related to customer swap transactions and are received from the institution that is our counterparty on the transactions. See Note 20 Derivative Financial Instruments for further discussion.

While management expects continued growth in non-interest income, the future rate of growth could be affected by increased competition from nationwide and regional financial institutions and by decreased demand in mortgage finance lending volume. In order to achieve continued growth in non-interest income, we may need to introduce new products or enter into new markets. Any new product introduction or new market entry could place additional demands on capital and managerial resources.

Non-interest Expense

	Year ended December 31		
	2013	2012	2011
		(in thousands)	
Salaries and employee benefits	$ 157,752	$ 121,456	$ 100,535
Net occupancy expense	16,821	14,852	13,657
Marketing	16,203	13,449	11,109
Legal and professional	18,104	17,557	14,996
Communications and technology	13,762	11,158	9,608
FDIC insurance assessment	8,057	5,568	7,543
Allowance and other carrying costs for OREO	1,788	9,075	9,586
Litigation settlement expense	(908)	4,000	
Other(1)	25,155	22,729	21,167
Total non-interest expense	$ 256,734	$ 219,844	$ 188,201

(1) Other expense includes such items as courier expenses, regulatory assessments other than FDIC insurance, due from bank charges and other general operating expenses, none of which account for 1% or more of total interest income and non-interest income.

Non-interest expense for the year ended December 31, 2013 increased $36.9 million compared to the same period of 2012 primarily related to increases in salaries and employee benefits, marketing expense, communications and data processing and FDIC insurance assessment, offset by decreases in allowance and other carrying costs for OREO and litigation settlement expense.

Salaries and employee benefits expense increased $36.3 million to $157.8 million during the year ended December 31, 2013. Of the $36.3 million increase during 2013, approximately $7.7 million related to a charge taken to reflect the financial effect of the planned organization change announced during the second quarter of 2013 related to the retirement and transition of our CEO and includes assumptions about future payouts that may or may not occur. These payouts, when and if realized, will be directly linked to our performance and stock price, but are required to be estimated at the time of the event. Additionally, there was another $2.2 million of charges recorded in the second quarter of 2013 related to the increased probability that certain company financial performance targets for executive cash-based incentives will be met. Additionally, these cash-based and performance units are expensed based on current stock prices, which has increased significantly during 2013 resulting in a $3.7 million increase in expense as compared to 2012. The remaining $23.3 million increase was primarily due to general business growth and build-out.

Marketing expense for the year ended December 31, 2013 increased $2.8 million compared to the same period in 2012. Marketing expense for the year ended December 31, 2013 included $1.0 million of direct marketing and advertising expense and $4.0 million in business development expense compared to $850,000 and $3.1 million, respectively, in 2012. Marketing expense for the year ended December 31, 2013 also included $11.2 million for the purchase of miles related to the American Airlines AAdvantage® program and treasury management deposit programs compared to $9.5 million during 2012. Marketing expense may increase as we seek to further develop our brand, reach more of our target customers and expand in our target markets.

Legal and professional expense increased $547,000, or 3%, for the year ended December 31, 2013 compared to the same period in 2012. Our legal and professional expense will continue to fluctuate from year to year and could increase in the future with growth and as we respond to continued regulatory changes and strategic initiatives. We expect to see a decrease in the cost of resolving problem assets under improving economic conditions.

Communications and technology expense increased $2.6 million to $13.8 million during the year ended December 31, 2013 as a result of general business and customer growth and continued build-out needed to support that growth.

FDIC insurance assessment expense increased $2.5 million from $5.6 million in 2012 to $8.1 million primarily as a result of a $3.0 million assessment by the FDIC that was paid during the third quarter of 2013. The assessment related to the year-end call reports for 2011 and 2012, which were amended for the change in the risk weight applicable to our mortgage finance loan portfolio as described in Note 13 Regulatory Restrictions. As previously disclosed, the amendment caused one capital ratio to retroactively fall below well-capitalized for December 31, 2012 and 2011.

For the year ended December 31, 2013, allowance and other carrying costs for OREO decreased $7.3 million to $1.8 million, $920,000 of which related to deteriorating values of assets held in OREO. The decrease is consistent with the decrease in our OREO balances during 2013.

Non-interest expense for the year ended December 31, 2012 increased $31.6 million compared to the same period of 2011 primarily related to increases in salaries and employee benefits, marketing expense, legal and professional expenses and litigation settlement expense.

Salaries and employee benefits expense increased $20.9 million to $121.5 million during the year ended December 31, 2012. This increase resulted primarily from general business growth and costs of performance-based incentives resulting from the increase in stock price.

Marketing expense for the year ended December 31, 2012 increased $2.3 million compared to the same period in 2011. Marketing expense for the year ended December 31, 2012 included $850,000 of direct marketing and advertising expense and $3.1 million in business development expense compared to

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$669,000 and $2.6 million, respectively, in 2011. Marketing expense for the year ended December 31, 2012 also included $9.5 million for the purchase of miles related to the American Airlines AAdvantage® program and treasury management deposit programs compared to $7.8 million during 2011. Marketing expense may increase as we seek to further develop our brand, reach more of our target customers and expand in our target markets.

Legal and professional expense increased $2.6 million, or 17%, for the year ended December 31, 2012 compared to the same period in 2011. Our legal and professional expense will continue to fluctuate from year to year and could increase in the future as we respond to continued regulatory changes and strategic initiatives, but we should see a decrease in the cost of resolving problem assets under improving economic conditions.

During the fourth quarter of 2012 we recorded a pre-tax charge of $4.0 million for settlement of the judgment of $65.5 million against us in Oklahoma district court. In the settlement, all litigation against us in the Oklahoma courts and actions by us against the plaintiff in the Texas courts will be dismissed with prejudice. Because the settlement was within policy limits of insurance coverage maintained by us, we have claims against our insurance carrier for more than the charge. In the third quarter of 2013, we settled one claim with our insurance company and recorded a recovery in the amount of $908,000. We intend to pursue the remaining claims aggressively.

Communications and technology expense increased $1.6 million to $11.6 million during the year ended December 31, 2012 as a result of general business and customer growth.

FDIC insurance assessment expense decreased by $1.9 million from $7.5 million in 2011 to $5.6 million as a result of changes to the FDIC assessment method.

Analysis of Financial Condition

Loans

Our total loans have grown at an annual rate of 13%, 30% and 30% in 2013, 2012 and 2011, respectively, reflecting the continued build-up of our lending operations. Our business plan focuses primarily on lending to middle market businesses and successful professionals and entrepreneurs, and as such, commercial and real estate loans have comprised a majority of our loan portfolio since we commenced operations, comprising 63% of total loans at December 31, 2013. Construction loans represent 11% of the portfolio at December 31, 2013. Consumer loans generally have represented 1% or less of the portfolio from December 31, 2009 to December 31, 2013. Mortgage finance loans relate to our mortgage warehouse lending operations where we invest in mortgage loan ownership interests that are typically sold within 10 to 20 days. Volumes fluctuate based on the level of market demand in the product and the number of days between purchase and sale of the loans, as well as overall market interest rates.

We originate the substantial majority of our loans. We also participate in syndicated loan relationships, both as a participant and as an agent. As of December 31, 2013, we have $1.4 billion in syndicated loans, $399.8 million of which we acted as agent. All syndicated loans, whether we act as agent or participant, are underwritten to the same standards as all other loans originated by us. In addition, as of December 31, 2013, none of our syndicated loans were on non-accrual.

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The following summarizes our loans on a gross basis by major category as of the dates indicated (in thousands):

	December 31				
	2013	2012	2011	2010	2009
Commercial	$ 5,020,565	$ 4,106,419	$ 3,275,150	$ 2,592,924	$ 2,457,533
Mortgage finance	2,784,265	3,175,272	2,080,081	1,194,209	693,504
Construction	1,262,905	737,637	422,026	270,008	669,426
Real estate	2,146,228	1,892,451	1,819,251	1,759,758	1,233,701
Consumer	15,350	19,493	24,822	21,470	25,065
Equipment leases	93,160	69,470	61,792	95,607	99,129
Total	$ 11,322,473	$ 10,000,742	$ 7,683,122	$ 5,933,976	$ 5,178,358

Commercial Loans and Leases. Our commercial loan portfolio is comprised of lines of credit for working capital and term loans and leases to finance equipment and other business assets. Our energy production loans are generally collateralized with proven reserves based on appropriate valuation standards. Our commercial loans and leases are underwritten after carefully evaluating and understanding the borrower s ability to operate profitably. Our underwriting standards are designed to promote relationship banking rather than making loans on a transaction basis. Our lines of credit typically are limited to a percentage of the value of the assets securing the line. Lines of credit and term loans typically are reviewed annually and are supported by accounts receivable, inventory, equipment and other assets of our clients businesses. At December 31, 2013, funded commercial loans and leases totaled approximately $5.0 billion, approximately 44% of our total funded loans.

Mortgage Finance Loans. Our mortgage finance loans consist of ownership interests purchased in single-family residential mortgages funded through our warehouse lending group. These loans are typically on our balance sheet for 10 to 20 days or less. We have agreements with mortgage lenders and purchase legal ownership interests in individual loans they originate. All loans are underwritten consistent with established programs for permanent financing with financially sound investors. Substantially all loans are conforming loans or loans eligible for sale to federal agencies or government sponsored entities. However, for accounting purposes, these loans are deemed to be loans to the originator and, as such, are classified as loans held for investment. At December 31, 2013, mortgage finance loans totaled approximately $2.8 billion, approximately 25% of our total funded loans. Mortgage finance loans as of December 31, 2013 are net of $33.1 million of participations sold.

Construction Loans. Our construction loan portfolio consists primarily of single- and multi-family residential properties and commercial projects used in manufacturing, warehousing, service or retail businesses. Our construction loans generally have terms of one to three years. We typically make construction loans to developers, builders and contractors that have an established record of successful project completion and loan repayment and have a substantial investment in the borrowers equity. However, construction loans are generally based upon estimates of costs and value associated with the completed project. Sources of repayment for these types of loans may be pre-committed permanent loans from other lenders, sales of developed property, or an interim loan commitment from us until permanent financing is obtained. The nature of these loans makes ultimate repayment extremely sensitive to overall economic conditions. Borrowers may not be able to correct conditions of default in loans, increasing risk of exposure to classification, non-performing status, reserve allocation and actual credit loss and foreclosure. These loans typically have floating rates and commitment fees. At December 31, 2013, funded construction real estate loans totaled approximately $1.3 billion, approximately 11% of our total funded loans.

Real Estate Loans. Approximately 24% of our real estate loan portfolio (excluding construction loans) and 5% of the total portfolio is comprised of loans secured by properties other than market risk or investment-type real estate. Market risk loans are real estate loans where the primary source of repayment is expected to come from the sale or lease of the real property collateral. We generally provide temporary financing for commercial and residential property. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Our real estate loans generally have maximum terms of five to seven years, and we provide loans with both floating and fixed rates. We generally avoid long-term loans for commercial real estate held for investment. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Appraised values may be highly variable due to market conditions and impact of the inability of potential purchasers and lessees to obtain financing and lack of transactions at comparable values. At December 31, 2013, real estate term loans totaled approximately $2.1 billion, or 19% of our total funded loans.

Letters of Credit. We issue standby and commercial letters of credit, and can service the international needs of our clients through correspondent banks. At December 31, 2013, our commitments under letters of credit totaled approximately $145.0 million.

Portfolio Geographic and Industry Concentrations

We continue to lend primarily in Texas. As of December 31, 2013, a substantial majority of the principal amount of the loans held for investment, excluding mortgage finance, in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions in Texas. The table below summarizes the industry concentrations of our funded loans at December 31, 2013. The risks created by these concentrations have been considered by management in the determination of the adequacy of the allowance for loan losses. Management believes the allowance for loan losses is appropriate to cover estimated losses on loans at each balance sheet date.

(in thousands except percentage data)	Amount	Percent of Total Loans
Services	$ 4,077,881	36.0%
Mortgage finance loans	2,784,265	24.6%
Contracting construction and real estate development	1,173,233	10.4%
Investors and investment management companies	1,164,685	10.3%
Petrochemical and mining	995,263	8.8%
Manufacturing	389,857	3.4%
Personal/household	207,337	1.8%
Wholesale	201,220	1.8%
Retail	207,607	1.8%
Contracting trades	79,326	0.7%
Government	28,421	0.3%
Agriculture	13,378	0.1%
Total	$ 11,322,473	100.0%

Excluding our mortgage finance business, our largest concentration in any single industry is in services. Loans extended to borrowers within the services industries include loans to finance working capital and equipment, as well as loans to finance investment and owner-occupied real estate. Significant trade categories represented within the services industries include, but are not limited to, real estate services, financial services, leasing companies, transportation and communication, and hospitality services. Borrowers represented within the real estate services category are largely owners and managers of both residential and non-residential commercial real estate properties. Loans extended to borrowers within the contracting industry are comprised largely of loans to land developers and to both heavy construction and general commercial contractors. Many of these loans are secured by real estate properties, the development of which is or may be financed by our bank. Loans extended to borrowers within the petrochemical and mining industries are predominantly loans to finance the exploration and production of petroleum and natural gas. These loans are generally secured by proven petroleum and natural gas reserves. Personal/household loans include loans to certain successful professionals and entrepreneurs for commercial purposes, in addition to consumer loans.

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We make loans that are appropriately collateralized under our credit standards. Approximately 98% of our funded loans are secured by collateral. Over 90% of the real estate collateral is located in Texas. The table below sets forth information regarding the distribution of our funded loans among various types of collateral at December 31, 2013 (in thousands except percentage data):

	Amount	Percent of Total Loans
Collateral type:		
Business assets	$ 3,472,108	30.7%
Real property	3,409,133	30.1%
Mortgage finance loans	2,784,265	24.7%
Energy	854,046	7.5%
Unsecured	261,621	2.3%
Other assets	264,686	2.3%
Highly liquid assets	184,139	1.6%
Rolling stock	50,754	0.4%
U. S. Government guaranty	41,721	0.4%
Total	$ 11,322,473	100.0%

As noted in the table above, 30% of our loans are secured by real estate. The table below summarizes our real estate loan portfolio as segregated by the type of property securing the credit. Property type concentrations are stated as a percentage of year-end total real estate loans as of December 31, 2013 (in thousands except percentage data):

	Amount	Percent of Total Real Estate Loans
Property type:		
Market risk		
Commercial buildings	$ 787,244	23.1%
Unimproved land	133,259	3.9%
Apartment buildings	353,734	10.4%
Shopping center/mall buildings	298,090	8.7%
1-4 Family dwellings (other than condominium)	517,549	15.2%
Residential lots	306,491	9.0%
Hotel/motel buildings	140,317	4.1%
Other	323,306	9.5%
Other than market risk		
Commercial buildings	289,795	8.5%
1-4 Family dwellings (other than condominium)	95,207	2.8%
Other	164,141	4.8%
Total real estate loans	$ 3,409,133	100.0%

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The table below summarizes our market risk real estate portfolio as segregated by the geographic region in which the property is located (in thousands except percentage data):

	Amount	Percent of Total
Geographic region:		
Dallas/Fort Worth	$ 1,018,719	35.7%
Houston	753,156	26.3%
Austin	347,286	12.1%
San Antonio	274,873	9.6%
Other Texas cities	251,014	8.8%
Other states	214,942	7.5%
Total market risk real estate loans	$ 2,859,990	100.0%

We extend market risk real estate loans, including both construction/development financing and limited term financing, to professional real estate developers and owners/managers of commercial real estate projects and properties who have a demonstrated record of past success with similar properties. Collateral properties include office buildings, warehouse/distribution buildings, shopping centers, apartment buildings, residential and commercial tract development located primarily within our five major metropolitan markets in Texas. As such loans are generally repaid through the borrowers sale or lease of the properties, loan amounts are determined in part from an analysis of pro forma cash flows. Loans are also underwritten to comply with product-type specific advance rates against both cost and market value. We engage a variety of professional firms to supply appraisals, market study and feasibility reports, environmental assessments and project site inspections to complement our internal resources to best underwrite and monitor these credit exposures.

The determination of collateral value is critically important when financing real estate. As a result, obtaining current and objectively prepared appraisals is a major part of our underwriting and monitoring processes. Generally, our policy requires a new appraisal every three years. However, in periods of economic uncertainty where real estate values can fluctuate rapidly as in recent years, more current appraisals are obtained when warranted by conditions such as a borrower s deteriorating financial condition, their possible inability to perform on the loan, and the increased risks involved with reliance on the collateral value as sole repayment of the loan. Generally, loans graded substandard or worse where real estate is a material portion of the collateral value and/or the income from the real estate or sale of the real estate is the primary source of debt service, annual appraisals are obtained. In all cases, appraisals are reviewed by a third party to determine reasonableness of the appraised value. The third party reviewer will challenge whether or not the data used is appropriate and relevant, form an opinion as to the appropriateness of the appraisal methods and techniques used, and determine if overall the analysis and conclusions of the appraiser can be relied upon. Additionally, the third party reviewer provides a detailed report of that analysis. Further review may be conducted by our credit officers, as well as by the Bank s managed asset committee as conditions warrant. These additional steps of review ensure that the underlying appraisal and the third party analysis can be relied upon. If we have differences, we will address those with the reviewer and determine the best method to resolve any differences. Both the appraisal process and the appraisal review process can be difficult during and following periods of economic weakness with the lack of comparable sales which is partially a result of the lack of available financing which can lead to overall depressed real estate values.

Large Credit Relationships

The primary market areas we serve include the five major metropolitan markets of Texas, including Austin, Dallas, Fort Worth, Houston and San Antonio. As a result, we originate and maintain large credit relationships with numerous customers in the ordinary course of business. The legal limit of our bank is approximately $199 million and our house limit is generally $25 million or less. Larger hold positions will be accepted occasionally for exceptionally strong borrowers and otherwise where business opportunity and perceived credit risk warrant a somewhat larger investment. We consider large credit relationships to be those with commitments equal to or in excess of $10.0 million. The following table provides additional information on our large credit relationships outstanding at year-end (in thousands):

		2013 Period-End Balances			2012 Period-End Balances	
	Number of Relationships	Committed	Outstanding	Number of Relationships	Committed	Outstanding
$20.0 million and greater	141	$ 3,694,305	$ 2,213,744	86	$ 2,123,328	$ 1,339,070
$10.0 million to $19.9 million	215	2,977,111	1,979,001	178	2,467,089	1,715,180

Growth in period end outstanding balances related to large credit relationships primarily resulted from an increase in number of commitments. The following table summarizes the average per relationship committed and average outstanding loan balance related to our large credit relationships at year-end (in thousands):

	2013 Average Balance		2012 Average Balance	
	Committed	Outstanding	Committed	Outstanding
$20.0 million and greater	$ 26,201	$ 15,700	$ 24,690	$ 15,571
$10.0 million to $19.9 million	13,847	9,205	13,860	9,636

Loan Maturity and Interest Rate Sensitivity on December 31, 2013

		Remaining Maturities of Selected Loans		
(in thousands)	Total	Within 1 Year	1-5 Years	After 5 Years
Loan maturity:				
Commercial	$ 5,020,565	$ 2,048,407	$ 2,762,786	$ 209,372
Mortgage finance	2,784,265	2,784,265		
Construction	1,262,905	300,615	910,004	52,286
Real estate	2,146,228	368,286	1,153,417	624,525
Consumer	15,350	10,316	4,319	715
Equipment leases	93,160	10,227	82,440	493
Total loans held for investment	$ 11,322,473	$ 5,522,116	$ 4,912,966	$ 887,391
Interest rate sensitivity for selected loans with:				
Predetermined interest rates	$ 1,426,574	$ 886,367	$ 407,544	$ 132,663
Floating or adjustable interest rates	9,895,899	4,635,749	4,505,422	754,728
Total loans held for investment	$ 11,322,473	$ 5,522,116	$ 4,912,966	$ 887,391

Interest Reserve Loans

As of December 31, 2013, we had $407.9 million in loans with interest reserves, which represents approximately 32% of our construction loans. Loans with interest reserves are common when originating construction loans, but the use of interest reserves is carefully controlled by our underwriting standards. The use of interest reserves is based on the feasibility of the project, the creditworthiness of the borrower and guarantors, and the loan to value coverage of the collateral. The interest reserve account allows the borrower, when financial condition precedents are met to draw loan funds to pay interest charges on the outstanding

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balance of the loan. When drawn, the interest is capitalized and added to the loan balance, subject to conditions specified at the time the credit is approved and during the initial underwriting. We have effective and ongoing controls for monitoring compliance with loan covenants for advancing funds and determination of default conditions. When lending relationships involve financing of land on which improvements will be constructed, construction funds are not advanced until the borrower has received lease or purchase commitments which will meet cash flow coverage requirements, and/or our analysis of market conditions and project feasibility indicate to management s satisfaction that such lease or purchase commitments are forthcoming and/or other sources of repayment have been identified to repay the loan. We maintain current financial statements on the borrowing entity and guarantors, as well as periodic inspections of the project and analysis of whether the project is on schedule or delayed. Updated appraisals are ordered when necessary to validate the collateral values to support all advances, including reserve interest. Advances of interest reserves are discontinued if collateral values do not support the advances or if the borrower does not comply with other terms and conditions in the loan agreements. In addition, most of our construction lending is performed in Texas and our lenders are very familiar with trends in local real estate. At a point where we believe that our collateral position is jeopardized, we retain the right to stop the use of the interest reserves. As of December 31, 2013, none of our loans with interest reserves were on nonaccrual.

Non-performing Assets

Non-performing assets include non-accrual loans and leases and repossessed assets. The table below summarizes our non-accrual loans by type (in thousands):

	As of December 31		
	2013	2012	2011
Non-accrual loans(1)(4)			
Commercial	$ 12,896	$ 15,373	$ 12,913
Construction	705	17,217	21,119
Real estate	18,670	23,066	19,803
Consumer	54	57	313
Equipment leases	50	120	432
Total non-accrual loans	32,375	55,833	54,580
Repossessed assets:			
OREO(3)	5,110	15,991	34,077
Other repossessed assets		42	1,516
Total other repossessed assets	5,110	16,033	35,593
Total non-performing assets	$ 37,485	$ 71,866	$ 90,173
Restructured loans(4)	$ 1,935	$ 10,407	$ 25,104
Loans past due 90 days and accruing(2)	$ 9,325	$ 3,674	$ 5,467

(1) The accrual of interest on loans is discontinued when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectibility is questionable, then cash payments are applied to principal. If these loans had been current throughout their terms, interest and fees on loans would have increased by approximately $2.5 million, $2.4 million and $5.9 million for the years ended December 31, 2013, 2012 and 2011, respectively.

(2) At December 31, 2013, 2012 and 2011, loans past due 90 days and still accruing includes premium finance loans of $3.8 million, $2.8 million and $2.5 million, respectively. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

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(3) At December 31, 2013, there is no valuation allowance recorded against the OREO balance. At December 31, 2012 and 2011, the OREO balance is net of $5.6 million and $10.7 million valuation allowance, respectively.

(4) As of December 31, 2013, 2012 and 2011, non-accrual loans included $17.8 million, $19.6 million and 13.8 million, respectively, in loans that met the criteria for restructured.

Total nonperforming assets at December 31, 2013 decreased $34.4 million from December 31, 2012, compared to a $18.3 million increase from December 31, 2011 to December 31, 2012. We experienced a decrease in levels of nonperforming assets in 2013 and 2012 and an overall improvement in credit quality. Despite the improvement in credit quality during 2013, our provision for credit losses increased as a result of the significant growth in the loans held for investment, excluding mortgage finance loans. This growth coupled with the improved credit quality resulted in a decrease in the reserve for loan losses as a percent of loans excluding mortgage finance loans for 2013 as compared to 2012.

The table below summarizes the non-accrual loans as segregated by loan type and type of property securing the credit as of December 31, 2013 (in thousands):

Non-accrual loans:	
Commercial	
Lines of credit secured by the following:	
Oil and gas properties	$ 1,614
Assets of the borrowers	9,819
Other	1,463
Total commercial	12,896
Real estate	
Secured by:	
Commercial property	9,606
Unimproved land and/or developed residential lots	4,819
Single family residences	888
Other	3,357
Total real estate	18,670
Construction	
Secured by:	
Other	705
Consumer	54
Equipment leases (commercial leases primarily secured by assets of the lessor)	50
Total non-accrual loans	$ 32,375

Reserves on impaired loans were $3.2 million at December 31, 2013, compared to $3.9 million at December 31, 2012 and $5.3 million at December 31, 2011. We recognized $2.4 million in interest income on non-accrual loans during 2013 compared to $2.6 million in 2012 and $2.2 million in 2011. Additional interest income that would have been recorded if the loans had been current during the years ended December 31, 2013, 2012 and 2011 totaled $2.5 million, $2.4 million and $5.9 million, respectively. Average impaired loans outstanding during the years ended December 31, 2013, 2012 and 2011 totaled $40.0 million, $66.4 million and $71.0 million, respectively.

Generally, we place loans on non-accrual when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest

income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectibility is questionable, then cash payments are applied to principal. As of December 31, 2013, none of our non-accrual loans were earning on a cash basis. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the original loan agreement. Reserves on impaired loans are measured based on the present value of the expected future cash flows discounted at the loan s effective interest rate or the fair value of the underlying collateral.

At December 31, 2013, we had $9.3 million in loans past due 90 days and still accruing interest. Of this total, $3.8 million are premium finance loans. These loans are primarily secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

Restructured loans are loans on which, due to the borrower s financial difficulties, we have granted a concession that we would not otherwise consider for borrowers of similar credit. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, either forgiveness of principal or accrued interest. As of December 31, 2013 we have $1.9 million in loans considered restructured that are not on nonaccrual. These loans do not have unfunded commitments at December 31, 2013. Of the nonaccrual loans at December 31, 2013, $17.8 million met the criteria for restructured. A loan continues to qualify as restructured until a consistent payment history has been evidenced, generally no less than twelve months. Assuming that the restructuring agreement specifies an interest rate at the time of the restructuring that is greater than or equal to the rate that we are willing to accept for a new extension of credit with comparable risk, then the loan no longer has to be considered a restructuring if it is in compliance with modified terms in calendar years after the year of the restructuring.

Potential problem loans consist of loans that are performing in accordance with contractual terms, but for which we have concerns about the borrower s ability to comply with repayment terms because of the borrower s potential financial difficulties. We monitor these loans closely and review their performance on a regular basis. At December 31, 2013 and 2012, we had $47.9 million and $10.9 million, respectively, in loans of this type which were not included in either non-accrual or 90 days past due categories.

The table below presents a summary of the activity related to OREO (in thousands):

	Year ended December 31		
	2013	2012	2011
Beginning balance	$ 15,991	$ 34,077	$ 42,261
Additions	1,331	3,434	22,180
Sales	(11,292)	(14,637)	(23,566)
Valuation allowance for OREO	958	(4,488)	(3,922)
Direct write-downs	(1,878)	(2,395)	(2,876)
Ending balance	$ 5,110	$ 15,991	$ 34,077

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The following table summarizes the assets held in OREO at December 31, 2013 (in thousands):

OREO:	
Commercial buildings	1,170
Undeveloped land and residential lots	3,223
Other	717
Total OREO	$ 5,110

When foreclosure occurs, fair value, which is generally based on appraised values, may result in partial charge-off of a loan upon taking property, and so long as the property is retained, reductions in appraised values will result in valuation adjustments taken as non-interest expense. In addition, if the decline in value is believed to be permanent and not just driven by market conditions, a direct write-down to the OREO balance may be taken. We generally pursue sales of OREO when conditions warrant, but we may choose to hold certain properties for a longer term, which can result in additional exposure related to the appraised values during that holding period. During the year ended December 31, 2013, we recorded $920,000 in valuation expense. Of the $920,000, $1.9 million related to direct write-downs, offset by a reduction in the valuation allowance of $958,000.

Summary of Loan Loss Experience

The provision for loan losses is a charge to earnings to maintain the reserve for loan losses at a level consistent with management s assessment of the collectability of the loan portfolio in light of current economic conditions and market trends. We recorded a provision for credit losses of $19.0 million for the year ended December 31, 2013, $11.5 million for the year ended December 31, 2012, and $28.5 million for the year ended December 31, 2011. In 2013 and 2012 we experienced improvements in credit quality, which resulted in decreases in the levels of reserves and provision as compared to 2009 through 2011. The increase in provision recorded during 2013 is directly related to the significant growth in loans excluding mortgage finance loans. We experienced improvements in all credit quality ratios during 2013, 2012 and 2011.

The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an appropriate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than $500,000 are specifically reviewed for loss potential. For loans deemed to be impaired, a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate a reserve assigned to off-balance sheet commitments, specifically unfunded loan commitments and letters of credit. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management s judgment, should be charged off.

The reserve allocation percentages assigned to each credit grade have been developed based primarily on an analysis of our historical loss rates. The allocations are adjusted for certain qualitative factors for such things as general economic conditions, changes in credit policies and lending standards. Changes in the trend and severity of problem loans can cause the estimation of losses to differ from past experience. In addition, the reserve considers the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio. The portion of the allowance that is not derived by the allowance allocation percentages compensates for the uncertainty and complexity in estimating loan and lease losses including factors and conditions that may not be fully reflected in the determination and application of the allowance allocation percentages. We evaluate many factors and conditions in determining the unallocated portion of the allowance, including the economic and business conditions affecting key lending areas, credit quality trends and general growth in the portfolio. The allowance is considered appropriate, given management s assessment of potential losses within the portfolio as of the evaluation date, the significant growth in the loan and lease portfolio, current economic conditions in the Company s market areas and other factors.

The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans is evaluated with new information. As our portfolio has matured, historical loss ratios have been closely monitored, and our reserve adequacy relies primarily on our loss history. The review of reserve adequacy is performed by executive management and presented to our board of directors for their review, consideration and ratification on a quarterly basis.

The reserve for credit losses, which includes a liability for losses on unfunded commitments, totaled $92.3 million at December 31, 2013, $78.2 million at December 31, 2012 and $72.8 million at December 31, 2011. The total reserve percentage decreased to 1.09% at year-end 2013 from 1.15% and 1.31% of loans excluding mortgage finance loans at December 31, 2012 and 2011, respectively. The combined reserve has trended down during 2011, 2012 and 2013 as we recognize losses on loans for which there were specific or general allocations of reserves and see improvement in our overall credit quality. The overall reserve for loan losses continued to result from consistent application of the loan loss reserve methodology as described above. At December 31, 2013, we believe the reserve is sufficient to cover all expected losses in the portfolio and has been derived from consistent application of the methodology described above. Should any of the factors considered by management in evaluating the adequacy of the allowance for loan losses change, our estimate of expected losses in the portfolio could also change, which would affect the level of future provisions for loan losses.

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The table below presents a summary of our loan loss experience for the past five years (in thousands except percentage and multiple data):

	Year Ended December 31				
	2013	2012	2011	2010	2009
Reserve for loan losses:					
Beginning balance	$ 74,337	$ 70,295	$ 71,510	$ 67,931	$ 45,365
Loans charged-off:					
Commercial	6,575	6,708	8,518	27,723	4,000
Construction				12,438	6,508
Real estate	144	899	21,275	9,517	4,696
Consumer	45	49	317	216	502
Equipment leases	2	204	1,218	1,555	4,022
Total charge-offs	6,766	7,860	31,328	51,449	19,728
Recoveries:					
Commercial	1,203	832	1,188	176	124
Construction		10	248	1	13
Real estate	270	812	350	138	53
Consumer	73	33	9	4	28
Equipment leases	322	108	383	158	54
Total recoveries	1,868	1,795	2,178	477	272
Net charge-offs	4,898	6,065	29,150	50,972	19,456
Provision for loan losses	18,165	10,107	27,935	54,551	42,022
Ending balance	$ 87,604	$ 74,337	$ 70,295	$ 71,510	$ 67,931
Reserve for off-balance sheet credit losses:					
Beginning balance	$ 3,855	$ 2,462	$ 1,897	$ 2,948	$ 1,470
Provision (benefit) for off-balance sheet credit losses	835	1,393	565	(1,051)	1,478
Ending balance	$ 4,690	$ 3,855	$ 2,462	$ 1,897	$ 2,948
Total reserve for credit losses	$ 92,294	$ 78,192	$ 72,757	$ 73,407	$ 70,879
Total provision for credit losses	$ 19,000	$ 11,500	$ 28,500	$ 53,500	$ 43,500
Reserve for loan losses to loans	0.78%	0.75%	0.92%	1.21%	1.32%
Reserve for loan losses to loans excluding mortgage finance loans(5)	1.03%	1.10%	1.26%	1.52%	1.52%
Net charge-offs to average loans	0.05%	0.07%	0.47%	0.95%	0.41%
Net charge-offs to average loans excluding mortgage finance loans(5)	0.07%	0.10%	0.58%	1.14%	0.46%
Total provision for credit losses to average loans	0.19%	0.14%	0.45%	1.00%	0.91%
Total provision for credit losses to average loans excluding mortgage finance loans(5)	0.25%	0.19%	0.56%	1.20%	1.04%
Recoveries to total charge-offs	27.61%	22.84%	6.95%	0.93%	1.38%
Reserve for off-balance sheet credit losses to off-balance sheet credit commitments	0.12%	0.14%	0.14%	0.14%	0.24%
Combined reserves for credit losses to loans held for investment	0.82%	0.78%	0.95%	1.24%	1.38%
Combined reserves for credit losses to loans excluding mortgage finance loans(5)	1.09%	1.15%	1.31%	1.56%	1.59%
Non-performing assets:					
Non-accrual loans(1)(4)	$ 32,375	$ 55,833	$ 54,580	$ 112,090	$ 95,625

OREO(3)	5,110	15,991	34,077	42,261	27,264
Other repossessed assets		42	1,516	451	162
Total	$ 37,485	$ 71,866	$ 90,173	$ 154,802	$ 123,051
Restructured loans	$ 1,935	$ 10,407	$ 25,104	$ 4,319	$
Loans past due 90 days and still accruing(2)	$ 9,325	$ 3,674	$ 5,467	$ 6,706	$ 6,081
Reserve as a percent of non-performing loans	2.7x	1.3x	1.3x	.6x	.7x

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1) The accrual of interest on loans is discontinued when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectibility is questionable, then cash payments are applied to principal. If these loans had been current throughout their terms, interest and fees on loans would have increased by approximately $2.5 million, $2.4 million and $5.9 million for the years ended December 31, 2013, 2012 and 2011, respectively.

2) At December 31, 2013, 2012 and 2011, loans past due 90 days and still accruing includes premium finance loans of $3.8 million, $2.8 million and $2.5 million, respectively. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

3) At December 31, 2013, we did not have a valuation allowance recorded against the OREO balance. At December 31, 2012 and 2011, OREO balance is net of $5.6 million and $10.7 million valuation allowance, respectively.

4) As of December 31, 2013, 2012 and 2011, non-accrual loans included $17.8 million, $19.6 million and $13.8 million, respectively, in loans that met the criteria for restructured.

5) Mortgage finance loans were previously classified as loans held for sale but have been reclassified as loans held for investment as described in Note 1 Operations and Summary of Significant Accounting Policies. The indicated ratios are presented excluding the mortgage finance loans because the risk profile of our mortgage finance loans is different than our other loans held for investment. No provision is allocated to these loans based on the internal risk grade assigned.

Loan Loss Reserve Allocation

	December 31									
	2013		2012		2011		2010		2009	
(in thousands except percentage data)	Reserve	% of Loans	Reserve	% of Loans	Reserve	% of Loans	Reserve	% of Loans	Reserve	% of Loans
Loan category:										
Commercial	$ 39,868	44%	$ 21,547	41%	$ 17,337	43%	$ 15,918	43%	$ 33,269	48%
Mortgage finance loans(1)		25%		32%		27%		20%		13%
Construction	14,553	11%	12,097	7%	7,845	5%	7,336	5%	10,974	13%
Real estate	24,210	19%	30,893	19%	33,721	24%	38,049	30%	14,874	24%
Consumer	149		226		223		306		1,258	
Equipment leases	3,105									