CULLEN/FROST BANKERS, INC.
Form 10-Q
October 25, 2018
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United States
Securities and Exchange Commission
Washington, D.C. 20549
Form 10-Q
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended: September 30, 2018
Or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission file number: 001-13221
Cullen/Frost Bankers, Inc.
(Exact name of registrant as specified in its charter)

Texas	74-1751768
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 W. Houston Street, San Antonio, Texas	78205
(Address of principal executive offices)	(Zip code)

(210) 220-4011
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

As of October 18, 2018 there were 63,944,066 shares of the registrant's Common Stock, $.01 par value, outstanding.

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Quarterly Report on Form 10-Q
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Part I. Financial Information
Item 1. Financial Statements (Unaudited)
Cullen/Frost Bankers, Inc.
Consolidated Balance Sheets
(Dollars in thousands, except per share amounts)

	September 30, 2018	December 31, 2017
Assets:		
Cash and due from banks	$505,333	$545,542
Interest-bearing deposits	2,430,289	4,347,538
Federal funds sold and resell agreements	483,867	159,967
Total cash and cash equivalents	3,419,489	5,053,047
Securities held to maturity, at amortized cost	1,111,762	1,432,098
Securities available for sale, at estimated fair value	11,178,591	10,489,009
Trading account securities	22,238	21,098
Loans, net of unearned discounts	13,814,838	13,145,665
Less: Allowance for loan losses	(137,578)	(155,364)
Net loans	13,677,260	12,990,301
Premises and equipment, net	541,236	520,958
Goodwill	654,952	654,952
Other intangible assets, net	3,980	5,073
Cash surrender value of life insurance policies	182,603	180,477
Accrued interest receivable and other assets	431,291	400,867
Total assets	$31,223,402	$31,747,880
Liabilities:		
Deposits:		
Non-interest-bearing demand deposits	$10,840,513	$11,197,093
Interest-bearing deposits	15,508,341	15,675,296
Total deposits	26,348,854	26,872,389
Federal funds purchased and repurchase agreements	1,083,777	1,147,824
Junior subordinated deferrable interest debentures, net of unamortized issuance costs	136,227	136,184
Subordinated notes, net of unamortized issuance costs	98,669	98,552
Accrued interest payable and other liabilities	247,629	195,068
Total liabilities	27,915,156	28,450,017
Shareholders’ Equity:		
Preferred stock, par value $0.01 per share; 10,000,000 shares authorized; 6,000,000 Series A shares ($25 liquidation preference) issued at September 30, 2018 and December 31, 2017	144,486	144,486
Common stock, par value $0.01 per share; 210,000,000 shares authorized; 64,236,306 shares issued at September 30, 2018 and December 31, 2017	642	642
Additional paid-in capital	962,917	953,361
Retained earnings	2,369,259	2,187,069
Accumulated other comprehensive income (loss), net of tax	(141,235)	79,512
Treasury stock, at cost; 313,490 shares at September 30, 2018 and 760,720 shares at December 31, 2017	(27,823)	(67,207)
Total shareholders’ equity	3,308,246	3,297,863
Total liabilities and shareholders’ equity	$31,223,402	$31,747,880

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Income
(Dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest income:				
Loans, including fees	$172,333	$138,400	$487,668	$392,073
Securities:				
Taxable	21,339	23,203	63,085	72,032
Tax-exempt	59,200	54,939	173,209	167,321
Interest-bearing deposits	14,445	10,800	42,456	26,712
Federal funds sold and resell agreements	1,399	244	3,575	514
Total interest income	268,716	227,586	769,993	658,652
Interest expense:				
Deposits	22,201	5,668	50,414	9,709
Federal funds purchased and repurchase agreements	2,292	523	3,557	849
Junior subordinated deferrable interest debentures	1,394	1,020	3,847	2,890
Other long-term borrowings	1,164	1,164	3,492	2,696
Total interest expense	27,051	8,375	61,310	16,144
Net interest income	241,665	219,211	708,683	642,508
Provision for loan losses	2,650	10,980	17,846	27,358
Net interest income after provision for loan losses	239,015	208,231	690,837	615,150
Non-interest income:				
Trust and investment management fees	30,801	27,493	89,509	81,690
Service charges on deposit accounts	21,569	20,967	63,554	62,934
Insurance commissions and fees	11,037	10,892	37,573	34,441
Interchange and debit card transaction fees	3,499	5,884	10,103	17,150
Other charges, commissions and fees	9,580	10,493	27,860	29,983
Net gain (loss) on securities transactions	(34)	(4,867)	(113)	(4,917)
Other	11,205	10,753	35,682	25,114
Total non-interest income	87,657	81,615	264,168	246,395
Non-interest expense:				
Salaries and wages	87,547	84,388	259,434	247,895
Employee benefits	18,355	17,730	58,257	57,553
Net occupancy	19,894	19,391	59,089	57,781
Technology, furniture and equipment	21,004	18,743	61,142	54,983
Deposit insurance	4,694	4,862	14,178	15,347
Intangible amortization	336	405	1,093	1,301
Other	41,838	41,304	125,994	127,929
Total non-interest expense	193,668	186,823	579,187	562,789
Income before income taxes	133,004	103,023	375,818	298,756
Income taxes	15,160	9,892	40,153	35,131
Net income	117,844	93,131	335,665	263,625
Preferred stock dividends	2,016	2,016	6,047	6,047
Net income available to common shareholders	$115,828	$91,115	$329,618	$257,578
Earnings per common share:				
Basic	$1.80	$1.43	$5.13	$4.02

Diluted	1.78	1.41	5.08	3.98

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Comprehensive Income (Loss)
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$117,844	$93,131	$335,665	$263,625
Other comprehensive income (loss), before tax:				
Securities available for sale and transferred securities:				
Change in net unrealized gain/loss during the period	(96,147)	7,082	(286,935)	131,283
Change in net unrealized gain on securities transferred to held to maturity	(3,764)	(3,514)	(8,424)	(13,660)
Reclassification adjustment for net (gains) losses included in net income	34	4,867	113	4,917
Total securities available for sale and transferred securities	(99,877)	8,435	(295,246)	122,540
Defined-benefit post-retirement benefit plans:				
Change in the net actuarial gain/loss	—	—	—	—
Reclassification adjustment for net amortization of actuarial gain/loss included in net income as a component of net periodic cost (benefit)	1,250	1,357	3,751	4,072
Total defined-benefit post-retirement benefit plans	1,250	1,357	3,751	4,072
Other comprehensive income (loss), before tax	(98,627)	9,792	(291,495)	126,612
Deferred tax expense (benefit)	(20,711)	3,427	(61,213)	44,314
Other comprehensive income (loss), net of tax	(77,916)	6,365	(230,282)	82,298
Comprehensive income (loss)	$39,928	$99,496	$105,383	$345,923

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Changes in Shareholders' Equity
(Dollars in thousands, except per share amounts)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Treasury Stock	Total
Three months ended:							
September 30, 2018							
Balance at beginning of period	$144,486	$ 642	$960,121	$2,297,099	$ (63,319)	$(29,517)	$3,309,512
Net income	—	—	—	117,844	—	—	117,844
Other comprehensive loss, net of tax	—	—	—	—	(77,916)	—	(77,916)
Stock option exercises/stock unit conversions (19,232 shares)	—	—	—	(575)	—	1,694	1,119
Stock-based compensation expense recognized in earnings	—	—	2,796	—	—	—	2,796
Cash dividends – preferred stock (approximately $0.34 per share)	—	—	—	(2,016)	—	—	(2,016)
Cash dividends - common stock ($0.67 per share)	—	—	—	(43,093)	—	—	(43,093)
Balance at end of period	$144,486	$ 642	$962,917	$2,369,259	$ (141,235)	$(27,823)	$3,308,246
September 30, 2017							
Balance at beginning of period	$144,486	$ 642	$948,593	$2,078,898	$ 51,310	$—	$3,223,929
Net income	—	—	—	93,131	—	—	93,131
Other comprehensive income, net of tax	—	—	—	—	6,365	—	6,365
Stock option exercises/stock unit conversions (22,724 shares)	—	—	578	(393)	—	1,088	1,273
Stock-based compensation expense recognized in earnings	—	—	2,722	—	—	—	2,722
Purchase of treasury stock (1,134,966 shares)	—	—	—	—	—	(100,000)	(100,000)
Cash dividends – preferred stock (approximately $0.34 per share)	—	—	—	(2,016)	—	—	(2,016)
Cash dividends – common stock ($0.57 per share)	—	—	—	(36,361)	—	—	(36,361)
Balance at end of period	$144,486	$ 642	$951,893	$2,133,259	$ 57,675	$(98,912)	$3,189,043

See accompanying Notes to Consolidated Financial Statements

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Changes in Shareholders’ Equity (continued)
(Dollars in thousands, except per share amounts)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Treasury Stock	Total
Nine months ended:							
September 30, 2018							
Balance at beginning of period	$144,486	$ 642	$953,361	$2,187,069	$ 79,512	$(67,207)	$3,297,863
Cumulative effect of accounting change	—	—	—	(2,285)	—	—	(2,285)
Total shareholders' equity at beginning of period, as adjusted	144,486	642	953,361	2,184,784	79,512	(67,207)	3,295,578
Net income	—	—	—	335,665	—	—	335,665
Other comprehensive loss, net of tax	—	—	—	—	(230,282)	—	(230,282)
Reclassification of certain income tax effects related to the change in the U.S. statutory federal income tax rate under the Tax Cuts and Jobs Act	—	—	—	(9,535)	9,535	—	—
Stock option exercises/stock unit conversions (447,831 shares)	—	—	—	(12,887)	—	39,454	26,567
Stock-based compensation expense recognized in earnings	—	—	9,556	—	—	—	9,556
Purchase of treasury stock (601 shares)	—	—	—	—	—	(70)	(70)
Cash dividends – preferred stock (approximately $1.01 per share)	—	—	—	(6,047)	—	—	(6,047)
Cash dividends – common stock ($1.91 per share)	—	—	—	(122,721)	—	—	(122,721)
Balance at end of period	$144,486	$ 642	$962,917	$2,369,259	$ (141,235)	$(27,823)	$3,308,246
September 30, 2017							
Balance at beginning of period	$144,486	$ 637	$906,732	$1,985,569	$ (24,623)	$(10,273)	$3,002,528
Net income	—	—	—	263,625	—	—	263,625
Other comprehensive income, net of tax	—	—	—	—	82,298	—	82,298
Stock option exercises/stock unit conversions (774,799 shares)	—	5	36,148	(2,134)	—	11,403	45,422
Stock-based compensation expense recognized in earnings	—	—	9,013	—	—	—	9,013
Purchase of treasury stock (1,135,435 shares)	—	—	—	—	—	(100,042)	(100,042)
Cash dividends – preferred stock (approximately $1.01 per share)	—	—	—	(6,047)	—	—	(6,047)

Cash dividends – common stock ($1.68 per share)	—	—	—	(107,754)	—	—	(107,754)
Balance at end of period	$144,486	$ 642	$951,893	$2,133,259	$ 57,675	$(98,912)	$3,189,043

See accompanying Notes to Consolidated Financial Statements

Cullen/Frost Bankers, Inc.
Consolidated Statements of Cash Flows
(Dollars in thousands)

	Nine Months Ended September 30,	
	2018	2017
Operating Activities:		
Net income	$335,665	$263,625
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	17,846	27,358
Deferred tax expense (benefit)	39,198	(9,505)
Accretion of loan discounts	(10,470)	(11,567)
Securities premium amortization (discount accretion), net	73,748	66,455
Net (gain) loss on securities transactions	113	4,917
Depreciation and amortization	37,452	35,819
Net (gain) loss on sale/write-down of assets/foreclosed assets	(6,122)	(2,045)
Stock-based compensation	9,556	9,013
Net tax benefit from stock-based compensation	3,378	5,844
Earnings on life insurance policies	(2,510)	(2,367)
Net change in:		
Trading account securities	(1,094)	(3,018)
Accrued interest receivable and other assets	(19,047)	10,495
Accrued interest payable and other liabilities	(17,545)	(39,580)
Net cash from operating activities	460,168	355,444
Investing Activities:		
Securities held to maturity:		
Purchases	(1,500)	—
Sales	—	—
Maturities, calls and principal repayments	300,340	780,562
Securities available for sale:		
Purchases	(14,983,642)	(9,138,457)
Sales	13,838,566	8,993,963
Maturities, calls and principal repayments	182,028	283,278
Proceeds from sale of loans	21,318	—
Net change in loans	(718,551)	(745,702)
Benefits received on life insurance policies	384	462
Proceeds from sales of premises and equipment	12,859	1,553
Purchases of premises and equipment	(56,781)	(23,796)
Proceeds from sales of repossessed properties	1,106	517
Net cash from investing activities	(1,403,873)	152,380
Financing Activities:		
Net change in deposits	(523,535)	591,694
Net change in short-term borrowings	(64,047)	20,927
Proceeds from issuance of subordinated notes	—	98,434
Principal payments on subordinated notes	—	(100,000)
Proceeds from stock option exercises	26,567	45,422
Purchase of treasury stock	(70)	(100,042)

Cash dividends paid on preferred stock	(6,047)	(6,047)
Cash dividends paid on common stock	(122,721)	(107,754)
Net cash from financing activities	(689,853)	442,634
Net change in cash and cash equivalents	(1,633,558)	950,458
Cash and cash equivalents at beginning of period	5,053,047	4,141,445
Cash and cash equivalents at end of period	$3,419,489	$5,091,903

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements
(Table amounts in thousands, except for share and per share amounts)
Note 1 - Significant Accounting Policies
Nature of Operations. Cullen/Frost Bankers, Inc. (“Cullen/Frost”) is a financial holding company and a bank holding company headquartered in San Antonio, Texas that provides, through its subsidiaries, a broad array of products and services throughout numerous Texas markets. The terms “Cullen/Frost,” “the Corporation,” “we,” “us” and “our” mean Cullen/Frost Bankers, Inc. and its subsidiaries, when appropriate. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, insurance, brokerage, mutual funds, leasing, treasury management, capital markets advisory and item processing.
Basis of Presentation. The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of Cullen/Frost and all other entities in which Cullen/Frost has a controlling financial interest. All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies we follow conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry.
The consolidated financial statements in this Quarterly Report on Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of our financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (“SEC”). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with our consolidated financial statements, and notes thereto, for the year ended December 31, 2017, included in our Annual Report on Form 10-K filed with the SEC on February 7, 2018 (the “2017 Form 10-K”). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.
Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses and the fair values of financial instruments and the status of contingencies are particularly subject to change.
Cash Flow Reporting. Additional cash flow information was as follows:

	Nine Months Ended September 30,	
	2018	2017
Cash paid for interest	$59,764	$15,611
Cash paid for income taxes	5,112	41,969
Significant non-cash transactions:		
Unsettled purchases/sales of securities	74,191	41,763
Loans foreclosed and transferred to other real estate owned and foreclosed assets	2,898	257

Accounting Changes, Reclassifications and Restatements. Certain items in prior financial statements have been reclassified to conform to the current presentation. In addition, we adopted ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" as of January 1, 2018. In accordance with ASU 2018-02, we elected to reclassify certain income tax effects related to the change in the U.S. statutory federal income tax rate under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017 (see Note 13 - Income Taxes), from accumulated other comprehensive income to retained earnings. Such amounts, which totaled $9.5 million, related to a net actuarial loss on defined benefit post-retirement plans and unrealized gains on securities available for sale and securities transferred to held to maturity. See Note 14 - Other Comprehensive Income. The effects of the Tax Cuts and Jobs Act on deferred taxes related to amounts initially recorded in accumulated other comprehensive income are provisional. As we finalize the accounting for the tax effects of the Tax Cuts and Jobs Act, additional reclassification adjustments may be recorded in future periods. See Note 13 - Income Taxes. Notwithstanding this election made in accordance with ASU 2018-02, our policy is to release such income tax effects only when the entire portfolio to which the underlying transactions relate is liquidated, sold or extinguished.

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We also adopted ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" as of January 1, 2018. Using a modified retrospective transition approach for contracts that were not complete as of our adoption, we recognized a cumulative effect reduction to beginning retained earnings totaling $2.3 million. The amount was related to certain revenue streams within trust and investment management fees. Additionally, based on our underlying contracts, ASU 2014-09 requires us to report network costs associated with debit card and ATM transactions netted against the related fee income from such transactions. Previously, such network costs were reported as a component of other non-interest expense. For the three and nine months ended September 30, 2018, gross interchange and debit card transaction fees totaled $6.5 million and $19.0 million, respectively, while related network costs totaled $3.0 million and $8.9 million, respectively. On a net basis, we reported $3.5 million and $10.1 million as interchange and debit card transaction fees in the accompanying Consolidated Statement of Income for the three and nine months ended September 30, 2018, respectively. For the three and nine months ended September 30, 2017, we reported interchange and debit card transaction fees totaling $5.9 million and $17.2 million, respectively, on a gross basis in the accompanying Consolidated Statement of Income while related network costs totaling $3.0 million and $9.1 million were reported as a component of other non-interest expense for the three and nine months ended September 30, 2017, respectively. ASU 2014-09 also required us to change the way we recognize certain recurring revenue streams reported as components of trust and investment management fees, insurance commissions and fees and other categories of non-interest income, however, such changes were not significant to our financial statements for the nine months ended September 30, 2018.

Under ASU 2014-09, we adopted new policies related to revenue recognition. In general, for revenue not associated with financial instruments, guarantees and lease contracts, we apply the following steps when recognizing revenue from contracts with customers: (i) identify the contract, (ii) identify the performance obligations, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations and (v) recognize revenue when performance obligation is satisfied. Our contracts with customers are generally short term in nature, typically due within one year or less or cancellable by us or our customer upon a short notice period. Performance obligations for our customer contracts are generally satisfied at a single point in time, typically when the transaction is complete, or over time. For performance obligations satisfied over time, we primarily use the output method, directly measuring the value of the products/services transferred to the customer, to determine when performance obligations have been satisfied. We typically receive payment from customers and recognize revenue concurrent with the satisfaction of our performance obligations. In most cases, this occurs within a single financial reporting period. For payments received in advance of the satisfaction of performance obligations, revenue recognition is deferred until such time the performance obligations have been satisfied. In cases where we have not received payment despite satisfaction of our performance obligations, we accrue an estimate of the amount due in the period our performance obligations have been satisfied. For contracts with variable components, only amounts for which collection is probable are accrued. We generally act in a principal capacity, on our own behalf, in most of our contracts with customers. In such transactions, we recognize revenue and the related costs to provide our services on a gross basis in our financial statements. In some cases, we act in an agent capacity, deriving revenue through assisting other entities in transactions with our customers. In such transactions, we recognized revenue and the related costs to provide our services on a net basis in our financial statements. These transactions primarily relate to insurance and brokerage commissions and fees derived from our customers' use of various interchange and ATM/debit card networks.

In August 2018, the Securities and Exchange Commission ("SEC") issued Final Rule Release No. 33-10532 - "Disclosure Update and Simplification." This rule amends various SEC disclosure requirements that have been determined to be redundant, duplicative, overlapping, outdated, or superseded. The changes are generally expected to reduce or eliminate certain disclosures; however, the amendments did expand interim period disclosure requirements related to changes in shareholders' equity. Although the final rule does not become effective until November 5, 2018, we elected to expand our presentation of the Statement of Changes in Shareholders' Equity, as will be required under the new rule, in our financial statements as of and for the three and nine months ended September 30, 2018.

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Note 2 - Securities

Securities. A summary of the amortized cost and estimated fair value of securities, excluding trading securities, is presented below.

	September 30, 2018				December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held to Maturity								
Residential mortgage-backed securities	$3,040	$8	$94	$2,954	$3,610	$15	$38	$3,587
States and political subdivisions	1,107,222	7,232	2,057	1,112,397	1,428,488	26,462	2,746	1,452,204
Other	1,500	—	6	1,494	—	—	—	—
Total	$1,111,762	$7,240	$2,157	$1,116,845	$1,432,098	$26,477	$2,784	$1,455,791
Available for Sale								
U.S. Treasury	$3,454,899	$—	$52,020	$3,402,879	$3,453,391	$7,494	$15,732	$3,445,153
Residential mortgage-backed securities	756,649	11,254	11,532	756,371	648,288	19,048	2,250	665,086
States and political subdivisions	7,052,156	40,759	116,225	6,976,690	6,185,711	167,293	16,795	6,336,209
Other	42,651	—	—	42,651	42,561	—	—	42,561
Total	$11,306,355	$52,013	$179,777	$11,178,591	$10,329,951	$193,835	$34,777	$10,489,009

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. At September 30, 2018, approximately 98.4% of the securities in our municipal bond portfolio were issued by political subdivisions or agencies within the State of Texas, of which approximately 68.0% are either guaranteed by the Texas Permanent School Fund, which has a “triple A” insurer financial strength rating, or are secured by U.S. Treasury securities via defeasance of the debt by the issuers. Securities with limited marketability and that do not have readily determinable fair values are carried at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for identical or similar securities of the same issuer. These securities include stock in the Federal Reserve Bank and the Federal Home Loan Bank and are reported as other available for sale securities in the table above. The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law was $3.7 billion at September 30, 2018 and $3.8 billion at December 31, 2017.

During the fourth quarter of 2012, we reclassified certain securities from available for sale to held to maturity. The securities had an aggregate fair value of $2.3 billion with an aggregate net unrealized gain of $165.7 million ($107.7 million, net of tax) on the date of the transfer. The net unamortized, unrealized gain on the remaining transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of September 30, 2018 totaled $3.1 million ($2.5 million, net of tax). This amount will be amortized out of accumulated other comprehensive income over the remaining life of the underlying securities as an adjustment of the yield on those securities.

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Unrealized Losses. As of September 30, 2018, securities with unrealized losses, segregated by length of impairment, were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held to Maturity						
Residential mortgage-backed securities	$413	$ 19	$1,850	$ 75	$2,263	$ 94
States and political subdivisions	403,965	2,057	—	—	403,965	2,057
Other	1,494	6	—	—	1,494	6
Total	$405,872	$ 2,082	$1,850	$ 75	$407,722	$ 2,157
Available for Sale						
U.S. Treasury	$2,295,611	$ 34,315	$1,107,268	$ 17,705	$3,402,879	$ 52,020
Residential mortgage-backed securities	294,839	5,979	98,757	5,553	393,596	11,532
States and political subdivisions	3,585,212	65,581	810,732	50,644	4,395,944	116,225
Total	$6,175,662	$ 105,875	$2,016,757	$ 73,902	$8,192,419	$ 179,777

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and our ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in cost.

Management has the ability and intent to hold the securities classified as held to maturity in the table above until they mature, at which time we expect to receive full value for the securities. Furthermore, as of September 30, 2018, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that we will not have to sell any such securities before a recovery of cost. Any unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2018, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in our consolidated income statement.

Contractual Maturities. The amortized cost and estimated fair value of securities, excluding trading securities, at September 30, 2018 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Residential mortgage-backed securities and equity securities are shown separately since they are not due at a single maturity date.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$56,511	$57,181	$858,235	$851,163
Due after one year through five years	131,987	133,521	3,243,532	3,204,804
Due after five years through ten years	492,460	492,354	489,960	487,536
Due after ten years	427,764	430,835	5,915,328	5,836,066
Residential mortgage-backed securities	3,040	2,954	756,649	756,371
Equity securities	—	—	42,651	42,651
Total	$1,111,762	$1,116,845	$11,306,355	$11,178,591

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Sales of Securities. Sales of securities available for sale were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Proceeds from sales	$2,948,178	$746,524	$13,838,566	$8,993,963
Gross realized gains	—	—	3	—
Gross realized losses	(34)	(4,867)	(116)	(4,917)
Tax (expense) benefit of securities gains/losses	7	1,703	24	1,721

Premiums and Discounts. Premium amortization and discount accretion included in interest income on securities was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Premium amortization	$(27,381)	$(24,586)	$(80,104)	$(72,733)
Discount accretion	2,569	1,783	6,356	6,278
Net (premium amortization) discount accretion	$(24,812)	$(22,803)	$(73,748)	$(66,455)

Trading Account Securities. Trading account securities, at estimated fair value, were as follows:

	September 30, 2018	December 31, 2017
U.S. Treasury	$ 21,804	$ 19,210
States and political subdivisions	434	1,888
Total	$ 22,238	$ 21,098

Net gains and losses on trading account securities were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net gain on sales transactions	$465	$414	$1,404	$1,018
Net mark-to-market gains (losses)	(8)	(8)	(21)	(51)
Net gain (loss) on trading account securities	$457	$406	$1,383	$967

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Note 3 - Loans

Loans were as follows:

	September 30, 2018	Percentage of Total	December 31, 2017	Percentage of Total
Commercial and industrial	$ 5,029,754	36.4 %	$ 4,792,388	36.4 %
Energy:				
Production	1,220,771	8.8	1,182,326	9.0
Service	164,889	1.2	171,795	1.3
Other	133,708	1.0	144,972	1.1
Total energy	1,519,368	11.0	1,499,093	11.4
Commercial real estate:				
Commercial mortgages	4,078,787	29.5	3,887,742	29.6
Construction	1,208,870	8.7	1,066,696	8.1
Land	315,384	2.3	331,986	2.5
Total commercial real estate	5,603,041	40.5	5,286,424	40.2
Consumer real estate:				
Home equity loans	352,292	2.5	355,342	2.7
Home equity lines of credit	326,876	2.4	291,950	2.2
Other	419,965	3.1	376,002	2.9
Total consumer real estate	1,099,133	8.0	1,023,294	7.8
Total real estate	6,702,174	48.5	6,309,718	48.0
Consumer and other	563,542	4.1	544,466	4.2
Total loans	$ 13,814,838	100.0 %	$ 13,145,665	100.0 %

Concentrations of Credit. Most of our lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio, as well as other markets. The majority of our loan portfolio consists of commercial and industrial and commercial real estate loans. As of September 30, 2018, there were no concentrations of loans related to any single industry in excess of 10% of total loans other than energy loans, which totaled 11.0% of total loans. Unfunded commitments to extend credit and standby letters of credit issued to customers in the energy industry totaled $1.1 billion and $46.7 million, respectively, as of September 30, 2018.

Foreign Loans. We have U.S. dollar denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant at September 30, 2018 or December 31, 2017.

Related Party Loans. In the ordinary course of business, we have granted loans to certain directors, executive officers and their affiliates (collectively referred to as “related parties”). Such loans totaled $238.6 million at September 30, 2018 and $166.4 million at December 31, 2017.

Non-Accrual and Past Due Loans. Non-accrual loans, segregated by class of loans, were as follows:

	September 30, 2018	December 31, 2017
Commercial and industrial	$ 12,278	$ 46,186
Energy	51,802	94,302
Commercial real estate:		
Buildings, land and other	15,913	7,589
Construction	—	—
Consumer real estate	971	2,109
Consumer and other	1,637	128
Total	$ 82,601	$ 150,314

Had non-accrual loans performed in accordance with their original contract terms, we would have recognized additional interest income, net of tax, of approximately $1.3 million and $4.2 million for the three and nine months ended September 30, 2018, compared to $783 thousand and $2.4 million for the three and nine months ended

September 30, 2017.

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An age analysis of past due loans (including both accruing and non-accruing loans), segregated by class of loans, as of September 30, 2018 was as follows:

	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and industrial	$ 33,985	$ 10,250	$ 44,235	$ 4,985,519	$ 5,029,754	$ 3,963
Energy	3,251	2,221	5,472	1,513,896	1,519,368	818
Commercial real estate:						
Buildings, land and other	21,596	2,980	24,576	4,369,595	4,394,171	2,606
Construction	784	1,042	1,826	1,207,044	1,208,870	1,042
Consumer real estate	7,743	1,773	9,516	1,089,617	1,099,133	1,432
Consumer and other	6,098	1,766	7,864	555,678	563,542	1,724
Total	$ 73,457	$ 20,032	$ 93,489	$ 13,721,349	$ 13,814,838	$ 11,585

Impaired Loans. Impaired loans are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired.

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
September 30, 2018					
Commercial and industrial	$ 19,857	$ 3,153	$ 6,574	$ 9,727	$ 4,622
Energy	68,087	7,942	43,614	51,556	12,672
Commercial real estate:					
Buildings, land and other	15,961	2,309	12,876	15,185	2,599
Construction	—	—	—	—	—
Consumer real estate	293	293	—	293	—
Consumer and other	1,595	—	1,595	1,595	1,595
Total	$ 105,793	$ 13,697	$ 64,659	$ 78,356	$ 21,488
December 31, 2017					
Commercial and industrial	$ 60,781	$ 28,038	$ 15,722	$ 43,760	$ 7,553
Energy	99,606	33,080	61,162	94,242	13,267
Commercial real estate:					
Buildings, land and other	10,795	6,394	—	6,394	—
Construction	—	—	—	—	—
Consumer real estate	1,214	1,214	—	1,214	—
Consumer and other	—	—	—	—	—
Total	$ 172,396	$ 68,726	$ 76,884	$ 145,610	$ 20,820

The average recorded investment in impaired loans was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Commercial and industrial	$ 13,447	$ 26,910	$ 21,025	$ 26,651
Energy	78,772	76,008	82,640	72,055
Commercial real estate:				
Buildings, land and other	14,306	5,553	12,328	6,106
Construction	—	—	—	—
Consumer real estate	671	1,209	807	1,155

Consumer and other	1,073	—	805	13
Total	$108,269	$109,680	$117,605	$105,980

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Troubled Debt Restructurings. Troubled debt restructurings during the nine months ended September 30, 2018 and September 30, 2017 are set forth in the following table.

	Nine Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	Balance at Restructure	Balance at Period-End	Balance at Restructure	Balance at Period-End
Commercial and industrial	$ 2,203	$ —	$ 4,026	$ 3,875
Energy	13,708	—	56,097	55,023
	$ 15,911	$ —	$ 60,123	$ 58,898

Loan modifications are typically related to extending amortization periods, converting loans to interest only for a limited period of time, deferral of interest payments, waiver of certain covenants, consolidating notes and/or reducing collateral or interest rates. The modifications during the reported periods did not significantly impact our determination of the allowance for loan losses.

Additional information related to restructured loans as of or for the nine months ended September 30, 2018 and September 30, 2017 is set forth in the following table.

	September 30, 2018	September 30, 2017
Restructured loans past due in excess of 90 days at period-end:		
Number of loans	—	1
Dollar amount of loans	$ —	$ 43,137
Restructured loans on non-accrual status at period end	—	54,082
Charge-offs of restructured loans:		
Recognized in connection with restructuring	—	—
Recognized on previously restructured loans	4,650	9,951
Proceeds from sale of restructured loans	15,750	—

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of our loan portfolio, management tracks certain credit quality indicators including trends related to (i) the weighted-average risk grade of commercial loans, (ii) the level of classified commercial loans, (iii) the delinquency status of consumer loans (see details above), (iv) net charge-offs, (v) non-performing loans (see details above) and (vi) the general economic conditions in the State of Texas.

We utilize a risk grading matrix to assign a risk grade to each of our commercial loans. Loans are graded on a scale of 1 to 14. A description of the general characteristics of the 14 risk grades is set forth in our 2017 Form 10-K. In monitoring credit quality trends in the context of assessing the appropriate level of the allowance for loan losses, we monitor portfolio credit quality by the weighted-average risk grade of each class of commercial loan. Individual relationship managers review updated financial information for all pass grade loans to reassess the risk grade on at least an annual basis. When a loan has a risk grade of 9, it is still considered a pass grade loan; however, it is considered to be on management’s “watch list,” where a significant risk-modifying action is anticipated in the near term. When a loan has a risk grade of 10 or higher, a special assets officer monitors the loan on an on-going basis.

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The following tables present weighted-average risk grades for all commercial loans by class.

	September 30, 2018 Weighted Average Risk Grade	September 30, 2018 Loans	December 31, 2017 Weighted Average Risk Grade	December 31, 2017 Loans
Commercial and industrial:				
Risk grades 1-8	6.10	$4,755,739	6.06	$4,378,839
Risk grade 9	9.00	123,199	9.00	170,285
Risk grade 10	10.00	67,645	10.00	99,260
Risk grade 11	11.00	70,893	11.00	97,818
Risk grade 12	12.00	7,656	12.00	38,633
Risk grade 13	13.00	4,622	13.00	7,553
Total	6.31	$5,029,754	6.41	$4,792,388
Energy				
Risk grades 1-8	5.81	$1,367,235	6.01	$1,199,207
Risk grade 9	9.00	13,352	9.00	50,427
Risk grade 10	10.00	42,862	10.00	64,282
Risk grade 11	11.00	44,116	11.00	90,875
Risk grade 12	12.00	39,131	12.00	81,035
Risk grade 13	13.00	12,672	13.00	13,267
Total	6.32	$1,519,368	6.97	$1,499,093
Commercial real estate:				
Buildings, land and other				
Risk grades 1-8	6.77	$4,091,571	6.75	$3,868,659
Risk grade 9	9.00	135,521	9.00	151,487
Risk grade 10	10.00	60,169	10.00	129,391
Risk grade 11	11.00	90,997	11.00	62,602
Risk grade 12	12.00	13,314	12.00	7,589
Risk grade 13	13.00	2,599	13.00	—
Total	6.99	$4,394,171	7.00	$4,219,728
Construction				
Risk grades 1-8	7.10	$1,129,492	7.11	$1,019,635
Risk grade 9	9.00	51,058	9.00	18,042
Risk grade 10	10.00	26,035	10.00	23,393
Risk grade 11	11.00	2,285	11.00	5,626
Risk grade 12	12.00	—	12.00	—
Risk grade 13	13.00	—	13.00	—
Total	7.25	$1,208,870	7.23	$1,066,696

Net (charge-offs)/recoveries, segregated by class of loans, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Commercial and industrial	$(7,807)	$(4,565)	$(19,030)	$(12,155)
Energy	(5,347)	451	(10,272)	(10,010)
Commercial real estate:				
Buildings, land and other	33	266	(288)	768
Construction	3	2	11	8

Consumer real estate	(388)	(629)	(1,078)	(422)
Consumer and other	(1,792)	(1,760)	(4,975)	(4,289)
Total	$(15,298)	$(6,235)	$(35,632)	$(26,100)

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In assessing the general economic conditions in the State of Texas, management monitors and tracks the Texas Leading Index ("TLI"), which is produced by the Federal Reserve Bank of Dallas. The TLI, the components of which are more fully described in our 2017 Form 10-K, totaled 129.4 at September 30, 2018 and 129.3 at December 31, 2017. A higher TLI value implies more favorable economic conditions.

Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of inherent losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. Our allowance for loan loss methodology, which is more fully described in our 2017 Form 10-K, follows the accounting guidance set forth in U.S. generally accepted accounting principles and the Interagency Policy Statement on the Allowance for Loan and Lease Losses, which was jointly issued by U.S. bank regulatory agencies. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss and recovery experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off.

The following table presents details of the allowance for loan losses allocated to each portfolio segment as of September 30, 2018 and December 31, 2017 and detailed on the basis of the impairment evaluation methodology we used:

	Commercial and Industrial	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
September 30, 2018						
Historical valuation allowances	$ 25,582	$9,654	$ 20,441	$ 2,641	$ 6,815	$65,133
Specific valuation allowances	4,622	12,672	2,599	—	1,595	21,488
General valuation allowances	9,361	5,849	4,187	1,620	(114)	20,903
Macroeconomic valuation allowances	11,426	3,270	11,977	1,933	1,448	30,054
Total	$ 50,991	$31,445	$ 39,204	$ 6,194	$ 9,744	$137,578
Allocated to loans:						
Individually evaluated	$ 4,622	$12,672	$ 2,599	$ —	$ 1,595	$21,488
Collectively evaluated	46,369	18,773	36,605	6,194	8,149	116,090
Total	$ 50,991	$31,445	$ 39,204	$ 6,194	$ 9,744	$137,578
December 31, 2017						
Historical valuation allowances	$ 26,401	$22,073	$ 18,931	$ 2,473	$ 5,603	$75,481
Specific valuation allowances	7,553	13,267	—	—	—	20,820
General valuation allowances	9,112	7,964	4,165	2,133	(91)	23,283
Macroeconomic valuation allowances	16,548	8,224	7,852	1,051	2,105	35,780
Total	$ 59,614	$51,528	$ 30,948	$ 5,657	$ 7,617	$155,364
Allocated to loans:						
Individually evaluated	$ 7,553	$13,267	$ —	$ —	$ —	$20,820
Collectively evaluated	52,061	38,261	30,948	5,657	7,617	134,544
Total	$ 59,614	$51,528	$ 30,948	$ 5,657	$ 7,617	$155,364

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Our recorded investment in loans as of September 30, 2018 and December 31, 2017 related to each balance in the allowance for loan losses by portfolio segment and detailed on the basis of the impairment methodology we used was as follows:

	Commercial and Industrial	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
September 30, 2018						
Individually evaluated	$ 9,727	$ 51,556	$ 15,185	$ 293	$ 1,595	$ 78,356
Collectively evaluated	5,020,027	1,467,812	5,587,856	1,098,840	561,947	13,736,482
Total	$ 5,029,754	$ 1,519,368	$ 5,603,041	$ 1,099,133	$ 563,542	$ 13,814,838
December 31, 2017						
Individually evaluated	$ 43,760	$ 94,242	$ 6,394	$ 1,214	$ —	$ 145,610
Collectively evaluated	4,748,628	1,404,851	5,280,030	1,022,080	544,466	13,000,055
Total	$ 4,792,388	$ 1,499,093	$ 5,286,424	$ 1,023,294	$ 544,466	$ 13,145,665

The following table details activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2018 and 2017. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Commercial and Industrial	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
Three months ended:						
September 30, 2018						
Beginning balance	$ 57,713	$ 37,313	$ 38,918	$ 6,336	$ 9,946	$ 150,226
Provision for loan losses	1,085	(521)	250	246	1,590	2,650
Charge-offs	(8,491)	(5,400)	—	(431)	(4,274)	(18,596)
Recoveries	684	53	36	43	2,482	3,298
Net charge-offs	(7,807)	(5,347)	36	(388)	(1,792)	(15,298)
Ending balance	$ 50,991	$ 31,445	$ 39,204	$ 6,194	$ 9,744	$ 137,578
September 30, 2017						
Beginning balance	$ 48,906	$ 54,277	$ 33,002	$ 5,535	$ 7,838	$ 149,558
Provision for loan losses	4,096	(2,815)	4,805	1,969	2,925	10,980
Charge-offs	(5,468)	—	—	(766)	(4,120)	(10,354)
Recoveries	903	451	268	137	2,360	4,119
Net charge-offs	(4,565)	451	268	(629)	(1,760)	(6,235)
Ending balance	$ 48,437	$ 51,913	$ 38,075	$ 6,875	$ 9,003	$ 154,303
Nine months ended:						
September 30, 2018						
Beginning balance	$ 59,614	$ 51,528	$ 30,948	$ 5,657	$ 7,617	$ 155,364
Provision for loan losses	10,407	(9,811)	8,533	1,615	7,102	17,846
Charge-offs	(21,896)	(10,939)	(619)	(1,632)	(12,240)	(47,326)
Recoveries	2,866	667	342	554	7,265	11,694
Net charge-offs	(19,030)	(10,272)	(277)	(1,078)	(4,975)	(35,632)
Ending balance	$ 50,991	$ 31,445	$ 39,204	$ 6,194	$ 9,744	$ 137,578
September 30, 2017						
Beginning balance	$ 52,915	$ 60,653	$ 30,213	$ 4,238	$ 5,026	$ 153,045
Provision for loan losses	7,677	1,270	7,086	3,059	8,266	27,358
Charge-offs	(14,574)	(10,595)	(14)	(779)	(11,291)	(37,253)
Recoveries	2,419	585	790	357	7,002	11,153

Net charge-offs	(12,155)	(10,010)	776	(422)	(4,289)	(26,100)
Ending balance	$ 48,437	$ 51,913	$ 38,075	$ 6,875	$ 9,003	$ 154,303

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Note 4 - Goodwill and Other Intangible Assets

Goodwill and other intangible assets are presented in the table below.

	September 30, 2018	December 31, 2017
Goodwill	$ 654,952	$ 654,952
Other intangible assets:		
Core deposits	$ 3,213	$ 4,044
Customer relationships	743	986
Non-compete agreements	24	43
	$ 3,980	$ 5,073

The estimated aggregate future amortization expense for intangible assets remaining as of September 30, 2018 is as follows:

Remainder of 2018	331
2019	1,167
2020	918
2021	697
2022	481
Thereafter	386
	$3,980

Note 5 - Deposits

Deposits were as follows:

	September 30, 2018	Percentage of Total		December 31, 2017	Percentage of Total	
Non-interest-bearing demand deposits:						
Commercial and individual	$ 10,137,696	38.4	%	$ 10,412,882	38.8	%
Correspondent banks	187,589	0.7		222,648	0.8	
Public funds	515,228	2.0		561,563	2.1	
Total non-interest-bearing demand deposits	10,840,513	41.1		11,197,093	41.7	
Interest-bearing deposits:						
Private accounts:						
Savings and interest checking	6,640,382	25.2		6,788,766	25.2	
Money market accounts	7,694,628	29.2		7,624,471	28.4	
Time accounts of $100,000 or more	484,236	1.8		453,668	1.7	
Time accounts under $100,000	327,790	1.3		324,636	1.2	
Total private accounts	15,147,036	57.5		15,191,541	56.5	
Public funds:						
Savings and interest checking	303,150	1.2		410,140	1.5	
Money market accounts	54,537	0.2		59,008	0.2	
Time accounts of $100,000 or more	3,523	—		14,301	0.1	
Time accounts under $100,000	95	—		306	—	
Total public funds	361,305	1.4		483,755	1.8	
Total interest-bearing deposits	15,508,341	58.9		15,675,296	58.3	
Total deposits	$ 26,348,854	100.0	%	$ 26,872,389	100.0	%

The following table presents additional information about our deposits:

	September 30, 2018	December 31, 2017
Deposits from foreign sources (primarily Mexico)	$ 739,424	$ 716,339
Deposits not covered by deposit insurance	12,403,549	13,281,040

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Note 6 - Commitments and Contingencies

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, we enter into various transactions, which, in accordance with generally accepted accounting principles are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. As more fully discussed in our 2017 Form 10-K, these transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

Financial instruments with off-balance-sheet risk were as follows:

	September 30, 2018	December 31, 2017
Commitments to extend credit	$ 8,284,873	$ 7,949,400
Standby letters of credit	244,743	236,595
Deferred standby letter of credit fees	1,657	1,843

Lease Commitments. We lease certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled $8.1 million and $24.4 million during the three and nine months ended September 30, 2018 and $7.7 million and $23.0 million during the three and nine months ended September 30, 2017. There has been no significant change in our expected future minimum lease payments since December 31, 2017. See the 2017 Form 10-K for information regarding these commitments.

Litigation. We are subject to various claims and legal actions that have arisen in the course of conducting business. Management does not expect the ultimate disposition of these matters to have a material adverse impact on our financial statements.

Note 7 - Capital and Regulatory Matters

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

Cullen/Frost’s and Frost Bank’s Common Equity Tier 1 capital includes common stock and related paid-in capital, net of treasury stock, and retained earnings. In connection with the adoption of the Basel III Capital Rules, we elected to opt-out of the requirement to include most components of accumulated other comprehensive income in Common Equity Tier 1. Common Equity Tier 1 for both Cullen/Frost and Frost Bank is reduced by, goodwill and other intangible assets, net of associated deferred tax liabilities, and subject to transition provisions. Frost Bank's Common Equity Tier 1 is also reduced by its equity investment in its financial subsidiary, Frost Insurance Agency (“FIA”).

Tier 1 capital includes Common Equity Tier 1 capital and additional Tier 1 capital. For Cullen/Frost, additional Tier 1 capital at September 30, 2018 and December 31, 2017 includes $144.5 million of 5.375% non-cumulative perpetual preferred stock. Frost Bank did not have any additional Tier 1 capital beyond Common Equity Tier 1 at September 30, 2018 or December 31, 2017.

Total capital includes Tier 1 capital and Tier 2 capital. Tier 2 capital for both Cullen/Frost and Frost Bank includes a permissible portion of the allowance for loan losses. Tier 2 capital for Cullen/Frost also includes $100.0 million of qualified subordinated debt and $133.0 million of trust preferred securities at both September 30, 2018 and December 31, 2017.

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The following tables present actual and required capital ratios as of September 30, 2018 and December 31, 2017 for Cullen/Frost and Frost Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of September 30, 2018 and December 31, 2017 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules. See the 2017 Form 10-K for a more detailed discussion of the Basel III Capital Rules.

	Actual		Minimum Capital Required - Basel III Phase-In Schedule		Minimum Capital Required - Basel III Fully Phased-In		Required to be Considered Well Capitalized	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
September 30, 2018								
Common Equity Tier 1 to Risk-Weighted Assets								
Cullen/Frost	$2,658,645	12.93%	$1,310,621	6.38%	$1,439,113	7.00 %	$1,336,319	6.50 %
Frost Bank	2,683,196	13.10	1,306,205	6.38	1,434,264	7.00	1,331,816	6.50
Tier 1 Capital to Risk-Weighted Assets								
Cullen/Frost	2,803,131	13.63	1,619,002	7.88	1,747,494	8.50	1,644,701	8.00
Frost Bank	2,683,196	13.10	1,613,547	7.88	1,741,606	8.50	1,639,159	8.00
Total Capital to Risk-Weighted Assets								
Cullen/Frost	3,174,209	15.44	2,030,177	9.88	2,158,670	10.50	2,055,876	10.00
Frost Bank	2,821,274	13.77	2,023,337	9.88	2,151,396	10.50	2,048,948	10.00
Leverage Ratio								
Cullen/Frost	2,803,131	9.19	1,220,627	4.00	1,220,627	4.00	1,525,784	5.00
Frost Bank	2,683,196	8.80	1,219,806	4.00	1,219,806	4.00	1,524,758	5.00
December 31, 2017								
Common Equity Tier 1 to Risk-Weighted Assets								
Cullen/Frost	$2,426,048	12.42%	$1,123,430	5.75%	$1,367,583	7.00 %	$1,269,965	6.50 %
Frost Bank	2,518,999	12.92	1,120,663	5.75	1,364,214	7.00	1,266,836	6.50
Tier 1 Capital to Risk-Weighted Assets								
Cullen/Frost	2,570,534	13.16	1,416,499	7.25	1,660,637	8.50	1,563,033	8.00
Frost Bank	2,518,999	12.92	1,413,010	7.25	1,656,546	8.50	1,559,183	8.00
Total Capital to Risk-Weighted Assets								
Cullen/Frost	2,959,326	15.15	1,807,257	9.25	2,051,375	10.50	1,953,792	10.00
Frost Bank	2,674,791	13.72	1,802,805	9.25	2,046,321	10.50	1,948,979	10.00
Leverage Ratio								
Cullen/Frost	2,570,534	8.46	1,215,227	4.00	1,215,186	4.00	1,519,034	5.00
Frost Bank	2,518,999	8.30	1,214,295	4.00	1,214,254	4.00	1,517,869	5.00

As of September 30, 2018, capital levels at Cullen/Frost and Frost Bank exceed all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis. Based on the ratios presented above, capital levels as of September 30, 2018 at Cullen/Frost and Frost Bank exceed the minimum levels necessary to be considered “well capitalized.”

Cullen/Frost and Frost Bank are subject to the regulatory capital requirements administered by the Federal Reserve Board and, for Frost Bank, the Federal Deposit Insurance Corporation (“FDIC”). Regulatory authorities can initiate certain mandatory actions if Cullen/Frost or Frost Bank fail to meet the minimum capital requirements, which could have a direct material effect on our financial statements. Management believes, as of September 30, 2018, that Cullen/Frost and Frost Bank meet all capital adequacy requirements to which they are subject.

Stock Repurchase Plans. From time to time, our board of directors has authorized stock repurchase plans. In general, stock repurchase plans allow us to proactively manage our capital position and return excess capital to shareholders. Shares purchased under such plans also provide us with shares of common stock necessary to satisfy obligations related to stock compensation

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awards. On October 24, 2017, our board of directors authorized a $150.0 million stock repurchase program, allowing us to repurchase shares of our common stock over a two-year period from time to time at various prices in the open market or through private transactions. No shares were repurchased under this plan during 2018 or 2017. Under a prior plan, we repurchased 1,134,966 shares under the plan at a total cost of $100.0 million during the third quarter of 2017.

Dividend Restrictions. In the ordinary course of business, Cullen/Frost is dependent upon dividends from Frost Bank to provide funds for the payment of dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of Frost Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years. Under the foregoing dividend restrictions and while maintaining its “well capitalized” status, at September 30, 2018, Frost Bank could pay aggregate dividends of up to $569.7 million to Cullen/Frost without prior regulatory approval.

Under the terms of the junior subordinated deferrable interest debentures that Cullen/Frost has issued to Cullen/Frost Capital Trust II and WNB Capital Trust I, Cullen/Frost has the right at any time during the term of the debentures to defer the payment of interest at any time or from time to time for an extension period not exceeding 20 consecutive quarterly periods with respect to each extension period. In the event that we have elected to defer interest on the debentures, we may not, with certain exceptions, declare or pay any dividends or distributions on our capital stock or purchase or acquire any of our capital stock.

Under the terms of our Series A Preferred Stock, in the event that we do not declare and pay dividends on our Series A Preferred Stock for the most recent dividend period, we may not, with certain exceptions, declare or pay dividends on, or purchase, redeem or otherwise acquire, shares of our common stock or any of our securities that rank junior to our Series A Preferred Stock.

Note 8 - Derivative Financial Instruments

The fair value of derivative positions outstanding is included in accrued interest receivable and other assets and accrued interest payable and other liabilities in the accompanying consolidated balance sheets and in the net change in each of these financial statement line items in the accompanying consolidated statements of cash flows.

Interest Rate Derivatives. We utilize interest rate swaps, caps and floors to mitigate exposure to interest rate risk and to facilitate the needs of our customers. Our objectives for utilizing these derivative instruments are described in our 2017 Form 10-K.

The notional amounts and estimated fair values of interest rate derivative contracts are presented in the following table. The fair values of interest rate derivative contracts are estimated utilizing internal valuation models with observable market data inputs, or as determined by the Chicago Mercantile Exchange (“CME”) for centrally cleared derivative contracts. CME rules legally characterize variation margin payments for centrally cleared derivatives as settlements of the derivatives' exposure rather than collateral. As a result, the variation margin payment and the related derivative instruments are considered a single unit of account for accounting and financial reporting purposes. Variation margin, as determined by the CME, is settled daily. As a result, derivative contracts that clear through the CME have an estimated fair value of zero as of September 30, 2018 and December 31, 2017.

	September 30, 2018		December 31, 2017	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Derivatives designated as hedges of fair value:				
Financial institution counterparties:				
Loan/lease interest rate swaps – assets	$11,284	$ 314	$13,679	$ 242
Loan/lease interest rate swaps – liabilities	4,226	(201)	11,147	(593)
Non-hedging interest rate derivatives:				
Financial institution counterparties:				
Loan/lease interest rate swaps – assets	780,531	6,179	430,449	1,418
Loan/lease interest rate swaps – liabilities	341,987	(5,133)	541,496	(12,820)
Loan/lease interest rate caps – assets	102,487	920	114,619	480

Customer counterparties:				
Loan/lease interest rate swaps – assets	341,987	7,017	541,496	17,882
Loan/lease interest rate swaps – liabilities	780,531	(20,613)	430,449	(4,861)
Loan/lease interest rate caps – liabilities	102,487	(920)	114,619	(480)

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The weighted-average rates paid and received for interest rate swaps outstanding at September 30, 2018 were as follows:

	Weighted-Average Interest Rate Paid	Interest Rate Received
Interest rate swaps:		
Fair value hedge loan/lease interest rate swaps	2.45 %	2.16 %
Non-hedging interest rate swaps – financial institution counterparties	4.09 %	3.73 %
Non-hedging interest rate swaps – customer counterparties	3.73 %	4.09 %

The weighted-average strike rate for outstanding interest rate caps was 2.96% at September 30, 2018.

Commodity Derivatives. We enter into commodity swaps and option contracts that are not designated as hedging instruments primarily to accommodate the business needs of our customers. Upon the origination of a commodity swap or option contract with a customer, we simultaneously enter into an offsetting contract with a third party financial institution to mitigate the exposure to fluctuations in commodity prices.

The notional amounts and estimated fair values of non-hedging commodity swap and option derivative positions outstanding are presented in the following table. We obtain dealer quotations and use internal valuation models with observable market data inputs to value our commodity derivative positions.

		September 30, 2018		December 31, 2017	
	Notional Units	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Financial institution counterparties:					
Oil – assets	Barrels	622	$ 917	253	$ 193
Oil – liabilities	Barrels	2,889	(34,941)	2,731	(13,448)
Natural gas – assets	MMBTUs	7,939	427	5,927	1,399
Natural gas – liabilities	MMBTUs	8,382	(598)	3,917	(326)
Customer counterparties:					
Oil – assets	Barrels	2,889	35,083	2,731	13,709
Oil – liabilities	Barrels	622	(917)	253	(187)
Natural gas – assets	MMBTUs	9,588	682	3,917	340
Natural gas – liabilities	MMBTUs	6,734	(392)	5,927	(1,366)

Foreign Currency Derivatives. We enter into foreign currency forward contracts that are not designated as hedging instruments primarily to accommodate the business needs of our customers. Upon the origination of a foreign currency denominated transaction with a customer, we simultaneously enter into an offsetting contract with a third party financial institution to negate the exposure to fluctuations in foreign currency exchange rates. We also utilize foreign currency forward contracts that are not designated as hedging instruments to mitigate the economic effect of fluctuations in foreign currency exchange rates on foreign currency holdings and certain short-term, non-U.S. dollar denominated loans. The notional amounts and fair values of open foreign currency forward contracts were as follows:

		September 30, 2018		December 31, 2017	
	Notional Currency	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Financial institution counterparties:					
Forward contracts – assets	EUR	1,097	$ 9	4,014	$ 77
Forward contracts – assets	GBP	793	9	127	1
Forward contracts – liabilities	EUR	—	—	4,846	(37)
Forward contracts – liabilities	CAD	22,971	(189)	25,413	(142)
Forward contracts – liabilities	GBP	—	—	1,178	(9)

Forward contracts – liabilities	AUD	54	—	—	—
Customer counterparties:					
Forward contracts – assets	EUR	—	—	3,867	58
Forward contracts – assets	CAD	22,918	245	25,282	279
Forward contracts – liabilities	EUR	—	—	4,041	(51)
Forward contracts – liabilities	GBP	—	—	127	—

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Gains, Losses and Derivative Cash Flows. For fair value hedges, the changes in the fair value of both the derivative hedging instrument and the hedged item are included in other non-interest income or other non-interest expense. The extent that such changes in fair value do not offset represents hedge ineffectiveness. Net cash flows from interest rate swaps on commercial loans/leases designated as hedging instruments in effective hedges of fair value are included in interest income on loans. For non-hedging derivative instruments, gains and losses due to changes in fair value and all cash flows are included in other non-interest income and other non-interest expense.

Amounts included in the consolidated statements of income related to interest rate derivatives designated as hedges of fair value were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Commercial loan/lease interest rate swaps:				
Amount of gain (loss) included in interest income on loans	$12	$(149)	$1	$(592)
Amount of (gain) loss included in other non-interest expense	—	(2)	(1)	(5)

As stated above, we enter into non-hedge related derivative positions primarily to accommodate the business needs of our customers. Upon the origination of a derivative contract with a customer, we simultaneously enter into an offsetting derivative contract with a third party financial institution. We recognize immediate income based upon the difference in the bid/ask spread of the underlying transactions with our customers and the third party. Because we act only as an intermediary for our customer, subsequent changes in the fair value of the underlying derivative contracts for the most part offset each other and do not significantly impact our results of operations.

Amounts included in the consolidated statements of income related to non-hedging interest rate, commodity and foreign currency derivative instruments are presented in the table below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Non-hedging interest rate derivatives:				
Other non-interest income	$699	$1,085	$2,889	$2,062
Other non-interest expense	2	—	(2)	1
Non-hedging commodity derivatives:				
Other non-interest income	456	231	492	387
Non-hedging foreign currency derivatives:				
Other non-interest income	53	83	203	101

Counterparty Credit Risk. Our credit exposure relating to interest rate swaps, commodity swaps/options and foreign currency forward contracts with bank customers was approximately $41.0 million at September 30, 2018. This credit exposure is partly mitigated as transactions with customers are generally secured by the collateral, if any, securing the underlying transaction being hedged. Our credit exposure, net of collateral pledged, relating to interest rate swaps, commodity swaps/options and foreign currency forward contracts with upstream financial institution counterparties was approximately $431 thousand at September 30, 2018. This amount was primarily related to excess collateral we posted to counterparties. Collateral levels for upstream financial institution counterparties are monitored and adjusted as necessary. See Note 9 – Balance Sheet Offsetting and Repurchase Agreements for additional information regarding our credit exposure with upstream financial institution counterparties.

The aggregate fair value of securities we posted as collateral related to derivative contracts totaled $7.0 million at September 30, 2018. At such date, we also had $26.7 million in cash collateral on deposit with other financial institution counterparties.

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Note 9 - Balance Sheet Offsetting and Repurchase Agreements

Balance Sheet Offsetting. Certain financial instruments, including resell and repurchase agreements and derivatives, may be eligible for offset in the consolidated balance sheet and/or subject to master netting arrangements or similar agreements. Our derivative transactions with upstream financial institution counterparties are generally executed under International Swaps and Derivative Association ("ISDA") master agreements which include "right of set-off" provisions. In such cases there is generally a legally enforceable right to offset recognized amounts and there may be an intention to settle such amounts on a net basis. Nonetheless, we do not generally offset such financial instruments for financial reporting purposes.

Information about financial instruments that are eligible for offset in the consolidated balance sheet as of September 30, 2018 is presented in the following tables.

	Gross Amount Recognized	Gross Amount Offset	Net Amount Recognized
September 30, 2018			
Financial assets:			
Derivatives:			
Loan/lease interest rate swaps and caps	$ 7,413	$ —	$ 7,413
Commodity swaps and options	1,344	—	1,344
Foreign currency forward contracts	18	—	18
Total derivatives	8,775	—	8,775
Resell agreements	12,142	—	12,142
Total	$ 20,917	$ —	$ 20,917
Financial liabilities:			
Derivatives:			