CULLEN/FROST BANKERS, INC.
Form 10-Q
July 27, 2016
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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: June 30, 2016
Or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission file number: 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, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No ý
As of July 22, 2016 there were 62,107,408 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)

	June 30, 2016	December 31, 2015
Assets:		
Cash and due from banks	$572,287	$532,824
Interest-bearing deposits	2,726,094	2,991,782
Federal funds sold and resell agreements	66,842	66,917
Total cash and cash equivalents	3,365,223	3,591,523
Securities held to maturity, at amortized cost	2,339,602	2,663,009
Securities available for sale, at estimated fair value	10,044,033	9,206,358
Trading account securities	27,934	16,579
Loans, net of unearned discounts	11,584,182	11,486,531
Less: Allowance for loan losses	(149,714)	(135,859)
Net loans	11,434,468	11,350,672
Premises and equipment, net	564,199	559,124
Goodwill	654,668	654,668
Other intangible assets, net	7,517	8,800
Cash surrender value of life insurance policies	176,345	175,191
Accrued interest receivable and other assets	362,260	340,018
Total assets	$28,976,249	$28,565,942
Liabilities:		
Deposits:		
Non-interest-bearing demand deposits	$9,779,387	$10,270,233
Interest-bearing deposits	14,508,064	14,073,362
Total deposits	24,287,451	24,343,595
Federal funds purchased and repurchase agreements	733,160	893,522
Junior subordinated deferrable interest debentures, net of unamortized issuance costs	136,098	136,069
Other long-term borrowings, net of unamortized issuance costs	99,930	99,870
Accrued interest payable and other liabilities	582,942	202,543
Total liabilities	25,839,581	25,675,599
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 June 30, 2016 and December 31, 2015	144,486	144,486
Common stock, par value $0.01 per share; 210,000,000 shares authorized; 63,632,464 shares issued at June 30, 2016 and December 31, 2015	637	637
Additional paid-in capital	902,892	897,350
Retained earnings	1,914,022	1,845,188
Accumulated other comprehensive income, net of tax	281,357	113,863
Treasury stock, at cost; 1,583,056 shares at June 30, 2016 and 1,650,131 shares at December 31, 2015	(106,726)	(111,181)
Total shareholders' equity	3,136,668	2,890,343
Total liabilities and shareholders' equity	$28,976,249	$28,565,942

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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest income:				
Loans, including fees	$113,349	$108,105	$225,935	$213,771
Securities:				
Taxable	25,531	27,917	51,505	58,089
Tax-exempt	50,910	48,053	101,243	94,599
Interest-bearing deposits	3,602	1,836	7,255	3,806
Federal funds sold and resell agreements	59	21	117	41
Total interest income	193,451	185,932	386,055	370,306
Interest expense:				
Deposits	1,773	2,182	3,560	4,938
Federal funds purchased and repurchase agreements	52	38	108	74
Junior subordinated deferrable interest debentures	803	672	1,553	1,327
Other long-term borrowings	321	231	608	455
Total interest expense	2,949	3,123	5,829	6,794
Net interest income	190,502	182,809	380,226	363,512
Provision for loan losses	9,189	2,873	37,689	11,035
Net interest income after provision for loan losses	181,313	179,936	342,537	352,477
Non-interest income:				
Trust and investment management fees	26,021	26,472	51,355	53,633
Service charges on deposit accounts	19,865	20,033	40,229	39,810
Insurance commissions and fees	9,360	10,130	24,783	24,765
Interchange and debit card transaction fees	5,381	4,917	10,403	9,560
Other charges, commissions and fees	10,069	10,113	19,122	18,554
Net gain (loss) on securities transactions	—	—	14,903	228
Other	7,321	7,317	13,365	15,647
Total non-interest income	78,017	78,982	174,160	162,197
Non-interest expense:				
Salaries and wages	78,106	76,633	157,403	152,705
Employee benefits	17,712	17,339	38,017	37,566
Net occupancy	18,242	16,429	35,429	31,510
Furniture and equipment	17,978	15,649	35,495	31,183
Deposit insurance	4,197	3,563	7,854	7,176
Intangible amortization	619	849	1,283	1,743
Other	42,591	42,777	83,123	82,867
Total non-interest expense	179,445	173,239	358,604	344,750
Income before income taxes	79,885	85,679	158,093	169,924
Income taxes	8,406	12,602	17,835	24,684
Net income	71,479	73,077	140,258	145,240
Preferred stock dividends	2,015	2,015	4,031	4,031
Net income available to common shareholders	$69,464	$71,062	$136,227	$141,209

Earnings per common share:

Basic	$1.12	$1.12	$2.19	$2.23
Diluted	1.11	1.11	2.18	2.22

See Notes to Consolidated Financial Statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	$71,479	$73,077	$140,258	$145,240
Other comprehensive income (loss), before tax:				
Securities available for sale and transferred securities:				
Change in net unrealized gain/loss during the period	165,288	(113,268)	287,506	(78,741)
Change in net unrealized gain on securities transferred to held to maturity	(9,185)	(8,207)	(17,351)	(16,094)
Reclassification adjustment for net (gains) losses included in net income	—	—	(14,903)	(228)
Total securities available for sale and transferred securities	156,103	(121,475)	255,252	(95,063)
Defined-benefit post-retirement benefit plans:				
Change in the net actuarial gain/loss	1,553	1,749	3,106	3,498
Remeasurement of projected benefit obligation related to SERP	(862)	—	(862)	—
Reclassification adjustment for SERP settlement costs included in net income	187	—	187	—
Total defined-benefit post-retirement benefit plans	878	1,749	2,431	3,498
Other comprehensive income (loss), before tax	156,981	(119,726)	257,683	(91,565)
Deferred tax expense (benefit) related to other comprehensive income	54,943	(41,904)	90,189	(32,048)
Other comprehensive income (loss), net of tax	102,038	(77,822)	167,494	(59,517)
Comprehensive income (loss)	$173,517	$(4,745)	$307,752	$85,723

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)

	Six Months Ended June 30,	
	2016	2015
Total shareholders' equity at beginning of period	$2,890,343	$2,851,403
Net income	140,258	145,240
Other comprehensive income (loss)	167,494	(59,517)
Stock option exercises (67,075 shares in 2016 and 171,474 shares in 2015)	3,586	8,950
Stock compensation expense recognized in earnings	5,477	5,337
Tax benefits related to stock compensation	65	750
Purchase of treasury stock (140,571 shares in 2015)	—	(10,594)
Cash dividends – preferred stock (approximately $0.67 per share in both 2016 and in 2015)	(4,031)	(4,031)
Cash dividends – common stock ($1.07 per share in 2016 and $1.04 per share in 2015)	(66,524)	(65,871)
Total shareholders' equity at end of period	$3,136,668	$2,871,667

See Notes to Consolidated Financial Statements.

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

	Six Months Ended June 30,	
	2016	2015
Operating Activities:		
Net income	$140,258	$145,240
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	37,689	11,035
Deferred tax expense (benefit)	(9,633)	(7,404)
Accretion of loan discounts	(8,185)	(6,951)
Securities premium amortization (discount accretion), net	38,806	35,511
Net (gain) loss on securities transactions	(14,903)	(228)
Depreciation and amortization	23,823	20,175
Net (gain) loss on sale/write-down of assets/foreclosed assets	(596)	(845)
Stock-based compensation	5,477	5,337
Tax deficiency from stock-based compensation	(60)	(3)
Excess tax benefits from stock-based compensation	(125)	(753)
Earnings on life insurance policies	(1,745)	(1,814)
Net change in:		
Trading account securities	177	(212)
Accrued interest receivable and other assets	(26,795)	(64,974)
Accrued interest payable and other liabilities	(4,474)	(17,811)
Net cash from operating activities	179,714	116,303
Investing Activities:		
Securities held to maturity:		
Purchases	—	—
Sales	135,610	—
Maturities, calls and principal repayments	164,687	103,580
Securities available for sale:		
Purchases	(1,514,263)	(931,021)
Sales	1,060,196	223,987
Maturities, calls and principal repayments	165,883	471,195
Proceeds from sale of loans	30,470	—
Net change in loans	(144,192)	(410,449)
Benefits received on life insurance policies	591	—
Proceeds from sales of premises and equipment	1,516	10
Purchases of premises and equipment	(23,459)	(96,805)
Proceeds from sales of repossessed properties	297	3,947
Net cash from investing activities	(122,664)	(635,556)
Financing Activities:		
Net change in deposits	(56,144)	(294,776)
Net change in short-term borrowings	(160,362)	(210,755)
Proceeds from stock option exercises	3,586	8,950
Excess tax benefits from stock-based compensation	125	753
Purchase of treasury stock	—	(10,594)

Cash dividends paid on preferred stock	(4,031)	(4,031)
Cash dividends paid on common stock	(66,524)	(65,871)
Net cash from financing activities	(283,350)	(576,324)
Net change in cash and cash equivalents	(226,300)	(1,095,577)
Cash and equivalents at beginning of period	3,591,523	4,364,123
Cash and equivalents at end of period	$3,365,223	$3,268,546

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 our 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, 2015, included in our Annual Report on Form 10-K filed with the SEC on February 4, 2016 (the “2015 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:

	Six Months Ended June 30,	
	2016	2015
Cash paid for interest	$5,770	$6,845
Cash paid for income taxes	25,979	22,300
Significant non-cash transactions:		
Securities purchased not yet settled	306,564	50,567
Loans foreclosed and transferred to other real estate owned and foreclosed assets	422	161
Loans to facilitate the sale of other real estate owned	—	20

Reclassifications and Restatements. Certain items in prior financial statements have been reclassified to conform to the current presentation. In that regard, in connection with the adoption of a new accounting standard that requires unamortized debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, our consolidated balance sheet as of December 31, 2015 reflects a $1.2 million decrease in accrued interest receivable and other assets, a $1.0 million decrease in junior subordinated deferrable interest debentures and a $130 thousand decrease in other long-term borrowings.

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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.

	June 30, 2016				December 31, 2015			
	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								
U.S. Treasury	$249,661	$5,461	$—	$255,122	$249,441	$7,776	$—	$257,217
Residential mortgage-backed securities	5,156	63	—	5,219	6,456	63	4	6,515
States and political subdivisions	2,083,435	72,954	3,697	2,152,692	2,405,762	46,003	6,149	2,445,616
Other	1,350	—	—	1,350	1,350	—	13	1,337
Total	$2,339,602	$78,478	$ 3,697	$2,414,383	$2,663,009	$53,842	$ 6,166	$2,710,685
Available for Sale								
U.S. Treasury	$3,984,495	$135,522	$—	$4,120,017	$3,980,986	$22,041	$ 8,507	$3,994,520
Residential mortgage-backed securities	861,794	46,504	113	908,185	1,000,024	42,142	734	1,041,432
States and political subdivisions	4,695,526	277,835	7	4,973,354	3,996,113	133,305	1,459	4,127,959
Other	42,477	—	—	42,477	42,447	—	—	42,447
Total	$9,584,292	$459,861	$ 120	$10,044,033	$9,019,570	$197,488	$ 10,700	$9,206,358

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. At June 30, 2016, approximately 97.9% of the securities in our municipal bond portfolio were issued by political subdivisions or agencies within the State of Texas, of which approximately 68.1% are either guaranteed by the Texas Permanent School Fund, which has a “triple A” insurer financial strength rating, or secured by U.S. Treasury securities via defeasance of the debt by the issuers. Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost 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 $3.3 billion at June 30, 2016 and $3.9 billion and December 31, 2015.

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. Some of these securities were sold during the first quarter of 2016, as more fully discussed below. The net unamortized, unrealized gain on the remaining transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of June 30, 2016 totaled $42.6 million ($27.7 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.

Unrealized Losses. As of June 30, 2016, 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	$—	$ —	$—	$ —	$—	$ —
States and political subdivisions	37,489	512	154,689	3,185	192,178	3,697
Total	$37,489	$ 512	$154,689	$ 3,185	$192,178	$ 3,697
Available for Sale						
Residential mortgage-backed securities	$139	$ 3	$16,844	$ 110	$16,983	$ 113
States and political subdivisions	10,340	7	—	—	10,340	7
Total	$10,479	$ 10	$16,844	$ 110	$27,323	$ 120

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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 will receive full value for the securities. Furthermore, as of June 30, 2016, 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 largely 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 bonds 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 June 30, 2016, 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 June 30, 2016 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	$608,032	$621,611	$59,059	$59,905
Due after one year through five years	349,978	371,006	3,778,355	3,873,477
Due after five years through ten years	277,818	287,257	1,204,980	1,282,404
Due after ten years	1,098,618	1,129,290	3,637,627	3,877,585
Residential mortgage-backed securities	5,156	5,219	861,794	908,185
Equity securities	—	—	42,477	42,477
Total	$2,339,602	$2,414,383	$9,584,292	$10,044,033

Sales of Securities. During the first quarter of 2016, a portion of the securities we sold included certain securities that were issued by municipalities and special-purpose districts under municipal control (together referred to as “municipalities”) within the State of Texas that have been significantly impacted by the significant decline in market oil prices due to the fact that their tax bases are heavily reliant on the energy industry relative to other sectors of the economy. Specifically, the revenues of these municipalities have been adversely impacted by the sustained low-level of oil prices. Additionally, some of these municipalities had been put on credit watch and subsequently received downgrades by credit rating agencies. In consideration of this, along with our own internal credit analysis, we determined that the creditworthiness of these municipalities had significantly deteriorated and that it was reasonably possible that all amounts due would not be collected. Because this increased risk exposure exceeded acceptable levels, we sold certain securities issued by those municipalities. We did not sell any securities issued by these municipalities that are either guaranteed by the Texas Permanent School Fund or secured by U.S. Treasury securities via defeasance of the debt by the issuers because, as a result of these credit enhancements, the collectibility of these securities is not in doubt. Some of the securities we sold were classified as held to maturity prior to their sale. Despite their classification as held to maturity, we believe the sale of these securities was merited and permissible under the applicable accounting guidelines because of the significant deterioration in the creditworthiness of the issuers.

Sales of securities held to maturity were as follows:

	Three Months Ended	Six Months Ended June 30,

	June 30, 2016	2015	2016	2015
Proceeds from sales	$ —	$ —	$ 135,610	$ —
Amortized cost	—	—	131,840	—
Gross realized gains	—	—	3,770	—
Gross realized losses	—	—	—	—
Tax (expense) benefit of securities gains/losses	—	—	(1,319)	—

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Sales of securities available for sale were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Proceeds from sales	$ —	$ —	$1,060,196	$223,987
Gross realized gains	—	—	11,133	228
Gross realized losses	—	—	—	—
Tax (expense) benefit of securities gains/losses	—	—	(3,897)	(80)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Premium amortization	$(22,219)	$(20,832)	$(44,559)	$(40,838)
Discount accretion	3,138	2,629	5,753	5,327
Net (premium amortization) discount accretion	$(19,081)	$(18,203)	$(38,806)	$(35,511)

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

	June 30, 2016	December 31, 2015
U.S. Treasury	$13,381	$ 16,443
States and political subdivisions	14,553	136
Total	$27,934	$ 16,579

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net gain on sales transactions	$351	$278	$653	$558
Net mark-to-market gains (losses)	(2)	(32)	(1)	(46)
Net gain (loss) on trading account securities	$349	$246	$652	$512

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Note 3 - Loans

Loans were as follows:

	June 30, 2016	Percentage of Total	December 31, 2015	Percentage of Total
Commercial and industrial	$4,253,822	36.7 %	$4,120,522	35.9 %
Energy:				
Production	1,059,524	9.1	1,249,678	10.9
Service	226,637	2.0	272,934	2.4
Other	217,447	1.9	235,583	2.0
Total energy	1,503,608	13.0	1,758,195	15.3
Commercial real estate:				
Commercial mortgages	3,380,524	29.2	3,285,041	28.6
Construction	804,341	6.9	720,695	6.3
Land	290,752	2.5	286,991	2.5
Total commercial real estate	4,475,617	38.6	4,292,727	37.4
Consumer real estate:				
Home equity loans	340,196	3.0	340,528	3.0
Home equity lines of credit	248,812	2.1	233,525	2.0
Other	312,142	2.7	306,696	2.6
Total consumer real estate	901,150	7.8	880,749	7.6
Total real estate	5,376,767	46.4	5,173,476	45.0
Consumer and other	449,985	3.9	434,338	3.8
Total loans	$11,584,182	100.0 %	$11,486,531	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 June 30, 2016, there were no concentrations of loans related to any single industry in excess of 10% of total loans other than energy loans, which totaled 13.0% 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 $60.8 million, respectively, as of June 30, 2016.

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 June 30, 2016 or December 31, 2015.

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

	June 30, 2016	December 31, 2015
Commercial and industrial	$27,955	$ 25,111
Energy	42,755	21,180
Commercial real estate:		
Buildings, land and other	11,469	34,519
Construction	551	569
Consumer real estate	2,132	1,862
Consumer and other	268	226
Total	$85,130	$ 83,467

As of June 30, 2016, non-accrual loans reported in the table above included $21.0 million related to loans that were restructured as "troubled debt restructurings" during 2016. See the section captioned "Troubled Debt Restructurings" elsewhere in this note. Had non-accrual loans performed in accordance with their original contract terms, we would have recognized additional interest income, net of tax, of approximately $936 thousand and $1.8 million for the three and six months ended June 30, 2016, compared to $364 thousand and $760 thousand for three and six months ended June 30, 2015.

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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 June 30, 2016 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	$ 33,273	$ 31,096	$64,369	$4,189,453	$4,253,822	$ 12,802
Energy	24,335	17,332	41,667	1,461,941	1,503,608	11,393
Commercial real estate:						
Buildings, land and other	22,458	8,124	30,582	3,640,694	3,671,276	3,731
Construction	2,074	326	2,400	801,941	804,341	—
Consumer real estate	3,168	1,996	5,164	895,986	901,150	1,573
Consumer and other	4,739	912	5,651	444,334	449,985	853
Total	$ 90,047	$ 59,786	$149,833	$11,434,349	$11,584,182	$ 30,352

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
June 30, 2016					
Commercial and industrial	$ 32,079	$ 18,723	$ 6,251	$ 24,974	$ 4,727
Energy	51,030	34,217	8,410	42,627	2,500
Commercial real estate:					
Buildings, land and other	14,131	7,840	1,680	9,520	875
Construction	326	326	—	326	—
Consumer real estate	725	428	—	428	—
Consumer and other	103	54	—	54	—
Total	$ 98,394	$ 61,588	$ 16,341	$ 77,929	$ 8,102
December 31, 2015					
Commercial and industrial	$ 26,067	$ 18,776	$ 4,084	$ 22,860	$ 2,378
Energy	25,240	8,689	12,450	21,139	2,000
Commercial real estate:					
Buildings, land and other	37,126	32,425	—	32,425	—
Construction	793	569	—	569	—
Consumer real estate	755	485	—	485	—
Consumer and other	—	—	—	—	—
Total	$ 89,981	$ 60,944	$ 16,534	$ 77,478	$ 4,378

The average recorded investment in impaired loans was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Commercial and industrial	$24,866	$29,680	$24,197	$30,406
Energy	78,359	636	59,286	636
Commercial real estate:				
Buildings, land and other	20,533	14,028	24,497	15,254
Construction	648	1,497	622	1,929
Consumer real estate	443	859	457	771

Consumer and other	27	—	18	—
Total	$124,876	$46,700	$109,077	$48,996

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Troubled Debt Restructurings. Troubled debt restructurings during the six months ended June 30, 2016 and June 30, 2015 are set forth in the following table.

	Six Months Ended June 30, 2016		Six Months Ended June 30, 2015	
	Balance at Restructure	Balance at Period-End	Balance at Restructure	Balance at Period-End
Commercial and industrial	$510	$ 505	$709	$ 584
Energy	62,546	20,795	—	—
Commercial real estate:				
Buildings, land and other	1,456	1,456	—	—
Construction	243	224	—	—
	$64,755	$ 22,980	$709	$ 584

The modifications during the six months ended June 30, 2016 primarily related to extending amortization periods, converting loans to interest only for a period of time, deferral of interest payments and the waiver of certain covenants, while the modifications during the six months ended June 30, 2015 primarily related to extending amortization periods and a temporary reduction in payments. The modifications during the reported periods did not significantly impact our determination of the allowance for loan losses. During the second quarter of 2016, we recognized a charge-off of $9.5 million related to a loan restructured during the first quarter of 2016. The loan was subsequently sold with proceeds from the sale totaling $30.5 million.

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 2015 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. The following tables present weighted average risk grades for all commercial loans by class.

	June 30, 2016		December 31, 2015	
	Weighted Average Risk Grade	Loans	Weighted Average Risk Grade	Loans
Commercial and industrial:				
Risk grades 1-8	5.95	$3,953,406	5.88	$3,869,203
Risk grade 9	9.00	98,610	9.00	100,670
Risk grade 10	10.00	88,370	10.00	76,030
Risk grade 11	11.00	85,456	11.00	49,508
Risk grade 12	12.00	23,041	12.00	22,644
Risk grade 13	13.00	4,939	13.00	2,467
Total	6.25	$4,253,822	6.13	$4,120,522
Energy				

Risk grades 1-8	6.19	$812,591	6.12	$1,385,749
Risk grade 9	9.00	124,776	9.00	212,250
Risk grade 10	10.00	295,723	10.00	62,163
Risk grade 11	11.00	227,763	11.00	76,853
Risk grade 12	12.00	40,255	12.00	19,180
Risk grade 13	13.00	2,500	13.00	2,000
Total	8.07	$1,503,608	6.89	$1,758,195

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(continued)	June 30, 2016		December 31, 2015	
	Weighted Average Risk Grade	Loans	Weighted Average Risk Grade	Loans
Commercial real estate:				
Buildings, land and other				
Risk grades 1-8	6.62	$3,375,360	6.58	$3,280,435
Risk grade 9	9.00	122,532	9.00	140,900
Risk grade 10	10.00	77,356	10.00	72,577
Risk grade 11	11.00	84,559	11.00	43,601
Risk grade 12	12.00	10,594	12.00	34,519
Risk grade 13	13.00	875	13.00	—
Total	6.89	$3,671,276	6.85	$3,572,032
Construction				
Risk grades 1-8	7.05	$794,323	6.91	$696,229
Risk grade 9	9.00	7,818	9.00	13,074
Risk grade 10	10.00	1,598	10.00	2,757
Risk grade 11	11.00	51	11.00	8,066
Risk grade 12	12.00	551	12.00	569
Risk grade 13	13.00	—	13.00	—
Total	7.08	$804,341	7.01	$720,695

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Commercial and industrial	$(3,966)	$(1,683)	$(5,098)	$(2,535)
Energy	(16,747)	1	(17,758)	3
Commercial real estate:				
Buildings, land and other	481	279	542	(28)
Construction	2	15	9	16
Consumer real estate	74	81	173	53
Consumer and other	(1,199)	(667)	(1,702)	(1,479)
Total	$(21,355)	$(1,974)	$(23,834)	$(3,970)

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 2015 Form 10-K, totaled 122.9 at May 31, 2016 (most recent date available) and 123.0 at December 31, 2015. 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 2015 Form 10-K and below for changes made during the first quarter of 2016, 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.

During the first quarter of 2016, we changed the way we estimate valuation allowances for consumer and other loans, particularly overdrafts. Prior to 2016, we used a single, combined historical loss allocation factor for all consumer and other loans, which included overdrafts. In 2016, we began using two separate historical loss allocation factors for consumer and other loans, one historical loss allocation factor for consumer and other loans, excluding overdrafts, and a separate historical loss allocation factor for overdrafts. While the effect of this change resulted in a decrease in the estimated valuation allowances needed for consumer and other loans, the impact of the change was not significant to our overall allocation of the allowance for loan losses.

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The following table presents details of the allowance for loan losses allocated to each portfolio segment as of June 30, 2016 and December 31, 2015 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
June 30, 2016						
Historical valuation allowances	$ 30,005	$42,179	$ 15,886	$ 2,160	$4,468	$94,698
Specific valuation allowances	4,727	2,500	875	—	—	8,102
General valuation allowances	5,147	3,762	3,215	1,284	(234)	13,174
Macroeconomic valuation allowances	7,699	17,898	7,087	491	565	33,740
Total	$ 47,578	$66,339	$ 27,063	$ 3,935	$4,799	$149,714
Allocated to loans:						
Individually evaluated	$ 4,727	$2,500	$ 875	$ —	$—	$8,102
Collectively evaluated	42,851	63,839	26,188	3,935	4,799	141,612
Total	$ 47,578	$66,339	$ 27,063	$ 3,935	$4,799	$149,714
December 31, 2015						
Historical valuation allowances	$ 25,428	$21,195	$ 15,544	$ 2,109	$12,813	$77,089
Specific valuation allowances	2,378	2,000	—	—	—	4,378
General valuation allowances	7,339	5,525	4,619	2,052	(6,932)	12,603
Macroeconomic valuation allowances	7,848	25,976	4,150	498	3,317	41,789
Total	$ 42,993	$54,696	$ 24,313	$ 4,659	$9,198	$135,859
Allocated to loans:						
Individually evaluated	$ 2,378	$2,000	$ —	$ —	$—	$4,378
Collectively evaluated	40,615	52,696	24,313	4,659	9,198	131,481
Total	$ 42,993	$54,696	$ 24,313	$ 4,659	$9,198	$135,859

Our recorded investment in loans as of June 30, 2016 and December 31, 2015 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
June 30, 2016						
Individually evaluated	$24,974	$42,627	$9,846	$428	$54	$77,929
Collectively evaluated	4,228,848	1,460,981	4,465,771	900,722	449,931	11,506,253
Total	$4,253,822	$1,503,608	$4,475,617	$901,150	$449,985	$11,584,182
December 31, 2015						
Individually evaluated	$22,860	$21,139	$32,994	$485	$—	$77,478
Collectively evaluated	4,097,662	1,737,056	4,259,733	880,264	434,338	11,409,053
Total	$4,120,522	$1,758,195	$4,292,727	$880,749	$434,338	$11,486,531

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The following table details activity in the allowance for loan losses by portfolio segment for the three and six months ended June 30, 2016 and 2015. 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:						
June 30, 2016						
Beginning balance	$ 45,084	$84,973	$ 23,587	$ 3,786	$ 4,450	$161,880
Provision for loan losses	6,460	(1,887)	2,993	75	1,548	9,189
Charge-offs	(4,857)	(16,749)	(19)	(23)	(3,252)	(24,900)
Recoveries	891	2	502	97	2,053	3,545
Net charge-offs	(3,966)	(16,747)	483	74	(1,199)	(21,355)
Ending balance	$ 47,578	$66,339	$ 27,063	$ 3,935	$ 4,799	$149,714
June 30, 2015						
Beginning balance	$ 43,767	$20,946	$ 27,105	$ 4,907	$ 8,983	$105,708
Provision for loan losses	341	5,353	(2,464)	(286)	(71)	2,873
Charge-offs	(2,374)	—	—	(21)	(2,692)	(5,087)
Recoveries	691	1	294	102	2,025	3,113
Net charge-offs	(1,683)	1	294	81	(667)	(1,974)
Ending balance	$ 42,425	$26,300	$ 24,935	$ 4,702	$ 8,245	$106,607
Six months ended:						
June 30, 2016						
Beginning balance	$ 42,993	$54,696	$ 24,313	$ 4,659	$ 9,198	$135,859
Provision for loan losses	9,683	29,401	2,199	(897)	(2,697)	37,689
Charge-offs	(6,718)	(17,760)	(47)	(177)	(5,976)	(30,678)
Recoveries	1,620	2	598	350	4,274	6,844
Net charge-offs	(5,098)	(17,758)	551	173	(1,702)	(23,834)
Ending balance	$ 47,578	$66,339	$ 27,063	$ 3,935	$ 4,799	$149,714
June 30, 2015						
Beginning balance	$ 44,273	$14,919	$ 27,163	$ 5,178	$ 8,009	$99,542
Provision for loan losses	687	11,378	(2,216)	(529)	1,715	11,035
Charge-offs	(4,506)	—	(478)	(101)	(5,497)	(10,582)
Recoveries	1,971	3	466	154	4,018	6,612
Net charge-offs	(2,535)	3	(12)	53	(1,479)	(3,970)
Ending balance	$ 42,425	$26,300	$ 24,935	$ 4,702	$ 8,245	$106,607

Note 4 - Goodwill and Other Intangible Assets

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

	June 30, 2016	December 31, 2015
Goodwill	$654,668	$ 654,668
Other intangible assets:		
Core deposits	$6,128	$ 7,086
Customer relationships	1,314	1,557
Non-compete agreements	75	157
	$7,517	$ 8,800

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The estimated aggregate future amortization expense for intangible assets remaining as of June 30, 2016 is as follows:

Remainder of 2016	$1,130
2017	1,619
2018	1,346
2019	1,102
2020	877
Thereafter	1,443
	$7,517

Note 5 - Deposits

Deposits were as follows:

	June 30, 2016	Percentage of Total		December 31, 2015	Percentage of Total	
Non-interest-bearing demand deposits:						
Commercial and individual	$8,925,728	36.8	%	$9,251,463	38.0	%
Correspondent banks	299,653	1.2		378,930	1.6	
Public funds	554,006	2.3		639,840	2.6	
Total non-interest-bearing demand deposits	9,779,387	40.3		10,270,233	42.2	
Interest-bearing deposits:						
Private accounts:						
Savings and interest checking	5,823,049	24.0		5,149,905	21.1	
Money market accounts	7,435,743	30.6		7,536,998	31.0	
Time accounts of $100,000 or more	412,333	1.7		420,697	1.7	
Time accounts under $100,000	394,882	1.6		405,726	1.7	
Total private accounts	14,066,007	57.9		13,513,326	55.5	
Public funds:						
Savings and interest checking	320,571	1.3		420,324	1.7	
Money market accounts	103,084	0.4		93,969	0.4	
Time accounts of $100,000 or more	17,648	0.1		44,941	0.2	
Time accounts under $100,000	754	—		802	—	
Total public funds	442,057	1.8		560,036	2.3	
Total interest-bearing deposits	14,508,064	59.7		14,073,362	57.8	
Total deposits	$24,287,451	100.0	%	$24,343,595	100.0	%

The following table presents additional information about our deposits:

	June 30, 2016	December 31, 2015
Deposits from the Certificate of Deposit Account Registry Service (CDARS)	$ —	$ 2,615
Deposits from the Promontory Interfinancial Network Insured Cash Sweep Service (acquired in the acquisition of WNB Bancshares, Inc.)	—	7,440
Deposits from foreign sources (primarily Mexico)	760,918	747,008
Deposits not covered by deposit insurance	11,672,042	11,953,367

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 2015 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.

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

	June 30, 2016	December 31, 2015
Commitments to extend credit	$6,979,193	$ 6,798,598
Standby letters of credit	246,867	277,158
Deferred standby letter of credit fees	1,883	2,115

Lease Commitments. We lease certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled $7.6 million and $15.1 million during the three and six months ended June 30, 2016 and $7.6 million and $15.3 million during the three and six months ended June 30, 2015. There has been no significant change in our expected future minimum lease payments since December 31, 2015. See the 2015 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 June 30, 2016 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 June 30, 2016 or December 31, 2015. At December 31, 2015, $33.3 million of trust preferred securities were included in Cullen/Frost's additional Tier 1 capital. Beginning January 1, 2016, trust preferred securities may not be included in Tier 1 capital. Trust preferred securities excluded from additional Tier 1 capital may be included in Tier 2 capital, without limitation.

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 trust preferred securities that were excluded from Tier 1 capital and qualified subordinated debt. Cullen/Frost's Tier 2 capital included $133.0 million and $99.8 million of trust preferred securities at June 30, 2016 and December 31, 2015, respectively. At December 31, 2015, Tier 2 capital for Cullen/Frost included $20.0 million related to the permissible portion of our aggregate $100.0 million of floating rate subordinated notes. The permissible portion of the notes decreases 20% per year during the final five years of the term of the notes. The notes mature on February 15, 2017 and no longer qualify as Tier 2 capital.

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The following table presents actual and required capital ratios 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 June 30, 2016 and December 31, 2015 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 2015 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
June 30, 2016								
Common Equity Tier 1 to Risk-Weighted Assets								
Cullen/Frost	$2,065,635	11.90%	$889,931	5.125%	$1,215,306	7.00 %	$1,128,693	6.50 %
Frost Bank	2,207,967	12.76	886,974	5.125	1,211,267	7.00	1,124,942	6.50
Tier 1 Capital to Risk-Weighted Assets								
Cullen/Frost	2,210,121	12.73	1,150,399	6.625	1,475,729	8.50	1,389,160	8.00
Frost Bank	2,207,967	12.76	1,146,576	6.625	1,470,824	8.50	1,384,544	8.00
Total Capital to Risk-Weighted Assets								
Cullen/Frost	2,492,835	14.36	1,497,689	8.625	1,822,960	10.50	1,736,451	10.00
Frost Bank	2,357,681	13.62	1,492,712	8.625	1,816,901	10.50	1,730,680	10.00
Leverage Ratio								
Cullen/Frost	2,210,121	8.13	1,087,126	4.00	1,087,007	4.00	1,358,908	5.00
Frost Bank	2,207,967	8.13	1,085,798	4.00	1,085,678	4.00	1,357,247	5.00
December 31, 2015								
Common Equity Tier 1 to Risk-Weighted Assets								
Cullen/Frost	$1,986,200	11.37%	$786,344	4.50 %	$1,222,837	7.00 %	$1,135,830	6.50 %
Frost Bank	2,131,360	12.24	783,727	4.50	1,218,766	7.00	1,132,049	6.50
Tier 1 Capital to Risk-Weighted Assets								
Cullen/Frost	2,163,936	12.38	1,048,458	6.00	1,484,874	8.50	1,397,944	8.00
Frost Bank	2,131,360	12.24	1,044,969	6.00	1,479,930	8.50	1,393,292	8.00
Total Capital to Risk-Weighted Assets								
Cullen/Frost	2,419,545	13.85	1,397,944	8.00	1,834,256	10.50	1,747,430	10.00
Frost Bank	2,267,219	13.02	1,393,292	8.00	1,828,149	10.50	1,741,615	10.00
Leverage Ratio								
Cullen/Frost	2,163,936	7.79	1,111,325	4.00	1,111,117	4.00	1,389,156	5.00
Frost Bank	2,131,360	7.68	1,110,143	4.00	1,109,935	4.00	1,387,679	5.00

As of June 30, 2016, 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 June 30, 2016 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 June 30, 2016, 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 awards. We did not have any active stock repurchase plans as of June 30, 2016.

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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 June 30, 2016, Frost Bank could pay aggregate dividends of up to $400.5 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.

Merger or Acquisition Transactions. Our ability to engage in certain merger or acquisition transactions, whether or not any regulatory approval is required, will be dependent upon our bank regulators' views at the time as to capital levels, quality of management and our overall condition and their assessment of a variety of other factors. Certain merger or acquisition transactions, including those involving the acquisition of a depository institution or the assumption of the deposits of any depository institution, require formal approval from various bank regulatory authorities, which will be subject to a variety of factors and considerations. As part of the approval process in connection with the acquisition of WNB Bancshares, Inc. in 2014, we agreed with the Federal Reserve Board that before bringing it any further expansionary proposals, except for proposed branches serving majority minority areas within our existing markets, we would enhance certain compliance programs, including those related to fair lending (the “WNB Commitment”). As of May 27, 2016, the Federal Reserve Board has released us from the expansionary restrictions set forth in the WNB Commitment.

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 2015 Form 10-K.

The notional amounts and estimated fair values of interest rate derivative contracts are presented in the following table. We obtain dealer quotations to value our interest rate derivative contracts designated as hedges of cash flows, while the fair values of other interest rate derivative contracts are estimated utilizing internal calculation methods with observable market data inputs.

	June 30, 2016		December 31, 2015	
	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	$ —	$ —	$ 49,927	$ 358
Loan/lease interest rate swaps – liabilities	73,566	(2,586)	31,038	(2,301)
Non-hedging interest rate derivatives:				
Financial institution counterparties:				

Loan/lease interest rate swaps – assets	—	—	62,887	278
Loan/lease interest rate swaps – liabilities	860,916	(61,070)	768,182	(37,522)
Loan/lease interest rate caps – assets	74,203	273	74,281	682
Customer counterparties:				
Loan/lease interest rate swaps – assets	860,916	61,071	780,082	37,630
Loan/lease interest rate swaps – liabilities	—	—	50,987	(188)
Loan/lease interest rate caps – liabilities	74,203	(273)	74,281	(682)

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The weighted-average rates paid and received for interest rate swaps outstanding at June 30, 2016 were as follows:

	Weighted-Average Interest Rate Paid	Interest Rate Received
Interest rate swaps:		
Fair value hedge loan/lease interest rate swaps	2.28 %	0.45 %
Non-hedging interest rate swaps – financial institution counterparties	4.03 %	2.20 %
Non-hedging interest rate swaps – customer counterparties	2.20 %	4.03 %

The weighted-average strike rate for outstanding interest rate caps was 2.41% at June 30, 2016.

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.

		June 30, 2016		December 31, 2015	
	Notional Units	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Financial institution counterparties:					
Oil – assets	Barrels	912	$ 3,176	1,184	$ 12,650
Oil – liabilities	Barrels	627	(3,023)	45	(352)
Natural gas – assets	MMBTUs	—	—	760	560
Natural gas – liabilities	MMBTUs	3,325	(1,946)	—	—
Customer counterparties:					
Oil – assets	Barrels	627	3,128	45	354
Oil – liabilities	Barrels	912	(3,044)	1,184	(12,454)
Natural gas – assets	MMBTUs	3,325	2,031	—	—
Natural gas – liabilities	MMBTUs	—	—	760	(549)

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:

		June 30, 2016		December 31, 2015	
	Notional Currency	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Financial institution counterparties:					
Forward contracts – assets	EUR	—	$ —	1,247	$ 13
Forward contracts – assets	GBP	469	2	568	2
Forward contracts – liabilities	EUR	933	(4)	572	(18)
Forward contracts – liabilities	CAD	2,310	(11)	1,440	(5)
Customer counterparties:					
Forward contracts – assets	EUR	—	—	575	22

Forward contracts – assets	CAD	2,302	19	1,437	9
Forward contracts – liabilities	EUR	—	—	343	(5)

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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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Commercial loan/lease interest rate swaps:				
Amount of gain (loss) included in interest income on loans	$(338)	$(463)	$(726)	$(888)
Amount of (gain) loss included in other non-interest expense	(7)	6	(7)	6

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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Non-hedging interest rate derivatives:				
Other non-interest income	$979	$240	$1,414	$1,562
Other non-interest expense	—	(5)	—	(3)
Non-hedging commodity derivatives:				
Other non-interest income	13	38	145	66
Non-hedging foreign currency derivatives:				
Other non-interest income	8	66	14	111

Counterparty Credit Risk. Our credit exposure relating to interest rate swaps, commodity swaps/options and foreign currency forward contracts with bank customers was approximately $64.8 million at June 30, 2016. 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 $8.7 million at June 30, 2016. 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 $36.7 million at June 30, 2016. At such date, we also had $34.9 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 June 30, 2016 is presented in the following tables.

	Gross Amount Recognized	Gross Amount Offset	Net Amount Recognized
June 30, 2016			
Financial assets:			
Derivatives:			
Loan/lease interest rate swaps and caps	$ 273	$ —	$ 273
Commodity swaps and options	3,176	—	3,176
Foreign currency forward contracts	2	—	2
Total derivatives	3,451	—	3,451
Resell agreements	14,142	—	14,142
Total	$ 17,593	$ —	$ 17,593
Financial liabilities:			
Derivatives:			
Loan/lease interest rate swaps	$ 63,656	$ —	$ 63,656
Commodity swaps and options	4,969	—	4,969
Foreign currency forward contracts	15	—	15
Total derivatives	68,640	—	68,640
Repurchase agreements	720,860	—	720,860
Total	$ 789,500	$ —	$ 789,500

	Net Amount Recognized	Gross Amounts Not Offset		Net Amount
		Financial Instruments	Collateral	
June 30, 2016				
Financial assets:				
Derivatives:				
Counterparty A	$ 196	$(196)	$—	$—
Counterparty B	2,139	(2,139)	—	—
Counterparty C	1,038	(1,038)	—	—
Other counterparties	78	(78)	—	—
Total derivatives	3,451	(3,451)	—	—
Resell agreements	14,142	—	(14,142)	—
Total	$ 17,593	$(3,451)	$(14,142)	$—
Financial liabilities:				
Derivatives:				
Counterparty A	$ 20,942	$(196)	$(20,746)	$—
Counterparty B	10,815	(2,139)	(7,776)	900
Counterparty C	4,501	(1,038)	(3,002)	461
Other counterparties	32,382	(78)	(31,373)	931

Total derivatives	68,640	(3,451)	(62,897)	2,292
Repurchase agreements	720,860	—	(720,860)	—
Total	$ 789,500	$(3,451)	$(783,757)	$ 2,292

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Information about financial instruments that are eligible for offset in the consolidated balance sheet as of December 31, 2015 is presented in the following tables.

	Gross Amount Recognized	Gross Amount Offset	Net Amount Recognized
December 31, 2015			
Financial assets:			
Derivatives:			
Loan/lease interest rate swaps and caps	$ 1,318	$ —	$ 1,318
Commodity swaps and options	13,210	—	13,210
Foreign currency forward contracts	15	—	15
Total derivatives	14,543	—	14,543
Resell agreements	13,442	—	13,442
Total	$ 27,985	$ —	$ 27,985
Financial liabilities:			
Derivatives:			
Loan/lease interest rate swaps	$ 39,823	$ —	$ 39,823
Commodity swaps and options	352	—	352
Foreign currency forward contracts	23	—	23
Total derivatives	40,198	—	40,198
Repurchase agreements	883,947	—	883,947
Total	$ 924,145	$ —	$ 924,145

	Net Amount Recognized	Gross Amounts Not Offset: Financial Instruments	Gross Amounts Not Offset: Collateral	Net Amount
December 31, 2015				
Financial assets:				
Derivatives:				
Counterparty A	$ 743	$ (743)	$ —	$ —
Counterparty B	6,901	(5,795)	(413)	693
Counterparty C	6,059	(3,447)	(2,312)	300
Other counterparties	840	(840)	—	—
Total derivatives	14,543	(10,825)	(2,725)	993
Resell agreements	13,442	—	(13,442)	—
Total	$ 27,985	$ (10,825)	$ (16,167)	$ 993
Financial liabilities:				
Derivatives:				
Counterparty A	$ 16,092	$ (743)	$ (15,347)	$ 2
Counterparty B	5,795	(5,795)	—	—
Counterparty C	3,447	(3,447)	—	—
Other counterparties	14,864	(840)	(13,456)	568
Total derivatives	40,198	(10,825)	(28,803)	570
Repurchase agreements	883,947	—	(883,947)	—
Total	$ 924,145	$ (10,825)	$ (912,750)	$ 570

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Repurchase Agreements. We utilize securities sold under agreements to repurchase to facilitate the needs of our customers and to facilitate secured short-term funding needs. Securities sold under agreements to repurchase are stated at the amount of cash received in connection with the transaction. We monitor collateral levels on a continuous basis. We may be required to provide additional collateral based on the fair value of the underlying securities. Securities pledged as collateral under repurchase agreements are maintained with our safekeeping agents.

The remaining contractual maturity of repurchase agreements in the consolidated balance sheets as of June 30, 2016 and December 31, 2015 is presented in the following tables.

	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater than 90 Days	Total
June 30, 2016					
Repurchase agreements:					
U.S. Treasury	$595,461	$ —	$—	$ —	$595,461
Residential mortgage-backed securities	125,399	—	—	—	125,399
Total borrowings	$720,860	$ —	$—	$ —	$720,860
Gross amount of recognized liabilities for repurchase agreements					$720,860
Amounts related to agreements not included in offsetting disclosures above					$—
December 31, 2015					
Repurchase agreements:					
U.S. Treasury	$664,419	$ —	$—	$ —	$664,419
Residential mortgage-backed securities	211,501	—	8,027	—	219,528
Total borrowings	$875,920	$ —	$8,027	$ —	$883,947
Gross amount of recognized liabilities for repurchase agreements					$883,947
Amounts related to agreements not included in offsetting disclosures above					