

CULLEN/FROST BANKERS, INC.

Form 10-Q

July 30, 2014

Table of Contents

United States

Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: June 30, 2014

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

(I.R.S. Employer

incorporation or organization)

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 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 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 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

As of July 23, 2014 there were 62,971,193 shares of the registrant's Common Stock, \$.01 par value, outstanding.

Table of Contents

Cullen/Frost Bankers, Inc.
 Quarterly Report on Form 10-Q
 June 30, 2014
 Table of Contents

	Page
<u>Part I - Financial Information</u>	
Item 1.	
<u>Financial Statements (Unaudited)</u>	
<u>Consolidated Balance Sheets</u>	<u>3</u>
<u>Consolidated Statements of Income</u>	<u>4</u>
<u>Consolidated Statements of Comprehensive Income</u>	<u>5</u>
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
Item 2.	<u>44</u>
Management's Discussion and Analysis of Financial Condition and Results of Operations	
Item 3.	<u>65</u>
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	
Item 4.	<u>66</u>
<u>Controls and Procedures</u>	
<u>Part II - Other Information</u>	
Item 1.	<u>67</u>
<u>Legal Proceedings</u>	
Item 1A.	<u>67</u>
<u>Risk Factors</u>	
Item 2.	<u>67</u>
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	
Item 3.	<u>67</u>
<u>Defaults Upon Senior Securities</u>	
Item 4.	<u>67</u>
<u>Mine Safety Disclosures</u>	
Item 5.	<u>67</u>
<u>Other Information</u>	
Item 6.	<u>67</u>
<u>Exhibits</u>	
<u>Signatures</u>	<u>68</u>

Table of Contents

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, 2014	December 31, 2013
Assets:		
Cash and due from banks	\$809,582	\$885,121
Interest-bearing deposits	4,193,255	3,646,756
Federal funds sold and resell agreements	17,773	24,248
Total cash and cash equivalents	5,020,610	4,556,125
Securities held to maturity, at amortized cost	3,065,867	3,139,748
Securities available for sale, at estimated fair value	6,322,943	5,895,436
Trading account securities	15,489	16,398
Loans, net of unearned discounts	10,679,377	9,515,700
Less: Allowance for loan losses	(98,286	) (92,438
Net loans	10,581,091	9,423,262
Premises and equipment, net	369,158	313,331
Goodwill	649,020	536,649
Other intangible assets, net	15,700	6,345
Cash surrender value of life insurance policies	170,245	141,108
Accrued interest receivable and other assets	313,316	284,537
Total assets	\$26,523,439	\$24,312,939
Liabilities:		
Deposits:		
Non-interest-bearing demand deposits	\$9,507,581	\$8,311,149
Interest-bearing deposits	13,009,025	12,377,637
Total deposits	22,516,606	20,688,786
Federal funds purchased and repurchase agreements	612,991	668,253
Junior subordinated deferrable interest debentures	137,115	123,712
Other long-term borrowings	100,000	100,000
Accrued interest payable and other liabilities	386,053	218,027
Total liabilities	23,752,765	21,798,778
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, 2014 and December 31, 2013	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, 2014 and 61,632,464 shares issued at December 31, 2013	637	617
Additional paid-in capital	879,580	724,197
Retained earnings	1,630,799	1,575,282
Accumulated other comprehensive income, net of tax	160,468	140,434
Treasury stock, at cost; 681,246 shares at June 30, 2014 and 1,066,021 shares at December 31, 2013	(45,296	) (70,855
Total shareholders' equity	2,770,674	2,514,161
Total liabilities and shareholders' equity	\$26,523,439	\$24,312,939

See Notes to Consolidated Financial Statements.

Table of Contents

Cullen/Frost Bankers, Inc.

Consolidated Statements of Income

(Dollars in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Interest income:				
Loans, including fees	\$ 110,268	\$ 103,316	\$ 214,583	\$ 205,372
Securities:				
Taxable	22,114	25,485	43,517	52,862
Tax-exempt	37,969	28,690	73,533	56,644
Interest-bearing deposits	2,681	1,498	5,085	2,851
Federal funds sold and resell agreements	23	29	43	51
Total interest income	173,055	159,018	336,761	317,780
Interest expense:				
Deposits	2,567	3,882	5,128	7,890
Federal funds purchased and repurchase agreements	34	29	61	59
Junior subordinated deferrable interest debentures	601	1,690	1,162	3,363
Other long-term borrowings	224	236	446	474
Total interest expense	3,426	5,837	6,797	11,786
Net interest income	169,629	153,181	329,964	305,994
Provision for loan losses	4,924	3,575	11,524	9,575
Net interest income after provision for loan losses	164,705	149,606	318,440	296,419
Non-interest income:				
Trust and investment management fees	26,748	22,561	52,159	44,446
Service charges on deposit accounts	20,462	20,044	40,436	40,088
Insurance commissions and fees	9,823	9,266	22,949	22,336
Interchange and debit card transaction fees	4,627	4,268	8,870	8,279
Other charges, commissions and fees	8,550	8,578	16,757	16,333
Net gain (loss) on securities transactions	2	6	2	11
Other	8,938	7,786	15,467	18,796
Total non-interest income	79,150	72,509	156,640	150,289
Non-interest expense:				
Salaries and wages	70,473	66,502	140,690	132,967
Employee benefits	14,806	14,629	32,194	32,620
Net occupancy	13,733	12,645	26,686	24,624
Furniture and equipment	15,207	14,986	30,160	29,171
Deposit insurance	3,145	2,835	6,262	5,724
Intangible amortization	806	788	1,495	1,608
Other	45,800	37,373	84,424	78,858
Total non-interest expense	163,970	149,758	321,911	305,572
Income before income taxes	79,885	72,357	153,169	141,136
Income taxes	13,415	12,694	25,511	26,285
Net income	66,470	59,663	127,658	114,851
Preferred stock dividends	2,015	2,688	4,031	2,688
Net income available to common shareholders	\$ 64,455	\$ 56,975	\$ 123,627	\$ 112,163
Earnings per common share:				
Basic	\$ 1.03	\$ 0.95	\$ 2.00	\$ 1.86

Diluted	1.02	0.94	1.99	1.85
See Notes to Consolidated Financial Statements.				

4

Table of Contents

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net income	\$66,470	\$59,663	\$127,658	\$114,851
Other comprehensive income (loss), before tax:				
Securities available for sale and transferred securities:				
Change in net unrealized gain/loss during the period	45,112	(74,025	) 66,543	(95,369
Change in net unrealized gain on securities transferred to held to maturity	(9,175	) (9,745	) (18,373	) (18,204
Reclassification adjustment for net (gains) losses included in net income	(2	) (6	) (2	) (11
Total securities available for sale and transferred securities	35,935	(83,776	) 48,168	(113,584
Defined-benefit post-retirement benefit plans:				
Change in the net actuarial gain/loss	671	1,639	1,343	3,279
Derivatives:				
Change in the accumulated gain/loss on effective cash flow hedge derivatives	—	(33	) —	(33
Reclassification adjustments for (gains) losses included in net income:				
Interest rate swaps on variable-rate loans	(9,345	) (9,345	) (18,690	) (18,690
Interest rate swap on junior subordinated deferrable interest debentures	—	1,103	—	2,188
Total derivatives	(9,345	) (8,275	) (18,690	) (16,535
Other comprehensive income (loss), before tax	27,261	(90,412	) 30,821	(126,840
Deferred tax expense (benefit) related to other comprehensive income	9,541	(31,644	) 10,787	(44,394
Other comprehensive income (loss), net of tax	17,720	(58,768	) 20,034	(82,446
Comprehensive income	\$84,190	\$895	\$147,692	\$32,405
See Notes to Consolidated Financial Statements.				

Table of Contents

Cullen/Frost Bankers, Inc.

Consolidated Statements of Changes in Shareholders' Equity

(Dollars in thousands, except per share amounts)

	Six Months Ended	
	June 30,	
	2014	2013
Total shareholders' equity at beginning of period	\$2,514,161	\$2,417,482
Net income	127,658	114,851
Other comprehensive income (loss)	20,034	(82,446)
Stock option exercises (384,775 shares in 2014 and 662,224 shares in 2013)	20,109	34,189
Stock compensation expense recognized in earnings	4,696	4,985
Tax benefits (deficiencies) related to stock compensation	1,664	(73)
Common stock issued in acquisition of WNB Bancshares (2,000,000 shares)	149,043	—
Issuance of preferred stock (6,000,000 shares in 2013)	—	144,486
Purchase of treasury stock (1,905,077 shares in 2013)	—	(115,200)
Accelerated share repurchase forward contract	—	(28,800)
Cash dividends – preferred stock (approximately \$0.67 per share in 2014 and \$0.45 per share in 2013)	(4,031)	(2,688)
Cash dividends – common stock (\$1.01 per share in 2014 and \$0.98 per share in 2013)	(62,660)	(58,948)
Total shareholders' equity at end of period	\$2,770,674	\$2,427,838
See Notes to Consolidated Financial Statements.		

Table of Contents

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

	Six Months Ended	
	June 30,	
	2014	2013
Operating Activities:		
Net income	\$127,658	\$114,851
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	11,524	9,575
Deferred tax expense (benefit)	(4,540)	(1,739)
Accretion of loan discounts	(7,033)	(5,790)
Securities premium amortization (discount accretion), net	28,359	18,124
Net (gain) loss on securities transactions	(2)	(11)
Depreciation and amortization	19,457	19,081
Net (gain) loss on sale/write-down of assets/foreclosed assets	939	3,023
Stock-based compensation	4,696	4,985
Net tax benefit (deficiency) from stock-based compensation	12	(448)
Excess tax benefits from stock-based compensation	(1,652)	(375)
Earnings on life insurance policies	(1,414)	(1,699)
Net change in:		
Trading account securities	909	13,297
Accrued interest receivable and other assets	(34,937)	(42,461)
Accrued interest payable and other liabilities	(43,764)	(163,670)
Net cash from operating activities	100,212	(33,257)
Investing Activities:		
Securities held to maturity:		
Purchases	—	(221,107)
Maturities, calls and principal repayments	43,271	9,723
Securities available for sale:		
Purchases	(3,303,838)	(8,910,706)
Sales	2,028	8,495,587
Maturities, calls and principal repayments	3,270,776	517,698
Net change in loans	(490,836)	(26,446)
Net cash (paid) received in acquisitions	830,656	—
Proceeds from sales of premises and equipment	28	16,301
Purchases of premises and equipment	(44,618)	(18,520)
Proceeds from sales of repossessed properties	3,410	4,081
Net cash from investing activities	310,877	(133,389)
Financing Activities:		
Net change in deposits	203,777	(419,147)
Net change in short-term borrowings	(105,451)	(11,238)
Principal payments on long-term borrowings	—	(7)
Proceeds from stock option exercises	20,109	34,189
Excess tax benefits from stock-based compensation	1,652	375
Proceeds from issuance of preferred stock	—	144,486
Purchase of treasury stock	—	(115,200)

Edgar Filing: CULLEN/FROST BANKERS, INC. - Form 10-Q

Accelerated share repurchase forward contract	—	(28,800)
Cash dividends paid on preferred stock	(4,031	)	(2,688
Cash dividends paid on common stock	(62,660	)	(58,948
Net cash from financing activities	53,396	(456,978)
Net change in cash and cash equivalents	464,485	(623,624)
Cash and equivalents at beginning of period	4,556,125	3,524,979	
Cash and equivalents at end of period	\$5,020,610	\$2,901,355	

See Notes to Consolidated Financial Statements.

7

Table of Contents

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. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, investment banking, insurance, brokerage, leasing, treasury management 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 (collectively referred to as the "Corporation"). All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies the Corporation follows 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 the Corporation's 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 the Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2013, included in the Corporation's Annual Report on Form 10-K filed with the SEC on February 6, 2014 (the "2013 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, the fair value of stock-based compensation awards, 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,	
	2014	2013
Cash paid for interest	\$6,461	\$12,039
Cash paid for income taxes	27,188	32,623
Significant non-cash transactions:		
Loans foreclosed and transferred to other real estate owned and foreclosed assets	1,622	2,913
Loans to facilitate the sale of other real estate owned	102	—
Deferred gain on sale of building and parking garage	—	1,120

Table of Contents

Note 2 - Mergers and Acquisitions

On May 30, 2014, the Corporation acquired WNB Bancshares, Inc. ("WNB"), including its subsidiary Western National Bank ("Western"), a privately-held bank holding company and bank located in the Permian Basin region of Texas. The Corporation purchased all of the outstanding shares of WNB for approximately \$198.1 million. The total purchase price included \$149.0 million of the Corporation's common stock (2 million shares) and \$49.1 million in cash. Western was integrated into Frost Bank as of the close of business on June 20, 2014.

The acquisition of WNB was accounted for using the acquisition method with all cash consideration funded through internal sources. The operating results of WNB are included with the Corporation's results of operations since the date of acquisition. The total purchase price paid for the acquisition of WNB was allocated based on the estimated fair values of the assets acquired and liabilities assumed as set forth below. The purchase price allocation is preliminary and is subject to final determination and valuation of the fair value of assets acquired and liabilities assumed.

Cash and cash equivalents	\$879,735
Securities available for sale	154,227
Loans	673,004
Premises and equipment	22,912
Core deposit intangible asset	10,850
Goodwill	112,371
Other assets	33,602
Deposits	(1,624,043)
Other borrowings	(63,592)
Other liabilities	(945)
	\$ 198,121

The loans acquired in this transaction were recorded at fair value with no carryover of any existing allowance for loan losses. Loans that were not deemed to be credit impaired at acquisition were subsequently considered as a part of the Corporation's determination of the adequacy of the allowance for loan losses. Purchased credit-impaired loans, meaning those loans with evidence of credit quality deterioration at acquisition, were not significant. The core deposit intangible asset acquired in this transaction will be amortized using an accelerated method over a period of 10 years. Pro forma condensed consolidated results of operations assuming WNB had been acquired at the beginning of the reported periods are not presented because the effect of this acquisition was not considered significant based on the SEC significance tests.

Expenditures related to the acquisition of WNB totaled \$4.8 million and \$6.0 million during the three and six months ended June 30, 2014, respectively, and are reported as a component of other non-interest expense in the accompanying consolidated income statements. During the third and fourth quarters of 2013, expenditures related to the acquisition of WNB totaled \$1.4 million.

Table of Contents

Note 3 - Securities

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

	June 30, 2014				December 31, 2013			
	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	\$248,797	\$18,000	\$—	\$266,797	\$248,592	\$20,139	\$—	\$268,731
Residential mortgage-backed securities	9,330	91	—	9,421	9,674	89	143	9,620
States and political subdivisions	2,806,390	20,671	32,285	2,794,776	2,880,482	7,691	137,861	2,750,312
Other	1,350	—	—	1,350	1,000	—	—	1,000
Total	\$3,065,867	\$38,762	\$32,285	\$3,072,344	\$3,139,748	\$27,919	\$138,004	\$3,029,663
Available for Sale								
U.S. Treasury	\$2,449,708	\$19,080	\$20	\$2,468,768	\$2,522,159	\$18,395	\$—	\$2,540,554
U.S. Government agencies/corporations	—	—	—	—	54,024	—	44	53,980
Residential mortgage-backed securities	1,514,030	77,194	663	1,590,561	1,710,664	66,791	1,439	1,776,016
States and political subdivisions	2,153,351	67,502	251	2,220,602	1,476,316	20,090	7,492	1,488,914
Other	43,012	—	—	43,012	35,972	—	—	35,972
Total	\$6,160,101	\$163,776	\$934	\$6,322,943	\$5,799,135	\$105,276	\$8,975	\$5,895,436

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. At June 30, 2014, approximately 96.9% of the securities in the Corporation's municipal bond portfolio were issued by political subdivisions or agencies within the State of Texas, of which approximately 69.7% 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 above table. 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 \$2.6 billion at June 30, 2014 and \$3.0 billion and December 31, 2013.

During the fourth quarter of 2012, the Corporation 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 transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of June 30, 2014 totaled \$110.9 million (\$72.1 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.

As of June 30, 2014, 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	200,820	828	1,410,468	31,457	1,611,288	32,285
Total	\$200,820	\$828	\$1,410,468	\$31,457	\$1,611,288	\$32,285
Available for Sale						
U.S. Treasury	\$150,176	\$20	\$—	\$—	\$150,176	\$20
Residential mortgage-backed securities	5,384	12	17,509	651	22,893	663
States and political subdivisions	63,962	213	5,378	38	69,340	251
Total	\$219,522	\$245	\$22,887	\$689	\$242,409	\$934

Table of Contents

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 ability of the Corporation to retain its 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 the Corporation will receive full value for the securities. Furthermore, as of June 30, 2014, 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 the Corporation 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, 2014, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Corporation's consolidated income statement.

The amortized cost and estimated fair value of securities, excluding trading securities, at June 30, 2014 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. 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	\$168,070	\$170,552	\$803,553	\$809,751
Due after one year through five years	463,083	489,871	1,537,991	1,551,000
Due after five years through ten years	155,173	153,605	1,266,080	1,291,383
Due after ten years	2,270,211	2,248,895	995,435	1,037,236
Residential mortgage-backed securities	9,330	9,421	1,514,030	1,590,561
Equity securities	—	—	43,012	43,012
Total	\$3,065,867	\$3,072,344	\$6,160,101	\$6,322,943

Sales of securities available for sale were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Proceeds from sales	\$2,028	\$3,997,485	\$2,028	\$8,495,587
Gross realized gains	3	6	3	11
Gross realized losses	(1)	—	(1)	—
Tax (expense) benefit of securities gains/losses	(1)	(2)	(1)	(4)

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

	June 30, 2014	December 31, 2013
U.S. Treasury	\$15,489	\$15,389
States and political subdivisions	—	1,009
Total	\$15,489	\$16,398

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

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013

Edgar Filing: CULLEN/FROST BANKERS, INC. - Form 10-Q

Net gain on sales transactions	\$253	\$282	\$493	\$576	
Net mark-to-market gains (losses)	—	(377) (3) (380)
Net gain (loss) on trading account securities	\$253	\$(95	) \$490	\$196

11

Table of Contents

Note 4 - Loans

Loans were as follows:

	June 30, 2014	Percentage of Total	December 31, 2013	Percentage of Total	
Commercial and industrial:					
Commercial	\$5,322,752	49.9	% \$4,587,499	48.2	%
Leases	302,081	2.8	319,577	3.4	
Total commercial and industrial	5,624,833	52.7	4,907,076	51.6	
Commercial real estate:					
Commercial mortgages	2,985,184	28.0	2,800,760	29.4	
Construction	577,446	5.4	426,639	4.5	
Land	272,959	2.5	239,937	2.5	
Total commercial real estate	3,835,589	35.9	3,467,336	36.4	
Consumer real estate:					
Home equity loans	336,890	3.2	329,853	3.5	
Home equity lines of credit	213,109	2.0	195,132	2.1	
1-4 family residential mortgages	35,625	0.3	32,447	0.3	
Construction	21,506	0.2	13,123	0.1	
Other	256,085	2.4	237,649	2.5	
Total consumer real estate	863,215	8.1	808,204	8.5	
Total real estate	4,698,804	44.0	4,275,540	44.9	
Consumer and other:					
Consumer installment	371,648	3.4	350,827	3.7	
Other	6,581	0.1	7,289	0.1	
Total consumer and other	378,229	3.5	358,116	3.8	
Unearned discounts	(22,489)	(0.2)	(25,032)	(0.3))
Total loans	\$10,679,377	100.0	% \$9,515,700	100.0	%

Loan Origination/Risk Management. The Corporation has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Corporation's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan

or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Corporation's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Corporation's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Corporation avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Corporation also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial

Table of Contents

real estate loans versus non-owner occupied loans. At June 30, 2014, approximately 57% of the outstanding principal balance of the Corporation's commercial real estate loans were secured by owner-occupied properties.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Corporation may originate from time to time, the Corporation generally requires the borrower to have had an existing relationship with the Corporation and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Corporation until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Corporation originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements.

The Corporation maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Corporation's policies and procedures.

Concentrations of Credit. Most of the Corporation's 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 the Corporation's loan portfolio consists of commercial and industrial and commercial real estate loans. As of June 30, 2014, there were no concentrations of loans related to any single industry in excess of 10% of total loans other than energy loans, which totaled 14.3% of total loans.

Foreign Loans. The Corporation has 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, 2014 or December 31, 2013.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, the Corporation considers the borrower's debt service capacity through the analysis of current financial information, if available, and/or current information with regards to the Corporation's collateral position. Regulatory provisions would typically require the placement of a loan on non-accrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection or (ii) full payment of principal and interest is not expected. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income on non-accrual loans is recognized only to the extent that cash payments are received in excess of principal due. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

Table of Contents

Non-accrual loans, segregated by class of loans, were as follows:

	June 30, 2014	December 31, 2013
Commercial and industrial:		
Energy	\$525	\$590
Other commercial	34,139	26,143
Commercial real estate:		
Buildings, land and other	21,833	27,035
Construction	301	—
Consumer real estate	2,179	2,207
Consumer and other	654	745
Total	\$59,631	\$56,720

As of June 30, 2014, non-accrual loans reported in the table above included \$6.7 million related to loans that were restructured as “troubled debt restructurings” during 2014. Had non-accrual loans performed in accordance with their original contract terms, the Corporation would have recognized additional interest income, net of tax, of approximately \$355 thousand and \$713 thousand for the three and six months ended June 30, 2014, compared to \$591 thousand and \$1.2 million for the same period in 2013.

An age analysis of past due loans (including both accruing and non-accruing loans), segregated by class of loans, as of June 30, 2014 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:						
Energy	\$1,808	\$525	\$2,333	\$1,528,313	\$1,530,646	\$—
Other commercial	17,242	8,951	26,193	4,067,994	4,094,187	4,048
Commercial real estate:						
Buildings, land and other	14,201	11,936	26,137	3,232,006	3,258,143	1,039
Construction	301	—	301	577,145	577,446	—
Consumer real estate	4,305	2,512	6,817	856,398	863,215	2,204
Consumer and other	3,053	777	3,830	374,399	378,229	585
Unearned discounts	—	—	—	(22,489)	(22,489)	—
Total	\$40,910	\$24,701	\$65,611	\$10,613,766	\$10,679,377	\$7,876

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan’s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Regulatory guidelines require the Corporation to reevaluate the fair value of collateral supporting impaired collateral dependent loans on at least an annual basis. While the Corporation’s policy is to comply with the regulatory guidelines, the Corporation’s general practice is to reevaluate the fair value of collateral supporting impaired collateral dependent loans on a quarterly basis. Thus, appraisals are never considered to be outdated, and the Corporation does not need to make any adjustments to the appraised values. The fair value of collateral supporting impaired collateral dependent loans is evaluated by the Corporation’s internal appraisal services using a methodology that is consistent with the Uniform Standards of Professional Appraisal Practice. The fair value of collateral supporting impaired collateral

dependent construction loans is based on an “as is” valuation.

14

Table of Contents

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, 2014					
Commercial and industrial:					
Energy	\$ 545	\$ 525	\$—	\$ 525	\$—
Other commercial	40,764	29,322	1,805	31,127	613
Commercial real estate:					
Buildings, land and other	25,390	18,894	998	19,892	776
Construction	478	301	—	301	—
Consumer real estate	881	689	—	689	—
Consumer and other	299	252	—	252	—
Total	\$68,357	\$49,983	\$2,803	\$52,786	\$1,389
December 31, 2013					
Commercial and industrial:					
Energy	\$ 545	\$ 531	\$—	\$ 531	\$—
Other commercial	31,429	15,337	7,004	22,341	4,140
Commercial real estate:					
Buildings, land and other	27,792	15,697	8,870	24,567	2,786
Construction	—	—	—	—	—
Consumer real estate	907	745	—	745	—
Consumer and other	334	278	—	278	—
Total	\$61,007	\$32,588	\$15,874	\$48,462	\$6,926
The average recorded investment in impaired loans was as follows:					
		Three Months Ended		Six Months Ended	
		June 30,		June 30,	
		2014	2013	2014	2013
Commercial and industrial:					
Energy		\$ 526	\$—	\$ 527	\$ 356
Other commercial		25,259	40,331	24,286	40,489
Commercial real estate:					
Buildings, land and other		20,460	37,473	21,829	37,035
Construction		307	1,035	204	1,057
Consumer real estate		704	818	717	833
Consumer and other		258	375	265	383
Total		\$47,514	\$80,032	\$47,828	\$80,153

Table of Contents

Troubled Debt Restructurings. The restructuring of a loan is considered a “troubled debt restructuring” if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules, reductions in collateral and other actions intended to minimize potential losses.

Troubled debt restructurings during the six months ended June 30, 2014 and June 30, 2013 are set forth in the following table.

	Six Months Ended June 30, 2014		Six Months Ended June 30, 2013	
	Balance at Restructure	Balance at Period-End	Balance at Restructure	Balance at Period-End
Commercial and industrial:				
Other commercial	\$3,752	\$3,672	\$2,138	\$1,343
Commercial real estate:				
Buildings, land and other	3,122	3,069	4,165	3,726
	\$6,874	\$6,741	\$6,303	\$5,069

The modifications during the reported periods primarily related to extending amortization periods, converting the loans to interest only for a limited period of time, consolidating notes and/or reducing collateral or interest rates. The modifications did not significantly impact the Corporation’s determination of the allowance for loan losses.

Approximately \$2.9 million of commercial and industrial loans and \$3.1 million of the commercial real estate loans restructured during the six months ended June 30, 2014 were related to a single loan relationship that was previously restructured during the third quarter of 2013. As of June 30, 2014, \$725 thousand of loans restructured during 2013 were in excess of 90 days past due. During the six months ended June 30, 2014, the Corporation charged-off \$427 thousand of commercial and industrial loans that were restructured during 2013. During the six months ended June 30, 2014, the Corporation also foreclosed upon certain commercial real estate loans that were restructured during 2013. The Corporation recognized \$500 thousand of other real estate owned and no charge-offs in connection with these foreclosures. The aforementioned charge-offs, foreclosures and past due loans did not significantly impact the Corporation’s determination of the allowance for loan losses.

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Corporation’s 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.

The Corporation utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 14. A description of the general characteristics of the 14 risk grades is as follows:

Grades 1, 2 and 3 – These grades include loans to very high credit quality borrowers of investment or near investment grade. These borrowers are generally publicly traded (grades 1 and 2), have significant capital strength, moderate leverage, stable earnings and growth, and readily available financing alternatives. Smaller entities, regardless of strength, would generally not fit in these grades.

Grades 4 and 5 – These grades include loans to borrowers of solid credit quality with moderate risk. Borrowers in these grades are differentiated from higher grades on the basis of size (capital and/or revenue), leverage, asset quality and the stability of the industry or market area.

Grades 6, 7 and 8 – These grades include “pass grade” loans to borrowers of acceptable credit quality and risk. Such borrowers are differentiated from Grades 4 and 5 in terms of size, secondary sources of repayment or they are of lesser stature in other key credit metrics in that they may be over-leveraged, under capitalized, inconsistent in performance or in an industry or an economic area that is known to have a higher level of risk, volatility, or susceptibility to weaknesses in the economy.

- Grade 9 – This grade includes loans on management’s “watch list” and is intended to be utilized on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near term.
-

Grade 10 – This grade is for “Other Assets Especially Mentioned” in accordance with regulatory guidelines. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation.

Grade 11 – This grade includes “Substandard” loans, in accordance with regulatory guidelines, for which the accrual of interest has not been stopped. By definition under regulatory guidelines, a “Substandard” loan has defined weaknesses which make payment default or principal exposure likely, but not yet certain. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business.

Table of Contents

Grade 12 – This grade includes “Substandard” loans, in accordance with regulatory guidelines, for which the accrual of interest has been stopped. This grade includes loans where interest is more than 120 days past due and not fully secured and loans where a specific valuation allowance may be necessary, but generally does not exceed 30% of the principal balance.

Grade 13 – This grade includes “Doubtful” loans in accordance with regulatory guidelines. Such loans are placed on non-accrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. Additionally, these loans generally have a specific valuation allowance in excess of 30% of the principal balance.

Grade 14 – This grade includes “Loss” loans in accordance with regulatory guidelines. Such loans are to be charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. “Loss” is not intended to imply that the loan or some portion of it will never be paid, nor does it in any way imply that there has been a forgiveness of debt.

Table of Contents

In monitoring credit quality trends in the context of assessing the appropriate level of the allowance for loan losses, the Corporation monitors 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 recalculate the risk grade on at least an annual basis. When a loan has a calculated 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 calculated risk grade of 10 or higher, a special assets officer monitors the loan on an on-going basis. The following table presents weighted average risk grades for all commercial loans by class.

	June 30, 2014		December 31, 2013	
	Weighted Average Risk Grade	Loans	Weighted Average Risk Grade	Loans
Commercial and industrial:				
Energy				
Risk grades 1-8	5.18	\$ 1,498,846	5.37	\$ 1,106,348
Risk grade 9	9.00	23,819	9.00	7,726
Risk grade 10	10.00	1,138	10.00	245
Risk grade 11	11.00	6,318	11.00	500
Risk grade 12	12.00	525	12.00	590
Risk grade 13	13.00	—	13.00	—
Total energy	5.27	\$ 1,530,646	5.40	\$ 1,115,409
Other commercial				
Risk grades 1-8	5.91	\$ 3,828,593	5.95	\$ 3,507,963
Risk grade 9	9.00	68,090	9.00	74,766
Risk grade 10	10.00	88,123	10.00	89,878
Risk grade 11	11.00	75,242	11.00	92,917
Risk grade 12	12.00	32,854	12.00	21,389
Risk grade 13	13.00	1,285	13.00	4,754
Total other commercial	6.19	\$ 4,094,187	6.27	\$ 3,791,667
Commercial real estate:				
Buildings, land and other				
Risk grades 1-8	6.50	\$ 3,041,659	6.59	\$ 2,844,665
Risk grade 9	9.00	116,775	9.00	65,770
Risk grade 10	10.00	35,763	10.00	49,881
Risk grade 11	11.00	42,112	11.00	53,208
Risk grade 12	12.00	21,058	12.00	24,387
Risk grade 13	13.00	776	13.00	2,786
Total commercial real estate	6.72	\$ 3,258,143	6.83	\$ 3,040,697
Construction				
Risk grades 1-8	6.84	\$ 572,960	7.05	\$ 418,999
Risk grade 9	9.00	2,629	9.00	1,301
Risk grade 10	10.00	1,343	10.00	5,931
Risk grade 11	11.00	213	11.00	408
Risk grade 12	12.00	301	12.00	—
Risk grade 13	13.00	—	13.00	—
Total construction	6.86	\$ 577,446	7.10	\$ 426,639

The Corporation has established maximum loan to value standards to be applied during the origination process of commercial and consumer real estate loans. The Corporation does not subsequently monitor loan-to-value ratios (either individually or on a weighted-average basis) for loans that are subsequently considered to be of a pass grade (grades 9 or better) and/or current with respect to principal and interest payments. As stated above, when an individual

commercial real estate loan has a calculated risk grade of 10 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired. At that time, the Corporation reassesses the loan to value position in the loan. If the loan is determined to be collateral dependent, specific allocations of the allowance for loan losses are made for the amount of any collateral deficiency. If a collateral deficiency is ultimately deemed to be uncollectible, the amount is charged-off. These loans and related assessments of collateral position are monitored on an individual, case-by-case basis. The Corporation does not monitor loan-to-value ratios on a weighted-average basis for commercial real estate loans having a calculated risk grade of 10 or higher. Nonetheless, there were two commercial real estate loans having

Table of Contents

a calculated risk grade of 10 or higher in excess of \$5 million as of June 30, 2014, which totaled \$14.8 million and had a weighted-average loan-to-value ratio of approximately 73.2%. When an individual consumer real estate loan becomes past due by more than 10 days, the assigned relationship manager will begin collection efforts. The Corporation only reassesses the loan to value position in a consumer real estate loan if, during the course of the collections process, it is determined that the loan has become collateral dependent, and any collateral deficiency is recognized as a charge-off to the allowance for loan losses. Accordingly, the Corporation does not monitor loan-to-value ratios on a weighted-average basis for collateral dependent consumer real estate loans.

Generally, a commercial loan, or a portion thereof, is charged-off immediately when it is determined, through the analysis of any available current financial information with regards to the borrower, that the borrower is incapable of servicing unsecured debt, there is little or no prospect for near term improvement and no realistic strengthening action of significance is pending or, in the case of secured debt, when it is determined, through analysis of current information with regards to the Corporation's collateral position, that amounts due from the borrower are in excess of the calculated current fair value of the collateral. Notwithstanding the foregoing, generally, commercial loans that become past due 180 cumulative days are classified as a loss and charged-off. Generally, a consumer loan, or a portion thereof, is charged-off in accordance with regulatory guidelines which provide that such loans be charged-off when the Corporation becomes aware of the loss, such as from a triggering event that may include new information about a borrower's intent/ability to repay the loan, bankruptcy, fraud or death, among other things, but in no case should the charge-off exceed specified delinquency time frames. Such delinquency time frames state that closed-end retail loans (loans with pre-defined maturity dates, such as real estate mortgages, home equity loans and consumer installment loans) that become past due 120 cumulative days and open-end retail loans (loans that roll-over at the end of each term, such as home equity lines of credit) that become past due 180 cumulative days should be classified as a loss and charged-off.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Commercial and industrial:				
Energy	\$460	\$—	\$447	\$(900)
Other commercial	(1,594)	(2,883)	(3,277)	(18,510)
Commercial real estate:				
Buildings, land and other	(400)	(244)	(2,018)	(29)
Construction	275	116	315	230
Consumer real estate	(27)	15	(4)	(261)
Consumer and other	(508)	(768)	(1,139)	(1,158)
Total	\$(1,794)	\$(3,764)	\$(5,676)	\$(20,628)

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 is a single summary statistic that is designed to signal the likelihood of the Texas economy's transition from expansion to recession and vice versa. Management believes this index provides a reliable indication of the direction of overall credit quality. The TLI is a composite of the following eight leading indicators: (i) Texas Value of the Dollar, (ii) U.S. Leading Index, (iii) real oil prices (iv) well permits, (v) initial claims for unemployment insurance, (vi) Texas Stock Index, (vii) Help-Wanted Index and (viii) average weekly hours worked in manufacturing. The TLI totaled 131.4 at May 31, 2014 (most recent date available) and 129.1 at December 31, 2013. 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 probable 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. The Corporation's allowance for loan loss methodology 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. In that

regard, the Corporation's allowance for loan losses includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Corporation's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly

Table of Contents

identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

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. While management utilizes its best judgment and information available, the ultimate determination of the appropriate level of the allowance is dependent upon a variety of factors beyond the Corporation's control, including, among other things, the performance of the Corporation's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications. The Corporation monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Corporation experiences over time.

The Corporation's allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other risk factors both internal and external to the Corporation.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 10 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical gross loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Corporation calculates historical gross loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical gross loss ratios are periodically (no less than annually) updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical gross loss ratio and the total dollar amount of the loans in the pool. The Corporation's pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

The components of the general valuation allowance include (i) the additional reserves allocated as a result of applying an environmental risk adjustment factor to the base historical loss allocation, (ii) the additional reserves allocated for loans to borrowers in distressed industries and (iii) the additional reserves allocated for groups of similar loans with risk characteristics that exceed certain concentration limits established by management.

The environmental adjustment factor is based upon a more qualitative analysis of risk and is calculated through a survey of senior officers who are involved in credit making decisions at a corporate-wide and/or regional level. On a quarterly basis, survey participants rate the degree of various risks utilizing a numeric scale that translates to varying grades of high, moderate or low levels of risk. The results are then input into a risk-weighting matrix to determine an appropriate environmental risk adjustment factor. The various risks that may be considered in the determination of the environmental adjustment factor include, among other things, (i) the experience, ability and effectiveness of the bank's lending management and staff; (ii) the effectiveness of the Corporation's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) the impact of legislative and governmental influences affecting industry sectors; (v) the effectiveness of the internal loan review function; (vi) the impact of competition on loan structuring

and pricing; and (vii) the impact of rising interest rates on portfolio risk. In periods where the surveyed risks are perceived to be higher, the risk-weighting matrix will generally result in a higher environmental adjustment factor, which, in turn will result in higher levels of general valuation allowance allocations. The opposite holds true in periods where the surveyed risks are perceived to be lower.

General valuation allowances also include amounts allocated for loans to borrowers in distressed industries. To determine the amount of the allocation for each loan portfolio segment, management calculates the weighted-average risk grade for all loans to borrowers in distressed industries by loan portfolio segment. A multiple is then applied to the amount by which the weighted-average risk grade for loans to borrowers in distressed industries exceeds the weighted-average risk grade for all pass-grade loans

Table of Contents

within the loan portfolio segment to derive an allocation factor for loans to borrowers in distressed industries. The amount of the allocation for each loan portfolio segment is the product of this allocation factor and the outstanding balance of pass-grade loans within the identified distressed industries that have a risk grade of 6 or higher. Management identifies potential distressed industries by analyzing industry trends related to delinquencies, classifications and charge-offs. At June 30, 2014 and December 31, 2013, certain segments of contractors were considered to be a distressed industry based on elevated levels of delinquencies, classifications and charge-offs relative to other industries within the Corporation's loan portfolio. Furthermore, the Corporation determined, through a review of borrower financial information that, as a whole, contractors have experienced, among other things, decreased revenues, reduced backlog of work, compressed margins and little, if any, net income. General valuation allowances also include allocations for groups of loans with similar risk characteristics that exceed certain concentration limits established by management and/or the Corporation's board of directors. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy, credit and/or collateral exceptions that exceed specified risk grades. Additionally, general valuation allowances are provided for loans that did not undergo a separate, independent concurrence review during the underwriting process (generally those loans under \$1.0 million at origination). The Corporation's allowance methodology for general valuation allowances also includes a reduction factor for recoveries of prior charge-offs to compensate for the fact that historical loss allocations are based upon gross charge-offs rather than net. The adjustment for recoveries is based on the lower of annualized, year-to-date gross recoveries or the total gross recoveries for the preceding four quarters, adjusted, when necessary, for expected future trends in recoveries.

The following table presents details of the allowance for loan losses, segregated by loan portfolio segment.

	Commercial and Industrial	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unallocated	Total
June 30, 2014						
Historical valuation allowances	\$37,103	\$14,226	\$2,081	\$10,054	\$—	\$63,464
Specific valuation allowances	613	776	—	—	—	1,389
General valuation allowances:						
Environmental risk adjustment	7,363	3,409	470	2,497	—	13,739
Distressed industries	4,006	17	—	—	—	4,023
Excessive industry concentrations	1,482	201	—	—	—	1,683
Large relationship concentrations	1,833	1,247	—	—	—	3,080
Highly-leveraged credit relationships	5,752	1,212	—	—	—	6,964
Policy exceptions	—	—	—	—	2,829	2,829
Credit and collateral exceptions	—	—	—	—	2,162	2,162
Loans not reviewed by concurrence	2,189	2,303	2,324	1,170	—	7,986
Adjustment for recoveries	(4,669)	(1,345)	(216)	(7,294)	—	(13,524)
General macroeconomic risk	—	—	—	—	4,491	4,491
Total	\$55,672	\$22,046	\$4,659	\$6,427	\$9,482	\$98,286
December 31, 2013						
Historical valuation allowances	\$29,357	\$13,042	\$2,644	\$8,695	\$—	\$53,738
Specific valuation allowances	4,140	2,786	—	—	—	6,926
General valuation allowances:						
Environmental risk adjustment	5,497	3,314	664	2,331	—	11,806
Distressed industries	7,812	384	—	—	—	8,196
	1,499	367	—	—	—	1,866

Excessive industry concentrations						
Large relationship concentrations	1,529	1,081	—	—	—	2,610
Highly-leveraged credit relationships	4,535	619	—	—	—	5,154
Policy exceptions	—	—	—	—	2,492	2,492
Credit and collateral exceptions	—	—	—	—	1,398	1,398
Loans not reviewed by concurrence	2,009	2,201	2,250	1,064	—	7,524
Adjustment for recoveries	(3,588	) (1,204	) (328	) (7,080	) —	(12,200
General macroeconomic risk	—	—	—	—	2,928	2,928
Total	\$52,790	\$22,590	\$5,230	\$5,010	\$6,818	\$92,438

Table of Contents

The Corporation monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Corporation experiences over time. In assessing the general macroeconomic trends/conditions, the Corporation analyzes trends in the components of the TLI, as well as any available information related to regional, national and international economic conditions and events and the impact such conditions and events may have on the Corporation and its customers. With regard to assessing loan portfolio conditions, the Corporation analyzes trends in weighted-average portfolio risk-grades, classified and non-performing loans and charge-off activity. In periods where general macroeconomic and loan portfolio conditions are in a deteriorating trend or remain at deteriorated levels, based on historical trends, the Corporation would expect to see the allowance for loan loss allocation model, as a whole, calculate higher levels of required allowances than in periods where general macroeconomic and loan portfolio conditions are in an improving trend or remain at an elevated level, based on historical trends.

The following table details activity in the allowance for loan losses by portfolio segment for the three and six months ended June 30, 2014 and 2013. 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	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unallocated	Total
Three months ended:						
June 30, 2014						
Beginning balance	\$57,054	\$21,020	\$4,533	\$5,691	\$6,858	\$95,156
Provision for loan losses	(248)	1,151	153	1,244	2,624	4,924
Charge-offs	(3,028)	(935)	(105)	(2,269)	—	(6,337)
Recoveries	1,894	810	78	1,761	—	4,543
Net charge-offs	(1,134)	(125)	(27)	(508)	—	(1,794)
Ending balance	\$55,672	\$22,046	\$4,659	\$6,427	\$9,482	\$98,286
June 30, 2013						
Beginning balance	\$51,085	\$24,809	\$5,148	\$3,724	\$8,823	\$93,589
Provision for loan losses	2,612	(1,108)	(246)	1,174	1,143	3,575
Charge-offs	(3,586)	(415)	(159)	(2,374)	—	(6,534)
Recoveries	703	287	174	1,606	—	2,770
Net charge-offs	(2,883)	(128)	15	(768)	—	(3,764)
Ending balance	\$50,814	\$23,573	\$4,917	\$4,130	\$9,966	\$93,400
Six months ended:						
June 30, 2014						
Beginning balance	\$52,790	\$22,590	\$5,230	\$5,010	\$6,818	\$92,438
Provision for loan losses	5,712	1,159	(567)	2,556	2,664	11,524
Charge-offs	(5,395)	(2,726)	(126)	(4,756)	—	(13,003)
Recoveries	2,565	1,023	122	3,617	—	7,327
Net charge-offs	(2,830)	(1,703)	(4)	(1,139)	—	(5,676)
Ending balance	\$55,672	\$22,046	\$4,659	\$6,427	\$9,482	\$98,286
June 30, 2013						
Beginning balance	\$54,164	\$29,346	\$5,252	\$3,507	\$12,184	\$104,453
Provision for loan losses	16,060	(5,974)	(74)	1,781	(2,218)	9,575
Charge-offs	(20,738)	(681)	(495)	(4,551)	—	(26,465)
Recoveries	1,328	882	234	3,393	—	5,837
Net charge-offs	(19,410)	201	(261)	(1,158)	—	(20,628)

Ending balance	\$50,814	\$23,573	\$4,917	\$4,130	\$9,966	\$93,400
----------------	----------	----------	---------	---------	---------	----------

22

Table of Contents

The following table details the amount of the allowance for loan losses allocated to each portfolio segment as of June 30, 2014, December 31, 2013 and June 30, 2013, detailed on the basis of the impairment methodology used by the Corporation.

	Commercial and Industrial	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unallocated	Total
June 30, 2014						
Loans individually evaluated for impairment	\$16,500	\$1,608	\$—	\$—	\$—	\$18,108
Loans collectively evaluated for impairment	39,172	20,438	4,659	6,427	9,482	80,178
Balance at June 30, 2014	\$55,672	\$22,046	\$4,659	\$6,427	\$9,482	\$98,286
December 31, 2013						
Loans individually evaluated for impairment	\$16,682	\$3,914	\$—	\$—	\$—	\$20,596
Loans collectively evaluated for impairment	36,108	18,676	5,230	5,010	6,818	71,842
Balance at December 31, 2013	\$52,790	\$22,590	\$5,230	\$5,010	\$6,818	\$92,438
June 30, 2013						
Loans individually evaluated for impairment	\$11,330	\$4,531	\$—	\$—	\$—	\$15,861
Loans collectively evaluated for impairment	39,484	19,042	4,917	4,130	9,966	77,539
Balance at June 30, 2013	\$50,814	\$23,573	\$4,917	\$4,130	\$9,966	\$93,400
The Corporation's recorded investment in loans as of June 30, 2014, December 31, 2013 and June 30, 2013 related to each balance in the allowance for loan losses by portfolio segment and detailed on the basis of the impairment methodology used by the Corporation was as follows:						
	Commercial and Industrial	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unearned Discounts	Total
June 30, 2014						
Loans individually evaluated for impairment	\$205,485	\$101,566	\$689	\$252	\$—	\$307,992
Loans collectively evaluated for impairment	5,419,348	3,734,023	862,526	377,977	(22,489)	10,371,385
Ending balance	\$5,624,833	\$3,835,589	\$863,215	\$378,229	\$(22,489)	\$10,679,377
December 31, 2013						
Loans individually evaluated for impairment	\$210,273	\$136,601	\$745	\$278	\$—	\$347,897
Loans collectively evaluated for impairment	4,696,803	3,330,735	807,459	357,838	(25,032)	9,167,803
Ending balance	\$4,907,076	\$3,467,336	\$808,204	\$358,116	\$(25,032)	\$9,515,700
June 30, 2013						
Loans individually evaluated for impairment	\$126,402	\$147,196	\$802	\$365	\$—	\$274,765
Loans collectively evaluated for impairment	4,646,215	3,224,072	784,403	324,957	(21,869)	8,957,778
Ending balance	\$4,772,617	\$3,371,268	\$785,205	\$325,322	\$(21,869)	\$9,232,543

Table of Contents

Note 5 - Goodwill and Other Intangible Assets

Goodwill and other intangible assets are presented in the table below. During the second quarter of 2014, the Corporation preliminarily recorded goodwill totaling \$112.4 million and a core deposit intangible asset totaling \$10.8 million in connection with the acquisition of WNB. See Note 2 — Mergers and Acquisitions.

	June 30, 2014	December 31, 2013
Goodwill	\$649,020	\$536,649
Other intangible assets:		
Core deposits	\$12,833	\$3,005
Customer relationship	2,463	2,828
Non-compete agreements	404	512
	\$15,700	\$6,345

The estimated aggregate future amortization expense for intangible assets remaining as of June 30, 2014 is as follows:

Remainder of 2014	\$2,191
2015	3,590
2016	2,649
2017	1,828
2018	1,527
Thereafter	3,915
	\$15,700

Note 6 - Deposits

Deposits were as follows:

	June 30, 2014	Percentage of Total		December 31, 2013	Percentage of Total	
Non-interest-bearing demand deposits:						
Commercial and individual	\$8,711,011	38.7	%	\$7,445,656	36.0	%
Correspondent banks	409,839	1.8		427,134	2.1	
Public funds	386,731	1.7		438,359	2.1	
Total non-interest-bearing demand deposits	9,507,581	42.2		8,311,149	40.2	
Interest-bearing deposits:						
Private accounts:						
Savings and interest checking	4,221,278	18.8		4,020,313	19.4	
Money market accounts	7,348,003	32.6		6,883,869	33.3	
Time accounts of \$100,000 or more	568,487	2.5		508,441	2.5	
Time accounts under \$100,000	473,711	2.1		438,800	2.1	
Total private accounts	12,611,479	56.0		11,851,423	57.3	
Public funds:						
Savings and interest checking	250,579	1.1		305,976	1.5	
Money market accounts	55,749	0.3		56,015	0.2	
Time accounts of \$100,000 or more	87,045	0.4		160,637	0.8	
Time accounts under \$100,000	4,173	—		3,586	—	
Total public funds	397,546	1.8		526,214	2.5	
Total interest-bearing deposits	13,009,025	57.8		12,377,637	59.8	
Total deposits	\$22,516,606	100.0	%	\$20,688,786	100.0	%

The following table presents additional information about the Corporation's deposits:

	June 30, 2014	December 31, 2013
Deposits from the Certificate of Deposit Account Registry Service (CDARS)	\$38,503	\$200
	121,229	—

Deposits from the Promontory Interfinancial Network Insured Cash Sweep Service
(acquired in the acquisition of WNB)

Deposits from foreign sources (primarily Mexico)	763,847	769,970
--	---------	---------

Table of Contents

Note 7 - Commitments and Contingencies

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, the Corporation enters into various transactions, which, in accordance with generally accepted accounting principles are not included in its consolidated balance sheets. The Corporation enters into these transactions to meet the financing needs of its customers. 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. The Corporation minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

The Corporation enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Corporation's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Corporation would be required to fund the commitment. The maximum potential amount of future payments the Corporation could be required to make is represented by the contractual amount of the commitment. If the commitment were funded, the Corporation would be entitled to seek recovery from the customer. The Corporation's policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

The Corporation considers the fees collected in connection with the issuance of standby letters of credit to be representative of the fair value of its obligation undertaken in issuing the guarantee. In accordance with applicable accounting standards related to guarantees, the Corporation defers fees collected in connection with the issuance of standby letters of credit. The fees are then recognized in income proportionately over the life of the standby letter of credit agreement. The deferred standby letter of credit fees represent the fair value of the Corporation's potential obligations under the standby letter of credit guarantees.

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

	June 30, 2014	December 31, 2013
Commitments to extend credit	\$7,296,613	\$6,919,942
Standby letters of credit	219,610	186,857
Deferred standby letter of credit fees	1,322	1,450

Lease Commitments. The Corporation leases certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled \$7.0 million and \$13.5 million during the three and six months ended June 30, 2014 and \$6.2 million and \$12.0 million during the three and six months ended June 30, 2013. There has been no significant change in the future minimum lease payments payable by the Corporation since December 31, 2013. See the 2013 Form 10-K for information regarding these commitments.

Litigation. The Corporation is 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 the Corporation's financial statements.

Note 8 - Capital and Regulatory Matters

Regulatory Capital Requirements. 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.

Quantitative measures established by regulations to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

Cullen/Frost's and Frost Bank's Tier 1 capital consists of shareholders' equity excluding unrealized gains and losses on securities available for sale, the accumulated gain or loss on effective cash flow hedging derivatives, the net actuarial

gain/loss on the Corporation's defined benefit post-retirement benefit plans, goodwill and other intangible assets. Tier 1 capital for Cullen/Frost also includes \$144.5 million of 5.375% non-cumulative perpetual preferred stock and \$133 million of trust preferred securities issued by its unconsolidated subsidiary trusts. Cullen/Frost's and Frost Bank's total capital is comprised of Tier 1 capital for each entity plus a permissible portion of the allowance for loan losses and outstanding subordinated debt. The Corporation's aggregate \$100 million of floating rate subordinated notes are not included in Tier 1 capital but the permissible portion (which decreases

Table of Contents

20% per year during the final five years of the term of the notes) totaling \$40 million at June 30, 2014 and \$60 million at December 31, 2013, is included in total capital of Cullen/Frost.

The Tier 1 and total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, excluding goodwill and other intangible assets, allocated by risk weight category, and certain off-balance-sheet items (primarily loan commitments). The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets.

Actual and required capital ratios for Cullen/Frost and Frost Bank were as follows:

	Actual		Minimum Required for Capital Adequacy Purposes		Required to be Considered Well Capitalized			
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio		
June 30, 2014								
Total Capital to Risk-Weighted Assets								
Cullen/Frost	\$2,222,110	14.76	% \$1,204,711	8.00	% \$1,505,889	10.00	%	
Frost Bank	1,974,337	13.14	1,202,231	8.00	1,502,789	10.00		
Tier 1 Capital to Risk-Weighted Assets								
Cullen/Frost	2,083,824	13.84	602,356	4.00	903,534	6.00		
Frost Bank	1,882,678	12.53	601,115	4.00	901,673	6.00		
Leverage Ratio								
Cullen/Frost	2,083,824	8.66	962,662	4.00	1,203,327	5.00		
Frost Bank	1,882,678	7.97	944,472	4.00	1,180,590	5.00		
December 31, 2013								
Total Capital to Risk-Weighted Assets								
Cullen/Frost	\$2,110,774	15.52	% \$1,088,349	8.00	% \$1,360,437	10.00	%	
Frost Bank	1,780,313	13.12	1,085,447	8.00	1,356,809	10.00		
Tier 1 Capital to Risk-Weighted Assets								
Cullen/Frost	1,958,336	14.39	544,175	4.00	816,262	6.00		
Frost Bank	1,707,307	12.58	542,724	4.00	814,085	6.00		
Leverage Ratio								
Cullen/Frost	1,958,336	8.49	922,728	4.00	1,153,410	5.00		
Frost Bank	1,707,307	7.42	920,107	4.00	1,150,134	5.00		

Management believes that, as of June 30, 2014, Cullen/Frost and its bank subsidiary, Frost Bank, were “well capitalized” based on the ratios presented above. In July 2013, Cullen/Frost’s and Frost Bank’s primary federal regulator, the Federal Reserve, published final rules establishing a new comprehensive capital framework for U.S. banking organizations which will become effective on January 1, 2015 (subject to a phase-in period). Management believes that, as of June 30, 2014, Cullen/Frost and Frost Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect. See the section captioned “Supervision and Regulation” in Item 1. Business of the Corporation’s 2013 Form 10-K for more information on the Basel III Capital Rules.

Cullen/Frost and Frost Bank are subject to the regulatory capital requirements administered by the Federal Reserve, 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 the Corporation’s financial statements. Management believes, as of June 30, 2014, that

Cullen/Frost and Frost Bank meet all capital adequacy requirements to which they are subject.

Trust Preferred Securities. In accordance with the applicable accounting standard related to variable interest entities, the accounts of the Corporation's wholly owned subsidiary trusts, Cullen/Frost Capital Trust II and WNB Capital Trust I, have not been included in the Corporation's consolidated financial statements. However, the \$133.0 million in trust preferred securities issued by these subsidiary trusts have been included in the Tier 1 capital of Cullen/Frost for regulatory capital purposes pursuant to guidance from the Federal Reserve. As more fully discussed in the Corporation's 2013 Form 10-K, new rules related to the implementation of the Basel III capital framework will require the phase-out of certain hybrid securities, such as trust preferred securities, as Tier 1 capital of bank holding companies beginning January 1, 2015.

Preferred Stock. On February 15, 2013, the Corporation issued and sold 6,000,000 shares, or \$150.0 million in aggregate liquidation preference, of its 5.375% Non-Cumulative Perpetual Preferred Stock, Series A, par value \$0.01 and liquidation

Table of Contents

preference \$25 per share (“Series A Preferred Stock”). Dividends on the Series A Preferred stock, if declared, accrue and are payable quarterly, in arrears, at a rate of 5.375%. The Series A Preferred Stock qualifies as Tier 1 capital for the purposes of the regulatory capital calculations. The net proceeds from the issuance and sale of the Series A Preferred Stock, after deducting underwriting discount and commissions, and the payment of expenses, were approximately \$144.5 million. The net proceeds from the offering were used to fund the accelerated share repurchase further discussed below.

Stock Repurchase Plans. From time to time, the Corporation’s board of directors has authorized stock repurchase plans. In general, stock repurchase plans allow the Corporation to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Corporation with shares of common stock necessary to satisfy obligations related to stock compensation awards. The accelerated share repurchase discussed below was part of a stock repurchase program that was authorized by the Corporation’s board of directors in December 2012 to buy up to \$150.0 million of the Corporation’s common stock.

Accelerated Share Repurchase. Concurrent with the issuance and sale of the Series A Preferred Stock, on February 12, 2013, the Corporation entered into an accelerated share repurchase agreement (the “ASR agreement”) with Goldman, Sachs & Co. (“Goldman Sachs”). Under the ASR agreement, the Corporation paid \$144.0 million to Goldman Sachs and received from Goldman Sachs 1,905,077 shares of the Corporation’s common stock, representing approximately 80% of the estimated total number of shares to be repurchased. Goldman Sachs borrowed such shares delivered to the Corporation from stock lenders, and during the term of the ASR agreement, purchased shares in the open market to return to those stock lenders. Final settlement of the ASR agreement occurred on August 13, 2013 and the Corporation received an additional 331,671 shares. The total number of shares that the Corporation repurchased was based on the volume-weighted-average price per share of the Corporation’s common stock during the repurchase period as adjusted pursuant to the terms and conditions of the ASR agreement.

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, 2014, Frost Bank could pay aggregate dividends of up to \$272.0 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 the Corporation has elected to defer interest on the debentures, the Corporation may not, with certain exceptions, declare or pay any dividends or distributions on its capital stock or purchase or acquire any of its capital stock.

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

Note 9 - 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. The Corporation utilizes interest rate swaps, caps and floors to mitigate exposure to interest rate risk and to facilitate the needs of its customers. The Corporation’s objectives for utilizing these derivative instruments is described below:

The Corporation has entered into certain interest rate swap contracts that are matched to specific fixed-rate commercial loans or leases that the Corporation has entered into with its customers. These contracts have been

designated as hedging instruments to hedge the risk of changes in the fair value of the underlying commercial loan/lease due to changes in interest rates. The related contracts are structured so that the notional amounts reduce over time to generally match the expected amortization of the underlying loan/lease.

During 2007, the Corporation entered into three interest rate swap contracts on variable-rate loans with a total notional amount of \$1.2 billion. The interest rate swap contracts were designated as hedging instruments in cash flow hedges with the objective of

Table of Contents

protecting the overall cash flows from the Corporation's monthly interest receipts on a rolling portfolio of \$1.2 billion of variable-rate loans outstanding throughout the 84-month period beginning in October 2007 and ending in October 2014 from the risk of variability of those cash flows such that the yield on the underlying loans would remain constant. As more fully discussed in the 2013 Form 10-K, the Corporation terminated portions of the hedges and settled portions of the interest rate swap contracts during November 2009 and terminated the remaining portions of the hedges and settled the remaining portions of the interest rate swap contracts during November 2010. The deferred accumulated gain applicable to the settled interest rate swap contracts included in accumulated other comprehensive income totaled \$11.9 million and \$30.6 million (\$7.7 million and \$19.9 million on an after-tax basis) at June 30, 2014 and December 31, 2013. The remaining deferred gain of \$11.9 million (\$7.7 million on an after-tax basis) at June 30, 2014 will be recognized ratably in earnings through October 2014.

During 2008, the Corporation entered into an interest rate swap contract on junior subordinated deferrable interest debentures with a total notional amount of \$120.0 million. The interest rate swap contract was designated as a hedging instrument in a cash flow hedge with the objective of protecting the quarterly interest payments on the Corporation's \$120.0 million of junior subordinated deferrable interest debentures issued to Cullen/Frost Capital Trust II throughout a five-year period beginning in December 2008 and ending in December 2013 from the risk of variability of those payments resulting from changes in the three-month LIBOR interest rate. Under the swap, the Corporation paid a fixed interest rate of 5.47% and received a variable interest rate of three-month LIBOR plus a margin of 1.55% on a total notional amount of \$120.0 million, with quarterly settlements. The swap terminated in December 2013.

The Corporation has entered into certain interest rate swap, cap and floor contracts that are not designated as hedging instruments. These derivative contracts relate to transactions in which the Corporation enters into an interest rate swap, cap and/or floor with a customer while at the same time entering into an offsetting interest rate swap, cap and/or floor with another financial institution. In connection with each swap transaction, the Corporation agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, the Corporation agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows the Corporation's customer to effectively convert a variable rate loan to a fixed rate. Because the Corporation acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts for the most part offset each other and do not significantly impact the Corporation's results of operations.

The notional amounts and estimated fair values of interest rate derivative contracts are presented in the following table. The Corporation obtains dealer quotations to value its interest rate derivative contracts designated as hedges of cash flows, while the fair values of other interest rate derivative contracts are estimated utilizing internal valuation models with observable market data inputs.

	June 30, 2014		December 31, 2013	
	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	\$34,244	\$705	\$50,965	\$1,386
Loan/lease interest rate swaps – liabilities	50,616	(3,779	) 43,631	(4,191
Non-hedging interest rate derivatives:				
Financial institution counterparties:				
Loan/lease interest rate swaps – assets	185,596	3,776	195,234	9,573
Loan/lease interest rate swaps – liabilities	628,254	(36,318	) 626,980	(32,469
Loan/lease interest rate caps – assets	73,058	1,397	53,058	1,309
Customer counterparties:				
Loan/lease interest rate swaps – assets	628,254	36,272	626,980	32,426
Loan/lease interest rate swaps – liabilities	185,596	(3,776	) 195,234	(9,573
Loan/lease interest rate caps – liabilities	73,058	(1,397	) 53,058	(1,309

Table of Contents

The weighted-average rates paid and received for interest rate swaps outstanding at June 30, 2014 were as follows:

	Weighted-Average		
	Interest	Interest	
	Rate	Rate	
	Paid	Received	
Interest rate swaps:			
Fair value hedge loan/lease interest rate swaps	2.56	% 0.15	%
Non-hedging interest rate swaps – financial institution counterparties	4.13	% 1.72	%
Non-hedging interest rate swaps – customer counterparties	4.06	% 1.67	%

The weighted-average strike rate for outstanding interest rate caps was 2.99% at June 30, 2014.

Commodity Derivatives. The Corporation enters into commodity swaps and option contracts that are not designated as hedging instruments primarily to accommodate the business needs of its customers. Upon the origination of a commodity swap or option contract with a customer, the Corporation simultaneously enters 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. The Corporation obtains dealer quotations and uses internal valuation models with observable market data inputs to value its commodity derivative positions.

		June 30, 2014		December 31, 2013	
	Notional	Notional	Estimated	Notional	Estimated
	Units	Amount	Fair Value	Amount	Fair Value
Financial institution counterparties:					
Oil – assets	Barrels	281	\$188	356	\$1,004
Oil – liabilities	Barrels	1,130	(6,523	) 1,574	(2,704
Natural gas – assets	MMBTUs	8,540	2,126	14,240	2,903
Natural gas – liabilities	MMBTUs	27,630	(4,527	) 22,510	(3,212
Customer counterparties:					
Oil – assets	Barrels	1,130	6,608	1,574	2,818
Oil – liabilities	Barrels	281	(188	) 356	(991
Natural gas – assets	MMBTUs	27,630	4,688	22,850	3,301
Natural gas – liabilities	MMBTUs	8,540	(2,124	) 13,900	(2,805

Foreign Currency Derivatives. The Corporation enters into foreign currency forward contracts that are not designated as hedging instruments primarily to accommodate the business needs of its customers. Upon the origination of a foreign currency denominated transaction with a customer, the Corporation simultaneously enters into an offsetting contract with a third party to negate the exposure to fluctuations in foreign currency exchange rates. The Corporation also utilizes foreign currency forward contracts that are not designated as hedging instruments to mitigate the economic effect of fluctuations in foreign currency exchange rates on 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, 2014		December 31, 2013	
	Notional	Notional	Estimated	Notional	Estimated
	Currency	Amount	Fair Value	Amount	Fair Value
Financial institution counterparties:					
Forward contracts – assets	EUR	—	\$—	1,175	\$5
Forward contracts – assets	CAD	—	—	18,886	85
Forward contracts – liabilities	GBP	548	(9) —	—
Forward contracts – liabilities	EUR	1,078	(8	) 494	(4
Forward contracts – liabilities	CAD	27,637	(437	) 14,078	(23
Customer counterparties:					
Forward contracts – assets	CAD	27,599	475	14,055	45
Forward contracts – liabilities	CAD	—	—	18,859	(58

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/

Table of Contents

leases designated as hedging instruments in effective hedges of fair value are included in interest income on loans. For cash flow hedges, the effective portion of the gain or loss due to changes in the fair value of the derivative hedging instrument is included in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is included in other non-interest income or other non-interest expense. Net cash flows from interest rate swaps on variable-rate loans designated as hedging instruments in effective hedges of cash flows and the reclassification from other comprehensive income of deferred gains associated with the termination of those hedges are included in interest income on loans. Net cash flows from the interest rate swap on junior subordinated deferrable interest debentures designated as a hedging instrument in an effective hedge of cash flows are included in interest expense on junior subordinated deferrable interest debentures. 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		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Commercial loan/lease interest rate swaps:				
Amount of gain (loss) included in interest income on loans	\$ (516	) \$ (609	) \$ (1,055	) \$ (1,232
Amount of (gain) loss included in other non-interest expense	(9	) (9	) —	6

Amounts included in the consolidated statements of income and in other comprehensive income for the period related to interest rate derivatives designated as hedges of cash flows were as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Interest rate swaps/caps/floors on variable-rate loans:				
Amount reclassified from accumulated other comprehensive income to interest income on loans	\$9,345	\$9,345	\$18,690	\$18,690
Interest rate swaps on junior subordinated deferrable interest debentures:				
Amount reclassified from accumulated other comprehensive income to interest expense on junior subordinated deferrable interest debentures	—	1,103	—	2,188
Amount of gain (loss) recognized in other comprehensive income	—	(33	) —	(33

No ineffectiveness related to interest rate derivatives designated as hedges of cash flows was recognized in the consolidated statements of income during the reported periods. The accumulated net after-tax gain related to effective cash flow hedges included in accumulated other comprehensive income totaled \$7.7 million at June 30, 2014 and \$19.9 million at December 31, 2013. The Corporation expects that the entire net after-tax gain of \$7.7 million related to effective cash flow hedges included in accumulated other comprehensive income at June 30, 2014 will be recognized ratably in earnings through October 2014. This amount represents management's best estimate given current expectations about market interest rates and volumes related to loan pools underlying the terminated cash flow hedges. Actual market interest rates and volumes related to loan pools underlying the terminated cash flow hedges may differ from management's expectations.

As stated above, the Corporation enters into non-hedge related derivative positions primarily to accommodate the business needs of its customers. Upon the origination of a derivative contract with a customer, the Corporation

simultaneously enters into an offsetting derivative contract with a third party. The Corporation recognizes immediate income based upon the difference in the bid/ask spread of the underlying transactions with its customers and the third party. Because the Corporation acts only as an intermediary for its customer, subsequent changes in the fair value of the underlying derivative contracts for the most part offset each other and do not significantly impact the Corporation's results of operations.

30

Table of Contents

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		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Non-hedging interest rate derivatives:				
Other non-interest income	\$644	\$67	\$865	\$185
Other non-interest expense	2	(37	) 2	(55
Non-hedging commodity derivatives:				
Other non-interest income	11	89	93	256
Non-hedging foreign currency derivatives:				
Other non-interest income	38	21	75	73

Counterparty Credit Risk. Derivative contracts involve the risk of dealing with both bank customers and institutional derivative counterparties and their ability to meet contractual terms. Institutional counterparties must have an investment grade credit rating and be approved by the Corporation's Asset/Liability Management Committee. The Corporation's credit exposure on interest rate swaps is limited to the net favorable value and interest payments of all swaps by each counterparty, while the Corporation's credit exposure on commodity swaps/options and foreign currency forward contracts is limited to the net favorable value of all contracts by each counterparty. Credit exposure may be reduced by the amount of collateral pledged by the counterparty. There are no credit-risk-related contingent features associated with any of the Corporation's derivative contracts. Certain derivative contracts with upstream financial institution counterparties may be terminated with respect to a party in the transaction, if such party does not have at least a minimum level rating assigned to either its senior unsecured long-term debt or its deposit obligations by certain third-party rating agencies.

The Corporation's credit exposure relating to interest rate swaps, commodity swaps/options and foreign currency forward contracts with bank customers was approximately \$45.4 million at June 30, 2014. This credit exposure is partly mitigated as transactions with customers are generally secured by the collateral, if any, securing the underlying transaction being hedged. The Corporation's 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 \$5.4 million at June 30, 2014. This amount was primarily related to excess collateral posted by the Corporation to counterparties. Collateral levels for upstream financial institution counterparties are monitored and adjusted as necessary. See Note 10 – Balance Sheet Offsetting for additional information regarding the Corporation's credit exposure with upstream financial institution counterparties.

The aggregate fair value of securities posted as collateral by the Corporation related to derivative contracts totaled \$46.6 million at June 30, 2014.

Table of Contents

Note 10 - Balance Sheet Offsetting

Certain financial instruments, including resell and repurchase agreements, securities lending arrangements and derivatives, may be eligible for offset in the consolidated balance sheet and/or subject to master netting arrangements or similar agreements. The Corporation's 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, the Corporation does 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, 2014 is presented in the following tables.

		Gross Amount Recognized	Gross Amount Offset	Net Amount Recognized
June 30, 2014				
Financial assets:				
Derivatives:				
Loan/lease interest rate swaps and caps		\$5,878	\$—	\$5,878
Commodity swaps and options		2,314	—	2,314
Foreign currency forward contracts		—	—	—
Total derivatives		8,192	—	8,192
Resell agreements		4,898	—	4,898
Total		\$13,090	\$—	\$13,090
Financial liabilities:				
Derivatives:				
Loan/lease interest rate swaps		\$40,097	\$—	\$40,097
Commodity swaps and options		11,050	—	11,050
Foreign currency forward contracts		454	—	454
Total derivatives		51,601	—	51,601
Repurchase agreements		612,541	—	612,541
Total		\$664,142	\$—	\$664,142
		Gross Amounts	Not Offset	
	Net Amount	Financial	Collateral	Net
	Recognized	Instruments		Amount
June 30, 2014				
Financial assets:				
Derivatives:				
Counterparty A	\$1,479	\$(1,479)) \$—	\$—
Counterparty B	2,063	(2,063)) —	—
Counterparty C	659	(659)) —	—
Other counterparties	3,991	(3,816)	) (40)	) 135
Total derivatives	8,192	(8,017)	) (40)	) 135
Resell agreements	4,898	—	(4,898)) —
Total	\$13,090	\$(8,017)	) \$(4,938)	) \$135
Financial liabilities:				
Derivatives:				
Counterparty A	\$18,933	\$(1,479)	) \$(17,109)	) \$345
Counterparty B	11,497	(2,063)	) (8,021)	) 1,413
Counterparty C	13,633	(659)	) (12,974)) —
Other counterparties	7,538	(3,816)	) (3,217)	) 505
Total derivatives	51,601	(8,017)	) (41,321)	) 2,263

Repurchase agreements	612,541	—	(612,541) —
Total	\$664,142	\$(8,017	) \$(653,862	) \$2,263

32

Table of Contents

Information about financial instruments that are eligible for offset in the consolidated balance sheet as of December 31, 2013 is presented in the following tables.

	Gross Amount Recognized	Gross Amount Offset	Net Amount Recognized
December 31, 2013			
Financial assets:			
Derivatives:			
Loan/lease interest rate swaps and caps	\$12,268	\$—	\$12,268
Commodity swaps and options	3,907	—	3,907
Foreign currency forward contracts	90	—	90
Total derivatives	16,265	—	16,265
Resell agreements	7,898	—	7,898
Total	\$24,163	\$—	\$24,163
Financial liabilities:			
Derivatives:			
Loan/lease interest rate swaps	\$36,660	\$—	\$36,660
Commodity swaps and options	5,916	—	5,916
Foreign currency forward contracts	27	—	27
Total derivatives	42,603	—	42,603
Repurchase agreements	668,053	—	668,053
Total	\$710,656	\$—	\$710,656

	Net Amount Recognized	Gross Amounts Financial Instruments	Not Offset Collateral	Net Amount
December 31, 2013				
Financial assets:				
Derivatives:				
Counterparty A	\$3,342	\$(3,342)) \$—	\$—
Counterparty B	8,196	(8,196)) —	—
Counterparty C	1,187	(1,187)) —	—
Other counterparties	3,540	(2,099)	) (1,360)	) 81
Total derivatives	16,265	(14,824)	) (1,360)	) 81
Resell agreements	7,898	—	) (7,898)) —
Total	\$24,163	\$(14,824)	) \$(9,258)	) \$81
Financial liabilities:				
Derivatives:				
Counterparty A	\$18,615	\$(3,342)	) \$(15,167)	) \$106
Counterparty B	9,054	(8,196)	) (613)	) 245
Counterparty C	10,870	(1,187)	) (9,683)) —
Other counterparties	4,064	(2,099)	) (1,549)	) 416
Total derivatives	42,603	(14,824)	) (27,012)	) 767
Repurchase agreements	668,053	—	) (668,053)) —
Total	\$710,656	\$(14,824)	) \$(695,065)	) \$767

Note 11 - Earnings Per Common Share

Earnings per common share is computed using the two-class method. Basic earnings per common share is computed by dividing net earnings allocated to common stock by the weighted-average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include non-vested stock awards/stock units and deferred stock units, though no actual shares of common stock related to non-vested stock units and deferred stock units have been issued. Non-vested stock awards/stock units and deferred stock units

are considered participating securities because holders of these securities receive non-forfeitable dividends at the same rate as holders of the Corporation's common stock. Diluted earnings per common share is computed using the weighted-average number of shares determined for the basic earnings per common share computation plus the dilutive effect of stock compensation using the treasury stock method.

Table of Contents

The following table presents a reconciliation of net income available to common shareholders, net earnings allocated to common stock and the number of shares used in the calculation of basic and diluted earnings per common share.

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Net income	\$66,470	\$59,663	\$127,658	\$114,851
Less: Preferred stock dividends	2,015	2,688	4,031	2,688
Net income available to common shareholders	64,455	56,975	123,627	112,163
Less: Earnings allocated to participating securities	246	209	472	407
Net earnings allocated to common stock	\$64,209	\$56,766	\$123,155	\$111,756
Distributed earnings allocated to common stock	\$32,050	\$30,058	\$62,421	\$58,733
Undistributed earnings allocated to common stock	32,159	26,708	60,734	53,023
Net earnings allocated to common stock	\$64,209	\$56,766	\$123,155	\$111,756
Weighted-average shares outstanding for basic earnings per common share	61,551,473	60,010,527	61,128,725	60,299,939
Dilutive effect of stock compensation	915,083	664,597	902,024	628,961
Weighted-average shares outstanding for diluted earnings per common share	62,466,556	60,675,124	62,030,749	60,928,900

Note 12 - Stock-Based Compensation

A combined summary of activity in the Corporation's active stock-based compensation plans is presented in the following table.

	Shares Available for Grant	Director Deferred Stock Units Outstanding	Non-Vested Stock Awards/Stock Units Outstanding		Stock Options Outstanding	
			Number of Shares	Weighted-Average Grant-Date Fair Value	Number of Shares	Weighted-Average Exercise Price
Balance, January 1, 2014	2,862,603	33,224	199,740	\$55.32	4,738,690	\$54.35
Authorized	—	—	—	—	—	—
Granted	(100,643)	5,643	—	—	95,000	79.16
Stock options exercised	—	—	—	—	(384,775)	52.26
Stock awards vested	—	—	—	—	—	—
Forfeited	40,220	—	—	—	(40,220)	56.08
Canceled/expired	—	—	—	—	—	—
Balance, June 30, 2014	2,802,180	38,867	199,740	\$55.32	4,408,695	\$55.05

Shares issued in connection with stock compensation awards are issued from available treasury shares. If no treasury shares are available, new shares are issued from available authorized shares. Shares issued in connection with stock compensation awards along with other related information were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
New shares issued from available authorized shares	—	—	—	153,275
Issued from available treasury stock	54,950	266,799	384,775	508,949
Total	54,950	266,799	384,775	662,224
Proceeds from stock option exercises	\$2,830	\$13,743	\$20,109	\$34,189

Table of Contents

Stock-based compensation expense is recognized ratably over the requisite service period for all awards. Stock-based compensation expense was as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Stock options	\$1,754	\$1,968	\$3,524	\$3,966
Non-vested stock awards/stock units	366	345	732	689
Deferred stock units	440	330	440	330
Total	\$2,560	\$2,643	\$4,696	\$4,985

Unrecognized stock-based compensation expense at June 30, 2014 was as follows:

Stock options	\$13,886
Non-vested stock awards/stock units	2,097
Total	\$15,983

Note 13 - Defined Benefit Plans

The components of the combined net periodic expense (benefit) for the Corporation's defined benefit pension plans were as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Expected return on plan assets, net of expenses	\$(3,128)	\$(2,772)	\$(6,257)	\$(5,544)
Interest cost on projected benefit obligation	2,000	1,836	4,001	3,671
Net amortization and deferral	671	1,639	1,343	3,279
Net periodic expense (benefit)	\$(457)	\$703	\$(913)	\$1,406

The Corporation's non-qualified defined benefit pension plan is not funded. No contributions to the qualified defined benefit pension plan were made during the six months ended June 30, 2014. The Corporation does not expect to make any contributions to the qualified defined benefit plan during the remainder of 2014.

Note 14 - Income Taxes

Income tax expense was as follows:

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2014	2013	2014	2013	
Current income tax expense	\$16,022	\$12,315	\$30,051	\$28,024	
Deferred income tax expense (benefit)	(2,607)	379	(4,540)	(1,739)	
Income tax expense, as reported	\$13,415	\$12,694	\$25,511	\$26,285	
Effective tax rate	16.8	% 17.5	% 16.7	% 18.6	%

Net deferred tax liabilities totaled \$66.2 million at June 30, 2014 and \$62.8 million at December 31, 2013. No valuation allowance was recorded against deferred tax assets at June 30, 2014 as management believes it is more likely than not that all of the deferred tax assets will be realized because they were supported by recoverable taxes paid in prior years. There were no unrecognized tax benefits during any of the reported periods. Interest and/or penalties related to income taxes are reported as a component of income tax expense. Such amounts were not significant during the reported periods.

The Corporation files income tax returns in the U.S. federal jurisdiction. The Company is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2010.

Table of Contents

Note 15 - Other Comprehensive Income (Loss)

The before and after tax amounts allocated to each component of other comprehensive income (loss) are presented in the following table. Reclassification adjustments related to securities available for sale are included in net gain (loss) on securities transactions in the accompanying consolidated statements of income. The change in the net actuarial gain/loss on defined-benefit post-retirement benefit plans is included in the computation of net periodic pension expense (see Note 13 – Defined Benefit Plans). Reclassification adjustments related to interest rate swaps on variable-rate loans are included in interest income and fees on loans in the accompanying consolidated statements of income. Reclassification adjustments related to the interest rate swap on junior subordinated deferrable interest debentures are included in interest expense on junior subordinated deferrable interest debentures in the accompanying consolidated statements of income.

	Three Months Ended June 30, 2014			Three Months Ended June 30, 2013		
	Before Tax Amount	Tax Expense, (Benefit)	Net of Tax Amount	Before Tax Amount	Tax Expense, (Benefit)	Net of Tax Amount
Securities available for sale and transferred securities:						
Change in net unrealized gain/loss during the period	\$45,112	\$15,789	\$29,323	\$(74,025)	\$(25,909)	\$(48,116)
Change in net unrealized gain on securities transferred to held to maturity	(9,175)	(3,212)	(5,963)	(9,745)	(3,411)	(6,334)
Reclassification adjustment for net (gains) losses included in net income	(2)	—	(2)	(6)	(2)	(4)
Total securities available for sale and transferred securities	35,935	12,577	23,358	(83,776)	(29,322)	(54,454)
Defined-benefit post-retirement benefit plans:						
Change in the net actuarial gain/loss	671	235	436	1,639	574	1,065
Derivatives:						
Change in the accumulated gain/loss on effective cash flow hedge derivatives	—	—	—	(33)	(12)	(21)
Reclassification adjustments for (gains) losses included in net income:						
Interest rate swaps on variable-rate loans	(9,345)	(3,271)	(6,074)	(9,345)	(3,270)	(6,075)
Interest rate swap on junior subordinated deferrable interest debentures	—	—	—	1,103	386	717
Total derivatives	(9,345)	(3,271)	(6,074)	(8,275)	(2,896)	(5,379)
Total other comprehensive income (loss)	\$27,261	\$9,541	\$17,720	\$(90,412)	\$(31,644)	\$(58,768)

Table of Contents

	Six Months Ended June 30, 2014			Six Months Ended June 30, 2013		
	Before Tax Amount	Tax Expense, (Benefit)	Net of Tax Amount	Before Tax Amount	Tax Expense, (Benefit)	Net of Tax Amount
Securities available for sale and transferred securities:						
Change in net unrealized gain/loss during the period	\$66,543	\$23,290	\$43,253	\$(95,369)	\$(33,379)	\$(61,990)
Change in net unrealized gain on securities transferred to held to maturity	(18,373)	(6,431)	(11,942)	(18,204)	(6,372)	(11,832)
Reclassification adjustment for net (gains) losses included in net income	(2)	—	(2)	(11)	(4)	(7)
Total securities available for sale and transferred securities	48,168	16,859	31,309	(113,584)	(39,755)	(73,829)
Defined-benefit post-retirement benefit plans:						
Change in the net actuarial gain/loss	1,343	470	873	3,279	1,148	2,131
Derivatives:						
Change in the accumulated gain/loss on effective cash flow hedge derivatives	—	—	—	(33)	(12)	(21)
Reclassification adjustments for (gains) losses included in net income:						
Interest rate swaps on variable-rate loans	(18,690)	(6,542)	(12,148)	(18,690)	(6,541)	(12,149)
Interest rate swap on junior subordinated deferrable interest debentures	—	—	—	2,188	766	1,422
Total derivatives	(18,690)	(6,542)	(12,148)	(16,535)	(5,787)	(10,748)
Total other comprehensive income (loss)	\$30,821	\$10,787	\$20,034	\$(126,840)	\$(44,394)	\$(82,446)
Activity in accumulated other comprehensive income (loss), net of tax, was as follows:						
	Securities Available For Sale	Defined Benefit Plans	Derivatives	Accumulated Other Comprehensive Income		
Balance January 1, 2014	\$146,672	\$(26,131)	\$19,893	\$140,434		
Other comprehensive income (loss) before reclassifications	31,311	873	—	32,184		
Amounts reclassified from accumulated other comprehensive income (loss)	(2)	—	(12,148)	(12,150)		
Net other comprehensive income (loss) during period	31,309	873	(12,148)	20,034		
Balance June 30, 2014	\$177,981	\$(25,258)	\$7,745	\$160,468		
Balance January 1, 2013	\$245,539	\$(49,071)	\$41,580	\$238,048		
Other comprehensive income (loss) before reclassifications	(73,822)	2,131	(21)	(71,712)		
Amounts reclassified from accumulated other comprehensive income (loss)	(7)	—	(10,727)	(10,734)		
Net other comprehensive income (loss) during period	(73,829)	2,131	(10,748)	(82,446)		
Balance June 30, 2013	\$171,710	\$(46,940)	\$30,832	\$155,602		

Table of Contents

Note 16 – Operating Segments

The Corporation is managed under a matrix organizational structure whereby its two primary operating segments, Banking and Frost Wealth Advisors, overlap a regional reporting structure. The regions are primarily based upon geographic location and include Austin, Corpus Christi, Dallas, Fort Worth, Houston, Permian Basin, Rio Grande Valley, San Antonio and Statewide. The Corporation is primarily managed based on the line of business structure. In that regard, all regions have the same lines of business, which have the same product and service offerings, have similar types and classes of customers and utilize similar service delivery methods. Pricing guidelines for products and services are the same across all regions. The regional reporting structure is primarily a means to scale the lines of business to provide a local, community focus for customer relations and business development.

Banking and Frost Wealth Advisors are delineated by the products and services that each segment offers. The Banking operating segment includes both commercial and consumer banking services, Frost Securities, Inc. and Frost Insurance Agency. Commercial banking services are provided to corporations and other business clients and include a wide array of lending and cash management products. Consumer banking services include direct lending and depository services. Frost Insurance Agency provides insurance brokerage services to individuals and businesses covering corporate and personal property and casualty products, as well as group health and life insurance products and human resources consulting services. Frost Securities, Inc. provides advisory and private equity services to middle market companies. The Frost Wealth Advisors operating segment includes fee-based services within private trust, retirement services, and financial management services, including personal wealth management and brokerage services. A third operating segment, Non-Banks, is for the most part the parent holding company, as well as certain other insignificant non-bank subsidiaries of the parent that, for the most part, have little or no activity. The parent company's principal activities include the direct and indirect ownership of the Corporation's banking and non-banking subsidiaries and the issuance of debt and equity. Its principal source of revenue is dividends from its subsidiaries. The accounting policies of each reportable segment are the same as those of the Corporation except for the following items, which impact the Banking and Frost Wealth Advisors segments: (i) expenses for consolidated back-office operations and general overhead-type expenses such as executive administration, accounting and internal audit are allocated to operating segments based on estimated uses of those services, (ii) income tax expense for the individual segments is calculated essentially at the statutory rate, and (iii) the parent company records the tax expense or benefit necessary to reconcile to the consolidated total.

The Corporation uses a match-funded transfer pricing process to assess operating segment performance. The process helps the Corporation to (i) identify the cost or opportunity value of funds within each business segment, (ii) measure the profitability of a particular business segment by relating appropriate costs to revenues, (iii) evaluate each business segment in a manner consistent with its economic impact on consolidated earnings, and (iv) enhance asset and liability pricing decisions.

Summarized operating results by segment were as follows:

	Banking	Frost Wealth Advisors	Non-Banks	Consolidated
Revenues from (expenses to) external customers:				
Three months ended:				
June 30, 2014	\$216,258	\$32,313	\$208	\$248,779
June 30, 2013	198,206	28,259	(775)	) 225,690
Six months ended:				
June 30, 2014	\$422,472	\$63,407	\$725	\$486,604
June 30, 2013	402,466	55,482	(1,665)	) 456,283
Net income (loss):				
Three months ended:				
June 30, 2014	\$63,872	\$5,388	\$(2,790)	) \$66,470
June 30, 2013	56,582	4,263	(1,182)	) 59,663
Six months ended:				
June 30, 2014	\$119,928	\$10,472	\$(2,742)	) \$127,658

June 30, 2013	110,135	7,501	(2,785) 114,851
---------------	---------	-------	--------	-----------

Note 17 – Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Corporation utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 establishes a fair value

Table of Contents

hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

• **Level 1 Inputs** – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

• **Level 3 Inputs** – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time.

The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein. A more detailed description of the valuation methodologies used for assets and liabilities measured at fair value is set forth below. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Corporation's monthly and/or quarterly valuation process.

Financial Assets and Financial Liabilities: Financial assets and financial liabilities measured at fair value on a recurring basis include the following:

Securities Available for Sale. U.S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Corporation obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

The Corporation reviews the prices supplied by the independent pricing service, as well as their underlying pricing methodologies, for reasonableness and to ensure such prices are aligned with traditional pricing matrices. In general, the Corporation does not purchase investment portfolio securities that are esoteric or that have a complicated structure. The Corporation's entire portfolio consists of traditional investments, nearly all of which are U.S. Treasury obligations, federal agency bullet or mortgage pass-through securities, or general obligation or revenue based municipal bonds. Pricing for such instruments is fairly generic and is easily obtained. From time to time, the Corporation will validate, on a sample basis, prices supplied by the independent pricing service by comparison to prices obtained from third-party sources or derived using internal models.

Trading Securities. U.S. Treasury securities and exchange-listed common stock are reported at fair value utilizing Level 1 inputs. Other securities classified as trading are reported at fair value utilizing Level 2 inputs in the same manner as described above for securities available for sale.

Derivatives. Derivatives are generally reported at fair value utilizing Level 2 inputs, except for foreign currency contracts, which are reported at fair value utilizing Level 1 inputs. The Corporation obtains dealer quotations and utilizes internally developed valuation models to value the swap related to its junior subordinated deferrable interest debentures and commodity swaps/options. The Corporation utilizes internally developed valuation models and/or

third-party models with observable market data inputs to validate the valuations provided by the dealers. Though there has never been a significant discrepancy in the valuations, should such a significant discrepancy arise, the Corporation would obtain price verification from a third-party dealer. The Corporation utilizes internal valuation models with observable market data inputs to estimate fair values of customer interest rate swaps, caps and floors. The Corporation also obtains dealer quotations for these derivatives for comparative purposes to assess the reasonableness of the model valuations. In cases where significant credit valuation adjustments are incorporated into the estimation of fair value, reported amounts are considered to have been derived utilizing Level 3 inputs.

Table of Contents

For purposes of potential valuation adjustments to its derivative positions, the Corporation evaluates the credit risk of its counterparties as well as that of the Corporation. Accordingly, the Corporation has considered factors such as the likelihood of default by the Corporation and its counterparties, its net exposures, and remaining contractual life, among other things, in determining if any fair value adjustments related to credit risk are required. Counterparty exposure is evaluated by netting positions that are subject to master netting arrangements, as well as considering the amount of collateral securing the position. The Corporation reviews its counterparty exposure on a regular basis, and, when necessary, appropriate business actions are taken to adjust the exposure. The Corporation also utilizes this approach to estimate its own credit risk on derivative liability positions. To date, the Corporation has not realized any significant losses due to a counterparty's inability to pay any net uncollateralized position. The change in value of derivative assets and derivative liabilities attributable to credit risk was not significant during the reported periods. The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
June 30, 2014				
Securities available for sale:				
U.S. Treasury	\$2,468,768	\$—	\$—	\$2,468,768
Residential mortgage-backed securities	—	1,590,561	—	1,590,561
States and political subdivisions	—	2,220,602	—	2,220,602
Other	—	43,012	—	43,012
Trading account securities:				
U.S. Treasury	15,489	—	—	15,489
States and political subdivisions	—	—	—	—
Derivative assets:				
Interest rate swaps, caps and floors	—	41,967	183	42,150
Commodity swaps and options	—	13,610	—	13,610
Foreign currency forward contracts	475	—	—	475
Derivative liabilities:				
Interest rate swaps, caps and floors	—	45,270	—	45,270
Commodity swaps and options	—	13,362	—	13,362
Foreign currency forward contracts	454	—	—	454
December 31, 2013				
Securities available for sale:				
U.S. Treasury	\$2,540,554	\$—	\$—	\$2,540,554
U.S. Government agencies/corporations	—	53,980	—	53,980
Residential mortgage-backed securities	—	1,776,016	—	1,776,016
States and political subdivisions	—	1,488,914	—	1,488,914
Other	—	35,972	—	35,972
Trading account securities:				
U.S. Treasury	15,389	—	—	15,389
States and political subdivisions	—	1,009	—	1,009
Derivative assets:				
Interest rate swaps, caps and floors	—	44,520	174	44,694
Commodity swaps and options	—	10,026	—	10,026
Foreign currency forward contracts	135	—	—	135
Derivative liabilities:				
Interest rate swaps, caps and floors	—	47,542	—	47,542
Commodity swaps and options	—	9,712	—	9,712

Foreign currency forward contracts	85	—	—	85
------------------------------------	----	---	---	----

Derivative assets, measured at fair value on a recurring basis using significant unobservable (Level 3) inputs during the reported periods consist of interest rate swaps sold to loan customers. The significant unobservable (Level 3) inputs used in the fair value measurement of these interest rate swaps sold to loan customers primarily relate to the probability of default and loss severity in

40

Table of Contents

the event of default. The probability of default is determined by the underlying risk grade of the loan (see Note 4 – Loans) underlying the interest rate swap in that the probability of default increases as a loan’s risk grade deteriorates, while the loss severity is estimated through an analysis of the collateral supporting both the underlying loan and interest rate swap. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity. As of June 30, 2014, the weighted-average risk grade of loans underlying interest rate swaps measured at fair value using significant unobservable (Level 3) inputs was 11.0. The weighted-average loss severity in the event of default on the interest rate swaps was 20%. A reconciliation of the beginning and ending balances of derivative assets measured at fair value on a recurring basis using significant unobservable (Level 3) inputs is not presented as such amounts were not significant during the reported periods.

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets measured at fair value on a non-recurring basis during the reported periods include certain impaired loans reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data, typically in the case of real estate collateral, or Level 3 inputs based on customized discounting criteria, typically in the case of non-real estate collateral such as inventory, accounts receivable, equipment or other business assets. Impaired loans that were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for loan losses based upon the fair value of the underlying collateral were not significant during the reported periods.

Non-Financial Assets and Non-Financial Liabilities: The Corporation has no non-financial assets or non-financial liabilities measured at fair value on a recurring basis. Certain non-financial assets measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. Non-financial assets measured at fair value on a non-recurring basis during the reported periods include certain foreclosed assets which, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for loan losses and certain foreclosed assets which, subsequent to their initial recognition, were remeasured at fair value through a write-down included in other non-interest expense. The fair value of a foreclosed asset is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. During the reported periods, all fair value measurements for foreclosed assets utilized Level 2 inputs.

The following table presents foreclosed assets that were remeasured and reported at fair value during the reported periods:

	Six Months Ended	
	June 30,	
	2014	2013
Foreclosed assets remeasured at initial recognition:		
Carrying value of foreclosed assets prior to remeasurement	\$1,854	\$3,489
Charge-offs recognized in the allowance for loan losses	(232	) (576
Fair value	\$1,622	\$2,913
Foreclosed assets remeasured subsequent to initial recognition:		
Carrying value of foreclosed assets prior to remeasurement	\$4,299	\$3,852
Write-downs included in other non-interest expense	(994	) (657
Fair value	\$3,305	\$3,195

Charge-offs recognized upon loan foreclosures are generally offset by general or specific allocations of the allowance for loan losses and generally do not, and did not during the reported periods, significantly impact the Corporation’s provision for loan losses. Regulatory guidelines require the Corporation to reevaluate the fair value of other real estate owned on at least an annual basis. The Corporation’s policy is to comply with the regulatory guidelines. Accordingly, appraisals are never considered to be outdated, and the Corporation does not make any adjustments to the appraised

values.

FASB ASC Topic 825 "Financial Instruments," requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. A detailed description of the valuation methodologies used in estimating the fair value of financial instruments is set forth in the 2013 Form 10-K.

41

Table of Contents

The estimated fair values of financial instruments that are reported at amortized cost in the Corporation's consolidated balance sheets, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value, were as follows:

	June 30, 2014		December 31, 2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Level 2 inputs:				
Cash and cash equivalents	\$5,020,610	\$5,020,610	\$4,556,125	\$4,556,125
Securities held to maturity	3,065,867	3,072,344	3,139,748	3,029,663
Cash surrender value of life insurance policies	170,245	170,245	141,108	141,108
Accrued interest receivable	109,652	109,652	99,281	99,281
Level 3 inputs:				
Loans, net	10,581,091	10,764,010	9,423,262	9,582,734
Financial liabilities:				
Level 2 inputs:				
Deposits	22,516,606	22,517,448	20,688,786	20,689,323
Federal funds purchased and repurchase agreements	612,991	612,991	668,253	668,253
Junior subordinated deferrable interest debentures	137,115	137,115	123,712	123,712
Subordinated notes payable and other borrowings	100,000	94,132	100,000	92,552
Accrued interest payable	1,636	1,636	1,300	1,300

Under ASC Topic 825, entities may choose to measure eligible financial instruments at fair value at specified election dates. The fair value measurement option (i) may be applied instrument by instrument, with certain exceptions, (ii) is generally irrevocable and (iii) is applied only to entire instruments and not to portions of instruments. Unrealized gains and losses on items for which the fair value measurement option has been elected must be reported in earnings at each subsequent reporting date. During the reported periods, the Corporation had no financial instruments measured at fair value under the fair value measurement option.

Note 18 - Accounting Standards Updates

ASU 2011-11, "Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities." ASU 2011-11 amends Topic 210, "Balance Sheet," to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU No. 2013-01, "Balance Sheet (Topic 210) – Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities," clarifies that ordinary trade receivables are not within the scope of ASU 2011-11. ASU 2011-11, as amended by ASU 2013-01, became effective for the Corporation on January 1, 2013. See Note 10 – Balance Sheet Offsetting for applicable disclosures.

ASU 2012-02, "Intangibles – Goodwill and Other (Topic 350) – Testing Indefinite-Lived Intangible Assets for Impairment." ASU 2012-02 gives entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events or circumstances, an entity determines it is more likely than not that an indefinite-lived intangible asset is impaired, then the entity must perform the quantitative impairment test. If, under the quantitative impairment test, the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance in ASU 2011-08. ASU 2012-02 became effective for the Corporation on January 1, 2013 and did not have a significant impact on the Corporation's financial statements.

ASU 2012-06, "Business Combinations (Topic 805) – Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution (a consensus of the FASB Emerging Issues Task Force)." ASU 2012-06 clarifies the applicable guidance for subsequently measuring an

indemnification asset recognized as a result of a government-assisted acquisition of a financial institution. Under ASU 2012-06, when a reporting entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and, subsequently, a change in the cash flows expected to be collected on the indemnification asset occurs (as a result of a change in cash flows expected to be collected on the assets subject to indemnification), the reporting entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement (that is, the lesser of the term of

Table of Contents

the indemnification agreement and the remaining life of the indemnified assets). ASU 2012-06 became effective for the Corporation on January 1, 2013 and did not have a significant impact on the Corporation's financial statements. ASU 2013-02, "Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU 2013-02 amends recent guidance related to the reporting of comprehensive income to enhance the reporting of reclassifications out of accumulated other comprehensive income. ASU 2013-02 became effective for the Corporation on January 1, 2013 and did not have a significant impact on the Corporation's financial statements. See Note 15 – Other Comprehensive Income (Loss).

ASU 2013-08, "Financial Services – Investment Companies (Topic 946) – Amendments to the Scope, Measurement and Disclosure Requirements." ASU 2013-08 clarifies the characteristics of investment companies and sets forth a new approach for determining whether a company is an investment company. The fundamental characteristics of an investment company include (i) the company obtains funds from investors and provides the investors with investment management services; (ii) the company commits to its investors that its business purpose and only substantive activities are investing the funds for returns solely from capital appreciation, investment income, or both; and (iii) the company or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income. ASU 2013-08 also sets forth the scope, measurement and disclosure requirements for investment companies. ASU 2013-08 became effective for the Corporation on January 1, 2014 and did not have a significant impact on the Corporation's financial statements.

ASU 2013-10, "Derivatives and Hedging (Topic 815) – Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes." ASU 2013-10 permits the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to interest rates on direct Treasury obligations of the U.S. government and the London Interbank Offered Rate ("LIBOR"). ASU 2013-10 became effective for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013 and did not have a significant impact on the Corporation's financial statements.

ASU 2013-12, "Definition of a Public Business Entity - An Addition to the Master Glossary." ASU 2013-12 amends the Master Glossary of the FASB Accounting Standards Codification to include one definition of public business entity for future use in U.S. GAAP and identifies the types of business entities that are excluded from the scope of the Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies. ASU 2013-12 did not have a significant impact on the Corporation's financial statements.

ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective for the Corporation on January 1, 2017 and is not expected to have a significant impact on the Corporation's financial statements.

ASU 2014-11, "Transfers and Servicing (Topic 860)." ASU 2014-11 requires that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. ASU 2014-11 requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral, remaining contractual tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 is effective for the Corporation on January 1, 2015 and is not expected to have a significant impact on the Corporation's financial statements.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Review

Cullen/Frost Bankers, Inc.

The following discussion should be read in conjunction with the Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2013, included in the 2013 Form 10-K. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results for the year ending December 31, 2014 or any future period.

Dollar amounts in tables are stated in thousands, except for per share amounts.

Forward-Looking Statements and Factors that Could Affect Future Results

Certain statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), notwithstanding that such statements are not specifically identified as such. In addition, certain statements may be contained in the Corporation's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Corporation that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to:

(i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of Cullen/Frost or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "targeted", "continue", "remain", "will", "should", "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

• Local, regional, national and international economic conditions and the impact they may have on the Corporation and its customers and the Corporation's assessment of that impact.

• Volatility and disruption in national and international financial markets.

• Government intervention in the U.S. financial system.

• Changes in the mix of loan geographies, sectors and types or the level of non-performing assets and charge-offs.

• Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.

• The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.

• Inflation, interest rate, securities market and monetary fluctuations.

• The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Corporation and its subsidiaries must comply.

• The soundness of other financial institutions.

• Political instability.

• Impairment of the Corporation's goodwill or other intangible assets.

• Acts of God or of war or terrorism.

• The timely development and acceptance of new products and services and perceived overall value of these products and services by users.

• Changes in consumer spending, borrowings and savings habits.

• Changes in the financial performance and/or condition of the Corporation's borrowers.

• Technological changes.

• Acquisitions and integration of acquired businesses.

• The ability to increase market share and control expenses.

• The Corporation's ability to attract and retain qualified employees.

•

Changes in the competitive environment in the Corporation's markets and among banking organizations and other financial service providers.

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.

- Changes in the reliability of the Corporation's vendors, internal control systems or information systems.

Changes in the Corporation's liquidity position.

Changes in the Corporation's organization, compensation and benefit plans.

Table of Contents

The costs and effects of legal and regulatory developments, the resolution of legal proceedings or regulatory or other governmental inquiries, the results of regulatory examinations or reviews and the ability to obtain required regulatory approvals.

Greater than expected costs or difficulties related to the integration of new products and lines of business.

- The Corporation's success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. The Corporation undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

Application of Critical Accounting Policies and Accounting Estimates

The accounting and reporting policies followed by the Corporation conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. 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 amounts reported in the financial statements and accompanying notes. While the Corporation bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The Corporation considers accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the Corporation's financial statements. Accounting policies related to the allowance for loan losses are considered to be critical, as these policies involve considerable subjective judgment and estimation by management.

For additional information regarding critical accounting policies, refer to Note 1 - Summary of Significant Accounting Policies in the notes to consolidated financial statements and the sections captioned "Application of Critical Accounting Policies and Accounting Estimates" and "Allowance for Loan Losses" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2013 Form 10-K. There have been no significant changes in the Corporation's application of critical accounting policies related to the allowance for loan losses since December 31, 2013.

Overview

A discussion of the Corporation's results of operations is presented below. Certain reclassifications have been made to make prior periods comparable. Taxable-equivalent adjustments are the result of increasing income from tax-free loans and securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 35% federal income tax rate, thus making tax-exempt asset yields comparable to taxable asset yields.

Table of Contents

Results of Operations

Net income available to common shareholders totaled \$64.5 million, or \$1.02 diluted per common share, and \$123.6 million, or \$1.99 diluted per common share, for the three and six months ended June 30, 2014 compared to \$57.0 million, or \$0.94 diluted per common share, and \$112.2 million, or \$1.85 diluted per common share, for the three and six months ended June 30, 2013, respectively. During the second quarter of 2014, the Corporation acquired WNB Bancshares, Inc. ("WNB"). Accordingly, the operating results of WNB are included with the Corporation's results of operations since May 30, 2014. See Note 2 - Mergers and Acquisitions in the accompanying consolidated financial statements.

Selected income statement data, returns on average assets and average common equity and dividends per common share for the comparable periods was as follows:

	Three Months Ended		Six Months Ended		
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	
Taxable-equivalent net interest income	\$ 198,926	\$ 173,966	\$ 386,720	\$ 346,767	
Taxable-equivalent adjustment	29,297	20,785	56,756	40,773	
Net interest income	169,629	153,181	329,964	305,994	
Provision for loan losses	4,924	3,575	11,524	9,575	
Net interest income after provision for loan losses	164,705	149,606	318,440	296,419	
Non-interest income	79,150	72,509	156,640	150,289	
Non-interest expense	163,970	149,758	321,911	305,572	
Income before income taxes	79,885	72,357	153,169	141,136	
Income taxes	13,415	12,694	25,511	26,285	
Net income	66,470	59,663	127,658	114,851	
Preferred stock dividends	2,015	2,688	4,031	2,688	
Net income available to common shareholders	\$ 64,455	\$ 56,975	\$ 123,627	\$ 112,163	
Earnings per common share – basic	\$ 1.03	\$ 0.95	\$ 2.00	\$ 1.86	
Earnings per common share – diluted	1.02	0.94	1.99	1.85	
Dividends per common share	0.51	0.50	1.01	0.98	
Return on average assets	1.04	% 1.03	% 1.02	% 1.02	%
Return on average common equity	10.33	9.93	10.15	9.71	
Average shareholders' equity to average assets	10.66	11.00	10.65	10.97	

Net income available to common shareholders increased \$7.5 million, or 13.1% , for the three months ended June 30, 2014 and increased \$11.5 million, or 10.2% for the six months ended June 30, 2014 compared to the same periods in 2013. The increase during the three months ended June 30, 2014 was primarily the result of a \$16.4 million increase in net interest income, a \$6.6 million increase in non-interest income and a \$673 thousand decrease in preferred stock dividends partly offset by a \$14.2 million increase in non-interest expense, a \$1.3 million increase in the provision for loan losses and a \$721 thousand increase in income tax expense. The increase during the six months ended June 30, 2014 was primarily the result of a \$24.0 million increase in net interest income, a \$6.4 million increase in non-interest income and a \$774 thousand decrease in income tax expense partly offset by a \$16.3 million increase in non-interest expense, a \$1.3 million increase in preferred stock dividends and a \$1.9 million increase in the provision for loan losses.

The Corporation's preferred stock was issued on February 15, 2013. The initial quarterly dividend payment during the second quarter of 2014 occurred on June 15, 2014. This dividend payment included an additional amount applicable to the period from the issuance date through March 15, 2014, the start date of the normal quarterly dividend cycle.

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

Net Interest Income

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Corporation's largest source of revenue, representing 67.8% of total revenue during the first six months of 2014. Net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the

period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Federal Reserve influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Corporation's loan portfolio is significantly affected by changes in the prime interest rate. The prime

Table of Contents

interest rate, which is the rate offered on loans to borrowers with strong credit, remained at 3.25% for the entire year in 2013 and through the second quarter of 2014. The Corporation's loan portfolio is also impacted, to a lesser extent, by changes in the London Interbank Offered Rate (LIBOR). At June 30, 2014, the one-month and three-month U.S. dollar LIBOR rates were 0.16% and 0.23%, respectively, while at June 30, 2013, the one-month and three-month U.S. dollar LIBOR rates were 0.20% and 0.27%, respectively. The intended federal funds rate, which is the cost of immediately available overnight funds, remained at zero to 0.25% for the entire year in 2013 and through the second quarter of 2014.

The Corporation's balance sheet has historically been asset sensitive, meaning that earning assets generally reprice more quickly than interest-bearing liabilities. Therefore, the Corporation's net interest margin was likely to increase in sustained periods of rising interest rates and decrease in sustained periods of declining interest rates. During the fourth quarter of 2007, in an effort to make the Corporation's balance sheet less sensitive to changes in interest rates, the Corporation entered into various interest rate swaps which effectively converted certain variable-rate loans into fixed-rate instruments for a period of seven years. During the fourth quarter of 2008, the Corporation also entered into an interest rate swap which effectively converted variable-rate debt into fixed-rate debt for a period of five years. As a result of these actions, the Corporation's balance sheet was more interest-rate neutral and changes in interest rates had a less significant impact on the Corporation's net interest margin than would have otherwise been the case. During the fourth quarter of 2009, a portion of the interest rate swaps on variable-rate loans was terminated, while the remaining interest rate swaps on variable-rate loans were terminated during the fourth quarter of 2010. These actions increased the asset sensitivity of the Corporation's balance sheet. The deferred accumulated gain applicable to the settled interest rate contracts included in accumulated other comprehensive income totaled \$11.9 million (\$7.7 million on an after-tax basis) at June 30, 2014. The remaining deferred gain of \$11.9 million (\$7.7 million on an after-tax basis) will be recognized ratably in interest income through October 2014. See Note 9 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements included elsewhere in this report for additional information related to these interest rate swaps.

The Corporation is primarily funded by core deposits, with non-interest-bearing demand deposits historically being a significant source of funds. This lower-cost funding base is expected to have a positive impact on the Corporation's net interest income and net interest margin in a rising interest rate environment. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts beginning July 21, 2011. Although the impact of this legislation on the Corporation has not yet been determined, the Corporation may begin to incur interest costs associated with demand deposits in the future as market conditions warrant. See Item 3. Quantitative and Qualitative Disclosures About Market Risk elsewhere in this report for information about the expected impact of this legislation on the Corporation's sensitivity to interest rates. Further analysis of the components of the Corporation's net interest margin is presented below.

The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities. The changes in net interest income due to changes in both average volume and average interest rate have been allocated to the average volume change or the average interest rate change in proportion to the absolute amounts of the change in each.

	Quarter to Date June 30, 2014	Year to Date June 30, 2014
	vs.	vs.
	June 30, 2013	June 30, 2013
Due to changes in average volumes	\$22,394	\$38,527
Due to changes in average interest rates	2,566	1,426
Total change	\$24,960	\$39,953

Taxable-equivalent net interest income for the three months ended June 30, 2014 increased \$25.0 million, or 14.3%, while taxable-equivalent net interest income for the six months ended June 30, 2014 increased \$40.0 million, or 11.5%, compared to the same periods in 2013, respectively. The increase during the three and six months ended June

30, 2014 was primarily related to an increase in the average volume of interest-earning assets and an increase in the net interest margin. The average volume of interest-earning assets for the three months ended June 30, 2014 increased \$2.6 billion, while the average volume of interest-earning assets for the six months ended June 30, 2014 increased \$2.2 billion compared to the same periods in 2013. Over the same time frame, the net interest margin increased 5 basis points from 3.43% during the three months ended June 30, 2013 to 3.48% during the three months ended June 30, 2014 and increased 1 basis point from 3.44% during the six months ended June 30, 2013 to 3.45% during the six months ended June 30, 2014. The increase in the net interest margin during the three and six months ended June 30, 2014 was primarily due an increase in the average yield on securities combined with a decrease in the average cost of funds. The net interest margin was negatively impacted by an increase in the relative proportion of average interest-earning assets invested in lower-yielding, interest-bearing deposits during 2014 compared to 2013 while the relative proportion of interest-earning assets

Table of Contents

invested in higher-yielding securities and loans decreased. These items are more fully discussed below. The average yield on interest-earning assets decreased 5 basis points from 3.56% in the first six months of 2013 to 3.51% in the first six months of 2014 while the average cost of funds decreased 10 basis points from 0.20% in the first six months of 2013 to 0.10% in the first six months of 2014. The average yield on interest-earning assets is primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of interest-earning assets. As stated above, market interest rates have remained at historically low levels during the reported periods. The effect of lower average market interest rates during the reported periods on the average yield on average interest-earning assets was partly limited by the aforementioned interest rate swaps on variable-rate loans.

The average volume of loans during the first six months of 2014 increased \$672.1 million compared to the same period in 2013. Loans made up approximately 43.4% of average interest-earning assets during the first six months of 2014 compared to 44.8% during the first six months of 2013. The average yield on loans decreased 13 basis points from 4.59% during the first six months of 2013 to 4.46% during the first six months of 2014. The decrease in the average yield on loans was partly related to lower average spreads due to increased competition in loan pricing. Loans generally have significantly higher yields compared to securities, interest-bearing deposits and federal funds sold and resell agreements and, as such, have a more positive effect on the net interest margin.

The average volume of securities during the first six months of 2014 decreased \$229.2 million compared to the same period in 2013. Securities made up approximately 38.8% of average interest-earning assets during the first six months of 2014 compared to 44.1% during the first six months of 2013. The average yield on securities was 3.95% in the first six months of 2014 compared to 3.34% in the first six months of 2013. The average yield on securities increased 61 basis points during the first six months of 2014 compared to the first six months of 2013 as a result of an increase in the relative proportion of investments held in higher-yielding, tax-exempt municipal securities. Tax-exempt municipal securities totaled 52.5% of average securities during the first six months of 2014 compared to 36.4% during the first six months of 2013. The average yield on taxable securities was 2.13% in the first six months of 2014 compared to 1.90% in the first six months of 2013, while the average taxable-equivalent yield on tax-exempt securities was 5.58% in the first six months of 2014 compared to 5.82% in the first six months of 2013. The average taxable-equivalent yield on tax-exempt securities decreased 24 basis points during the first six months of 2014 compared to the first six months of 2013 in part due to the investment of funds in lower-yielding, shorter duration municipal securities during the latter part of 2013.

Average federal funds sold, resell agreements and interest-bearing deposits during the first six months of 2014 increased \$1.7 billion compared to the same period in 2013. Federal funds sold, resell agreements and interest-bearing deposits made up approximately 17.8% of average interest-earning assets during the first six months of 2014 compared to 11.1% during the first six months of 2013. The combined average yield on federal funds sold, resell agreements and interest-bearing deposits was 0.26% and 0.25% during the first six months of 2014 and 2013, respectively. The increase in average federal funds sold, resell agreements and interest-bearing deposits compared to the first six months of 2013 was primarily related to excess liquidity from deposit growth.

Average deposits increased \$2.1 billion during the first six months of 2014 compared to the first six months of 2013. Average interest-bearing deposits for the first six months of 2014 increased \$1.1 billion compared to the same period in 2013, while average non-interest-bearing deposits for the first six months of 2014 increased \$1.0 billion compared to the same period in 2013. The ratio of average interest-bearing deposits to total average deposits was 59.5% during the first six months of 2014 compared to 60.3% during the first six months of 2013. The average cost of deposits is primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of interest-bearing deposits. The average cost of interest-bearing deposits and total deposits was 0.08% and 0.05% during the first six months of 2014 compared to 0.14% and 0.08% during the same periods in 2013. The decrease in the average cost of interest-bearing deposits during the comparable periods was primarily the result of decreases in interest rates offered on certain deposit products due to decreases in average market interest rates and decreases in renewal interest rates on maturing certificates of deposit given the current low interest rate environment. Additionally, the relative proportion of higher-cost certificates of deposit to total average interest-bearing deposits decreased from 8.7% during the first six months of 2013 to 7.7% during the first six months of 2014.

The Corporation's net interest spread, which represents the difference between the average rate earned on earning assets and the average rate paid on interest-bearing liabilities, was 3.41% during the first six months of 2014 compared to 3.36% during the first six months of 2013. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment. A discussion of the effects of changing interest rates on net interest income is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

The Corporation's hedging policies permit the use of various derivative financial instruments, including interest rate swaps, swaptions, caps and floors, to manage exposure to changes in interest rates. Details of the Corporation's derivatives and hedging activities are set forth in Note 9 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements

Table of Contents

included elsewhere in this report. Information regarding the impact of fluctuations in interest rates on the Corporation's derivative financial instruments is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

Provision for Loan Losses

The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses totaled \$4.9 million and \$11.5 million for the three and six months ended June 30, 2014 compared to \$3.6 million and \$9.6 million for the three and six months ended June 30, 2013. See the section captioned "Allowance for Loan Losses" elsewhere in this discussion for further analysis of the provision for loan losses.

Non-Interest Income

The components of non-interest income were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Trust and investment management fees	\$26,748	\$22,561	\$52,159	\$44,446
Service charges on deposit accounts	20,462	20,044	40,436	40,088
Insurance commissions and fees	9,823	9,266	22,949	22,336
Interchange and debit card transaction fees	4,627	4,268	8,870	8,279
Other charges, commissions and fees	8,550	8,578	16,757	16,333
Net gain (loss) on securities transactions	2	6	2	11
Other	8,938	7,786	15,467	18,796
Total	\$79,150	\$72,509	\$156,640	\$150,289

Total non-interest income for the three and six months ended June 30, 2014 increased \$6.6 million, or 9.2%, and \$6.4 million, or 4.2%, compared to the same periods in 2013. Changes in the components of non-interest income are discussed below.

Trust and Investment Management Fees. Trust and investment management fees for the three and six months ended June 30, 2014 increased \$4.2 million, or 18.6%, and \$7.7 million, or 17.4%, compared to the same periods in 2013. Trust investment fees are the most significant component of trust and investment management fees, making up approximately 68% and 67% of total trust and investment management fees for the first six months of 2014 and 2013, respectively. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related trust investment fees.

The increase in trust and investment management fees during the three months ended June 30, 2014 compared to the same period in 2013 was primarily the result of an increase in trust investment fees (up \$3.0 million), oil and gas fees (up \$877 thousand) and estate fees (up \$450 thousand). The increase in trust and investment management fees during the six months ended June 30, 2014 compared to the same period in 2013 was primarily the result of an increase in trust investment fees (up \$5.7 million), oil and gas fees (up \$1.1 million), estate fees (up \$570 thousand) and real estate fees (up \$450 thousand). The increases in trust investment fees during the three and six months ended June 30, 2014 compared to the same periods in 2013 were partly due to higher average equity valuations during 2014, business development efforts and a change in the fee schedule beginning in the fourth quarter of 2013. The increases in oil and gas fees during the six months ended June 30, 2014 compared to the same periods in 2013 were partly related to increased mineral production.

At June 30, 2014, trust assets, including both managed assets and custody assets, were primarily composed of equity securities (47.4% of assets), fixed income securities (39.1% of assets) and cash equivalents (7.9% of assets). The estimated fair value of these assets was \$29.9 billion (including managed assets of \$12.6 billion and custody assets of \$17.3 billion) at June 30, 2014, compared to \$28.4 billion (including managed assets of \$11.9 billion and custody assets of \$16.5 billion) at December 31, 2013 and \$26.3 billion (including managed assets of \$11.1 billion and custody assets of \$15.2 billion) at June 30, 2013.

Service Charges on Deposit Accounts. Service charges on deposit accounts for the three and six months ended June 30, 2014 increased \$418 thousand, or 2.1%, and \$348 thousand, or 0.9%, compared to the same periods in 2013. The increase was primarily due to increases in service charges on commercial accounts (up \$529 thousand and \$918 thousand during the three and six months ended June 30, 2014, respectively) partly offset by a decrease in overdraft/insufficient funds charges on consumer accounts (down \$53 thousand and \$429 thousand during the three and six months ended June 30, 2014, respectively). Overdraft/insufficient funds charges totaled \$7.9 million (\$6.1 million consumer and \$1.8 million commercial) during the three months ended June 30, 2014

Table of Contents

compared to \$7.9 million (\$6.2 million consumer and \$1.7 million commercial) during the same period in 2013. Overdraft/insufficient funds charges totaled \$15.4 million (\$11.9 million consumer and \$3.5 million commercial) during the six months ended June 30, 2014 compared to \$15.9 million (\$12.4 million consumer and \$3.5 million commercial) during six months ended June 30, 2013.

Insurance Commissions and Fees. Insurance commissions and fees for the three and six months ended June 30, 2014 increased \$557 thousand, or 6.0%, and \$613 thousand, or 2.7%, compared to the same periods in 2013. The increase during the three months ended June 30, 2014 was related to an increases in commission income (up \$328 thousand) and contingent commissions (up \$229 thousand). The increase during the six months ended June 30, 2014 was related to an increase in commission income (up \$640 thousand) partly offset by a decrease in contingent commissions (down \$27 thousand). The increases in commission income during the three and six months ended June 30, 2014 were primarily related to increases in commercial lines property and casualty commissions resulting from the impact of the acquisition of Kolkhorst Insurance Agency during the fourth quarter of 2013, new business and, to a lesser extent, higher rates, partly offset by decreases in employee benefit commissions and fees. The decrease in employee benefit commissions and fees during 2014 was partly related to customers electing to early renew policies during the fourth quarter of 2013 as a result of the Affordable Care Act.

Insurance commissions and fees include contingent commissions totaling \$586 thousand and \$3.1 million during the three and six months ended June 30, 2014 compared to \$357 thousand and \$3.1 million during the three and six months ended June 30, 2013. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers related to the loss performance of insurance policies previously placed. Such commissions are seasonal in nature and are generally received during the first quarter of each year. These commissions totaled \$2.0 million and \$2.1 million during the six months ended June 30, 2014 and 2013, respectively. Contingent commissions also include amounts received from various benefit plan insurance companies related to the volume of business generated and/or the subsequent retention of such business. These benefit plan related commissions totaled \$587 thousand and \$1.1 million during the three and six months ended June 30, 2014 and \$354 thousand and \$1.0 million during the three and six months ended June 30, 2013.

Interchange and Debit Card Transaction Fees. Interchange and debit card transaction fees consist of income from check card usage, point of sale income from PIN-based debit card transactions and ATM service fees. Interchange and debit card transaction fees for the three and six months ended June 30, 2014 increased \$359 thousand, or 8.4%, and \$591 thousand, or 7.1% compared to the three and six months ended June 30, 2013. The increases are primarily due to increases in income from check card usage (up \$797 thousand and \$1.5 million for the three and six months ended June 30, 2014, respectively) partly offset by decreases in point of sale income from PIN-based debit card transactions (down \$405 thousand and \$814 thousand for the three and six months ended June 30, 2014, respectively).

Federal Reserve rules applicable to financial institutions that have assets of \$10 billion or more provide that the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction. An upward adjustment of no more than 1 cent to an issuer's debit card interchange fee is allowed if the card issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. In July 2013, a federal judge vacated the Federal Reserve's rule setting debit transaction interchange fees under the Dodd-Frank Act, on the basis that the rule violated the intent of the law. The ruling states that only incremental costs, such as those related to authorization, clearing and settlement, incurred by the issuer for a particular debit transaction should be allowed and the Federal Reserve should not have considered fixed costs, fraud prevention costs, fraud losses and network fees when determining the fee cap. The judge's ruling was stayed in September 2013 and subsequently reversed on appeal in March 2014. Because of the uncertainty as to the outcome of any further litigation and any future rulemaking by the Federal Reserve, the Corporation cannot provide any assurance as to the ultimate impact of any rule change on the amount of interchange and debit card transaction fees reported in future periods.

Other Charges, Commissions and Fees. Other charges, commissions and fees for the three months ended June 30, 2014 decreased \$28 thousand, or 0.3%, compared to the same period in 2013. The decrease in other charges, commissions and fees during the three months ended June 30, 2014 included decreases in income related to the sale of annuities (down \$277 thousand), human resources consulting revenue (down \$125 thousand) and other service

charges (down \$98 thousand). These decreases were mostly offset by increases in wire transfer fees, in part due to a new fee schedule, (up \$377 thousand) and unused balance fees on loan commitments (up \$130 thousand). Other charges, commissions and fees for the six months ended June 30, 2014 increased \$424 thousand, or 2.6% compared to the same period in 2013. The increase in other charges, commissions and fees during the six months ended June 30, 2014 included increases in wire transfer fees, in part due to a new fee schedule, (up \$742 thousand) and unused balance fees on loan commitments (up \$265 thousand). These increases were partly offset by decreases in letter of credit fees (down \$231 thousand), other service charges (down \$206 thousand) and human resources consulting revenue (down \$115 thousand).

Table of Contents

Net Gain/Loss on Securities Transactions. During the six months ended June 30, 2014, the Corporation sold available-for-sale securities with an amortized cost totaling \$2.0 million and realized a net gain of \$2 thousand on those sales. These securities consisted of municipal securities acquired in connection with the acquisition of WNB during the second quarter of 2014. During the six months ended June 30, 2013, the Corporation sold available-for-sale securities with an amortized cost totaling \$8.5 billion and realized a net gain of \$11 thousand on those sales. These securities were primarily purchased during 2013 and subsequently sold in connection with the Corporation's tax planning strategies related to the Texas franchise tax. The gross proceeds from the sales of these securities outside of Texas are included in total revenues/receipts from all sources reported for Texas franchise tax purposes, which results in a reduction in the overall percentage of revenues/receipts apportioned to Texas and subjected to taxation under the Texas franchise tax.

Other Non-Interest Income. Other non-interest income for the three months ended June 30, 2014 increased \$1.2 million, or 14.8%, compared to the same period in 2013. Other non-interest income during the three months ended June 30, 2014 included increases in sundry income from various miscellaneous items (up \$958 thousand) and income from securities trading and customer derivative transactions (up \$865 thousand). During the second quarter of 2014, sundry income from various miscellaneous items included \$1.3 million related to a distribution received on a small business investment company ("SBIC") investment and \$1.3 million related to the recovery of interest on loans charged-off in previous years. The increase in income from securities trading and customer derivative transactions was primarily related to an increase in customer interest rate swap transaction fees. The increase from the aforementioned items was partly offset by an decrease in gains realized on the sale of assets (down \$455 thousand). During the second quarter of 2013, the Corporation recognized a \$251 thousand gain related to the sale of a building.

Other non-interest income for the six months ended June 30, 2014 decreased \$3.3 million, or 17.7%, compared to the same period in 2013. Other non-interest income during the six months ended June 30, 2013 included \$4.5 million related to the sale of a building and parking garage, as further discussed below. Excluding the impact of the prior-year gain, other non-interest income effectively increased \$1.1 million. This effective increase in other non-interest income during the six months ended June 30, 2014 included increases in sundry income from various miscellaneous items, in part due to the aforementioned items above, (up \$1.1 million), income from securities trading and customer derivative transactions (up \$815 thousand) and mineral interest income related to bonus, rental and shut-in payments and oil and gas royalties received from severed mineral interests on property owned by Main Plaza Corporation, a wholly owned non-banking subsidiary of the Corporation (up \$295 thousand). The increase from these items was partly offset by decreases in income from public finance underwriting (down \$404 thousand) and income related to earnings on the cash surrender value of life insurance policies (down \$285 thousand).

During the first quarter of 2013, the Corporation realized a \$5.6 million gain related to the sale of a building and parking garage. The Corporation leased back portions of the building through the third quarter of 2013 and the first quarter of 2015. As a result, a portion of the gain was deferred and only \$4.5 million of the total \$5.6 million gain was recognized during the six months ended June 30, 2013. During the first six months of 2014, other non-interest income included \$307 thousand related to the amortization of the deferred gain. The remaining deferred portion of the gain, which totaled \$461 thousand at June 30, 2014, will be recognized ratably over the remaining lease period.

Non-Interest Expense

The components of non-interest expense were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Salaries and wages	\$70,473	\$66,502	\$140,690	\$132,967
Employee benefits	14,806	14,629	32,194	32,620
Net occupancy	13,733	12,645	26,686	24,624
Furniture and equipment	15,207	14,986	30,160	29,171
Deposit insurance	3,145	2,835	6,262	5,724
Intangible amortization	806	788	1,495	1,608
Other	45,800	37,373	84,424	78,858

Total	\$163,970	\$149,758	\$321,911	\$305,572
-------	-----------	-----------	-----------	-----------

Total non-interest expense for the three and six months ended June 30, 2014 increased \$14.2 million, or 9.5%, and \$16.3 million, or 5.3%, compared to the same periods in 2013. Other non-interest expense during the three and six months ended June 30, 2014 was particularly impacted by the acquisition of WNB. Changes in the components of non-interest expense, including the aforementioned acquisition related expenses, are discussed below.

Table of Contents

Salaries and Wages. Salaries and wages for the three and six months ended June 30, 2014 increased \$4.0 million, or 6.0%, and \$7.7 million, or 5.8% compared to the same periods in 2013. This increases were primarily related to an increase in the number of employees and normal annual merit and market increases partly offset by decreases in stock-based compensation expense.

Employee Benefits. Employee benefits expense for the three months ended June 30, 2014 increased \$177 thousand, or 1.2%, compared to the same period in 2013. The increase was primarily related to increases in expenses related to the Corporation's 401 (k) and profit sharing plans (up \$690 thousand), medical insurance expense (up \$407 thousand) and payroll taxes (up \$205 thousand). The increases in the these items were mostly offset by decrease in expenses related to the Corporation's defined benefit retirement plans. The Corporation recognized a combined net periodic pension benefit of \$457 thousand on its defined benefit retirement plans during the second quarter of 2014 compared to a combined net periodic pension expense of \$703 thousand during the second quarter of 2013, resulting in a \$1.2 million decrease in expenses related to the Corporation's defined benefit retirement plans. Employee benefits expense for the six months ended June 30, 2014 decreased \$426 thousand, or 1.3% compared to the same period in 2013. The decrease was primarily related to a decrease in expenses related to the Corporation's defined benefit retirement plans (down \$2.3 million). The Corporation recognized a combined net periodic pension benefit of \$913 thousand on its defined benefit retirement plans during the first six months of 2014 compared to a combined net periodic pension expense of \$1.4 million during the first six months of 2013. The decrease in employee benefits expense for the six months ended June 30, 2014 was partly offset by increases in medical insurance expense (up \$685 thousand), payroll taxes (up \$560 thousand) and expenses related to the Corporation's 401(k) and profit sharing plans (up \$507 thousand). The Corporation's defined benefit retirement and restoration plans were frozen effective as of December 31, 2001 and were replaced by a profit sharing plan. Management believes these actions helped to reduce the volatility in retirement plan expense. However, the Corporation still has funding obligations related to the defined benefit and restoration plans and could recognize retirement expense related to these plans in future years, which would be dependent on the return earned on plan assets, the level of interest rates and employee turnover.

Net Occupancy. Net occupancy expense for the three and six months ended June 30, 2014 increased \$1.1 million, or 8.6%, and \$2.1 million, or 8.4%, compared to the same periods in 2013. The increases were primarily related to increases in lease expense (up \$800 thousand and \$1.4 million during the three and six months ended June 30, 2014, respectively), repairs and maintenance expense (up \$285 thousand and \$387 thousand during the three and six months ended June 30, 2014, respectively), building depreciation (up \$145 thousand and \$191 thousand during the three and six months ended June 30, 2014, respectively) and, during the six months ended June 30, 2014, a decrease in parking garage income (down \$153 thousand) due to the sale of a parking garage during the first quarter of 2013.

Furniture and Equipment. Furniture and equipment expense for the three and six months ended June 30, 2014 increased \$221 thousand, or 1.5%, and \$989 thousand, or 3.4%, compared to the same periods in 2013. The increases during the three months and six months ended June 30, 2014 were primarily related to increases in software maintenance (up \$539 thousand and \$850 thousand during the three and six months ended June 30, 2014, respectively) and furniture and fixtures depreciation (up \$134 thousand and \$425 thousand during the three and six months ended June 30, 2014, respectively). The increases from the aforementioned items were party offset by decreases in service contracts expense (down \$232 thousand and \$198 thousand for the three and six months ended June 30, 2014, respectively) and software amortization (down \$116 thousand and \$65 thousand for the three and six months ended June 30, 2014, respectively).

Deposit Insurance. Deposit insurance expense totaled \$3.1 million and \$6.3 million for the three and six months ended June 30, 2014 compared to \$2.8 million and \$5.7 million for the three and six months ended June 30, 2013. The increases in deposit insurance expense for the three and six months ended 2014 compared to the same periods in 2013 were primarily related to an increase in assets.

Intangible Amortization. Intangible amortization is primarily related to core deposit intangibles and, to a lesser extent, intangibles related to customer relationships and non-compete agreements. Intangible amortization for the three months ended June 30, 2014 increased \$18 thousand, or 2.3%, while intangible amortization for the six months ended June 30, 2014 decreased \$113 thousand, or 7.0%, compared to the same periods in 2013. Intangible amortization during the three months ended June 30, 2014 was impacted by the amortization of the core deposit intangible recorded

in connection with the acquisition of WNB during the second quarter of 2014. The decrease in intangible amortization during the six months ended June 30, 2014 was primarily the result of the completion of amortization of certain intangible assets as well as a reduction in the annual amortization rate of certain intangible assets as the Corporation uses an accelerated amortization approach which results in higher amortization rates during the earlier years of the useful lives of intangible assets. The decrease in intangible amortization was partly offset by the additional amortization related to intangible assets recorded in connection with the acquisition of Kolkhorst Insurance Agency, Inc. during the fourth quarter of 2013 and the aforementioned core deposit intangible recorded in connection with the acquisition of WNB during the second quarter of 2014.

Table of Contents

Other Non-Interest Expense. Other non-interest expense for the three and six months ended June 30, 2014 increased \$8.4 million, or 22.5%, and \$5.6 million, or 7.1%, compared to the same periods in 2013. The increases were impacted by expenses related to the acquisition of WNB during the second quarter of 2014. Acquisition related expenses included in other non-interest expense totaled \$4.8 million and \$6.0 million during the three and six months ended June 30, 2014, respectively. Such amounts included \$3.2 million in professional services expenses, \$1.3 million in severance and \$1.5 million in various other expenses during the six months ended June 30, 2014. Additionally, during the six months ended June 30, 2013, the Corporation wrote down certain land and other assets totaling \$7.2 million. Approximately, \$6.2 million of this amount was related to the write-down of certain long-term bank owned property in downtown San Antonio that was made available for sale. Excluding the aforementioned acquisition related expenses during 2014 and the write-downs in 2013, other non-interest expense for the three and six months ended June 30, 2014 effectively increased \$3.6 million, or 9.6%, and \$6.8 million, or 9.4%, compared to the same periods in 2013. The effective increase during the three months ended June 30, 2014 was partly related to increases in check card expense (up \$1.6 million), sundry and other miscellaneous expenses (up \$753 thousand), write-downs of other real estate owned (up \$658 thousand) and professional services expense (up \$235 thousand), among other things. The effective increase during the six months ended June 30, 2014 was partly related to increases in check card expense (up \$1.8 million); amortization of net deferred cost related to loan commitments (up \$1.3 million); sundry and other miscellaneous expenses (up \$928 thousand); professional services expense (up \$638 thousand); advertising/promotions expense (up \$416 thousand); and travel, meals and entertainment expense (up \$430 thousand); among other items.

Results of Segment Operations

The Corporation's operations are managed along two operating segments: Banking and Frost Wealth Advisors. A description of each business and the methodologies used to measure financial performance is described in Note 16 - Operating Segments in the accompanying notes to consolidated financial statements included elsewhere in this report. Net income (loss) by operating segment is presented below:

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Banking	\$63,872	\$56,582	\$119,928	\$110,135
Frost Wealth Advisors	5,388	4,263	10,472	7,501
Non-Banks	(2,790)	(1,182)	(2,742)	(2,785)
Consolidated net income	\$66,470	\$59,663	\$127,658	\$114,851

Banking

Net income for the three and six months ended June 30, 2014 increased \$7.3 million, or 12.9%, and \$9.8 million, or 8.9%, compared to the same periods in 2013. The increase during the three months ended June 30, 2014 was primarily the result of a \$15.3 million increase in net interest income and a \$2.7 million increase in non-interest income partly offset by an \$8.9 million increase in non-interest expense, a \$1.3 million increase in the provision for loan losses and a \$518 thousand increase in income tax expense. The increase during the six months ended June 30, 2014 was primarily the result of a \$21.7 million increase in net interest income and a \$2.7 million decrease in income tax expense partly offset by an \$11.0 million increase in non-interest expense, a \$1.9 million increase in the provision for loan losses and a \$1.7 million decrease in non-interest income.

Net interest income for the three and six months ended June 30, 2014 increased \$15.3 million, or 10.0%, and \$21.7 million, or 7.1%, compared to the same periods in 2013. The increases were primarily related to increases in the average volume of interest-earning assets and increases in the net interest margin. See the analysis of net interest income included in the section captioned "Net Interest Income" included elsewhere in this discussion.

The provision for loan losses for the three and six months ended June 30, 2014 totaled \$4.9 million and \$11.5 million compared to \$3.6 million and \$9.6 million for the same periods in 2013. The increases were partly due to an increase in the volume of loans compared to the same periods in 2013. See the analysis of the provision for loan losses included in the section captioned "Allowance for Loan Losses" included elsewhere in this discussion.

Non-interest income for the three months ended June 30, 2014 increased \$2.7 million, or 6.1%, while non-interest income for the six months ended June 30, 2014 decreased \$1.7 million, or 1.8%, compared to the same periods in 2013, respectively. The increase in non-interest income during the three months ended June 30, 2014 was primarily related to increases in other non-interest income, insurance commissions and fees, service charges on deposits and interchange and debit card transaction fees. The decrease in non-interest income during the six months ended June 30, 2014 was primarily related to a decrease in other non-interest income partly offset by increases in insurance commissions and fees and interchange and debit card transaction fees. The increase in other non-interest income during the three months ended June 30, 2014 was partly related to a distribution received on a capital

Table of Contents

investment, the recovery of interest on loans charged-off in previous years and an increase in income from securities trading and customer derivative transactions. The decrease in other non-interest income during the six months ended was primarily related to a non-recurring gain realized on the sale of a building and parking garage during the first six months of 2013. The increases in insurance commissions and fees for the three and six months ended June 30, 2014 were primarily related to increases in commercial lines property and casualty commissions resulting from new business and, to a lesser extent, higher rates, partly offset by decreases in employee benefit commissions and fees. The increases in interchange and debit card transaction fees for the three and six months ended June 30, 2014 were primarily due to increases in income from check card usage partly offset by decreases in point of sale income from PIN-based debit card transactions. See the analysis of these categories of non-interest income included in the section captioned "Non-Interest Income" included elsewhere in this discussion.

Non-interest expense for the three and six months months ended June 30, 2014 increased \$8.9 million, or 7.1%, and \$11.0 million, or 4.3%, compared to the same periods in 2013. The increase during the three months ended June 30, 2014 was primarily due to increases in other non-interest expense, salaries and wages and net occupancy. The increase during the six months ended June 30, 2014 was primarily due to increases in salaries and wages, net occupancy, other non-interest expense and furniture and equipment expense.

The increase in other non-interest expense during the three months ended June 30, 2014 was partly related to increases in check card expense, sundry and other miscellaneous expenses, write-downs of other real estate owned and professional services expense, among other things. The increase in other non-interest expense during the six months ended June 30, 2014 was partly related to increases in check card expense; amortization of net deferred cost related to loan commitments; sundry and other miscellaneous expenses; professional services expense; advertising/promotions expense; and travel, meals and entertainment expense; among other things. The increases in salaries and wages during the three and six months ended June 30, 2014 were primarily related to an increase in the number of employees and normal annual merit and market increases partly offset by decreases in stock-based compensation expense. The increases in net occupancy expense during the three and six months ended June 30, 2014 were primarily related to increases in lease expense, repairs and maintenance expense, building depreciation and, during the six months ended June 30, 2014, a decrease in parking garage income due to the sale of a parking garage during the first quarter of 2013. The increase in furniture and equipment expense during the six months ended June 30, 2014 was primarily related to increases in software maintenance and furniture and fixtures depreciation. See the analysis of these items included in the section captioned "Non-Interest Expense" included elsewhere in this discussion.

Frost Insurance Agency, which is included in the Banking operating segment, had gross commission revenues of \$9.8 million and \$23.1 million during the three and six months ended June 30, 2014 and \$9.3 million and \$22.5 million during the three and six months ended June 30, 2013. The increase during the three months ended June 30, 2014 was related to increases in both commission income and contingent commissions. The increase during the six months ended June 30, 2014 was related to an increase in commission income partially offset by a decrease in contingent commissions. See the analysis of insurance commissions and fees included in the section captioned "Non-Interest Income" included elsewhere in this discussion. Frost Insurance Agency also had consulting revenues totaling \$239 thousand and \$598 thousand during the three and six months ended June 30, 2014 and \$364 thousand and \$713 thousand during the three and six months ended June 30, 2013. Consulting revenues are primarily related to human resources consulting services and are reported as a component of other charges, commissions and fees.

Frost Wealth Advisors

Net income for the three and six months ended June 30, 2014 increased \$1.1 million, or 26.4%, and \$3.0 million, or 39.6%, compared to the same periods in 2013. The increase during the three months ended June 30, 2014 was primarily due to a \$4.0 million increase in non-interest income partly offset by a \$2.3 million increase in non-interest expense and a \$606 thousand increase in income tax expense. The increase during the six months ended June 30, 2014 was primarily due to a \$7.9 million increase in non-interest income partly offset by a \$3.4 million increase in non-interest expense and a \$1.6 million increase in income tax expense.

Non-interest income for the three and six months ended June 30, 2014 increased \$4.0 million, or 15.2%, and \$7.9 million, or 15.1%, compared to the same periods in 2013. The increases during the three and six months ended June 30, 2014 were primarily related to increases in trust and investment management fees. Trust and investment

management fee income is the most significant income component for Frost Wealth Advisors. Investment fees are the most significant component of trust and investment management fees, making up approximately 68% of total trust and investment management fees for the first six months of 2014. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related investment fees. The increase in trust and investment management fee income during the three and six months ended June 30, 2014 compared to the same periods in 2013 was primarily the result of an increase in trust investment fees, oil and gas fees and estate fees and, for the six months ended June 30, 2014, an increase in real estate fees. The increase in trust investment fees during the six months ended June 30, 2014 compared to the same period in 2013 was primarily due to higher average equity valuations during 2014, business development

Table of Contents

efforts and a change in the fee schedule during the fourth quarter of 2013. See the analysis of trust and investment management fees included in the section captioned "Non-Interest Income" included elsewhere in this discussion. Non-interest expense for the three and six months ended June 30, 2014 increased \$2.3 million, or 10.7%, and \$3.4 million, or 7.6%, compared to the same periods in 2013. The increases were primarily due to increases in other non-interest expense (up \$1.5 million and \$1.7 million, respectively), and salaries and wages (up \$680 thousand and \$1.4 million, respectively). The increases in other non-interest expense were related to increases in professional services expense as well as increases in various miscellaneous categories of expense and overhead cost allocations. The increase in salaries and wages were primarily related to normal annual merit and market increases.

Non-Banks

The Non-Banks operating segment had net loss of \$2.8 million and \$2.7 million for the three and six months ended June 30, 2014, respectively, compared to a net loss of \$1.2 million and \$2.8 million, respectively, for the same periods in 2013. The increase in net loss during the three months ended June 30, 2014 was primarily due to a \$3.0 million increase in non-interest expense partly offset by a \$1.1 million decrease in net interest expense and a \$403 thousand increase in income tax benefit. The net loss during the six months ended June 30, 2014 did not significantly fluctuate as a \$2.2 million decrease in net interest expense was mostly offset by a \$2.0 million increase in non-interest expense. The increases in non-interest expense during the three and six months ended June 30, 2014 were primarily related to expenses associated with the acquisition of WNB during the second quarter of 2014, of which, approximately \$3.0 million, primarily related to professional services, were included in the non-banks segment. The decreases in net interest expense for the three and six months ended June 30, 2014 were primarily related to a decrease in the interest rate paid on the Corporation's junior subordinated deferrable interest debentures as a result of the termination of an interest rate swap on the debentures in December of 2013. See Note 9 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements included elsewhere in this report for additional information related to the interest rate swap.

Income Taxes

The Corporation recognized income tax expense of \$13.4 million and \$25.5 million, for an effective tax rate of 16.8% and 16.7% for the three and six months ended June 30, 2014 compared to \$12.7 million and \$26.3 million, for an effective tax rate of 17.5% and 18.6% for the three and six months ended June 30, 2013. The effective income tax rates differed from the U.S. statutory rate of 35% during the comparable periods primarily due to the effect of tax-exempt income from loans, securities and life insurance policies. The lower effective tax rate during 2014 was partly related to an increase in the relative proportion of tax-exempt income as the Corporation purchased additional tax-exempt municipal securities.

Average Balance Sheet

Average assets totaled \$24.4 billion for the six months ended June 30, 2014 representing an increase of \$2.2 billion, or 9.9%, compared to average assets for the same period in 2013. The growth in average assets was primarily funded by an increase in average deposits. Average assets during the six months ended June 30, 2014 were also partly impacted by the acquisition of WNB on May 30, 2014. See Note 2 - Mergers and Acquisitions in the accompany consolidated financial statements included elsewhere in this report for additional information related to this acquisition. The increase was primarily reflected in earning assets, which increased \$2.2 billion, or 10.7%, during the first six months of 2014 compared to the same period of 2013. The increase in earning assets was primarily due to a \$1.7 billion increase in average interest-bearing deposits and an \$672.1 million increase in average loans. The Corporation acquired cash and cash equivalents totaling \$879.7 million and loans totaling \$673.0 million in connection with the acquisition of WNB, which impacted average cash and cash equivalents and average loans by approximately \$151 million and \$115 million, respectively, during the six months ended June 30, 2014. Total deposits averaged \$20.9 billion for the first six months of 2014, increasing \$2.1 billion, or 11.3%, compared to the same period in 2013. The Corporation acquired deposits totaling \$1.6 billion in connection with the acquisition of WNB, which impacted average deposits by approximately \$278 million during the six months ended June 30, 2014. Average interest-bearing accounts totaled 59.5% and 60.3% of average total deposits during the first six months of 2014 and 2013, respectively.

Table of Contents

Loans

Loans were as follows as of the dates indicated:

	June 30, 2014	Percentage of Total	December 31, 2013	Percentage of Total	
Commercial and industrial:					
Commercial	\$5,322,752	49.9	% \$4,587,499	48.2	%
Leases	302,081	2.8	319,577	3.4	
Total commercial and industrial	5,624,833	52.7	4,907,076	51.6	
Commercial real estate:					
Commercial mortgages	2,985,184	28.0	2,800,760	29.4	
Construction	577,446	5.4	426,639	4.5	
Land	272,959	2.5	239,937	2.5	
Total commercial real estate	3,835,589	35.9	3,467,336	36.4	
Consumer real estate:					
Home equity loans	336,890	3.2	329,853	3.5	
Home equity lines of credit	213,109	2.0	195,132	2.1	
1-4 family residential mortgages	35,625	0.3	32,447	0.3	
Construction	21,506	0.2	13,123	0.1	
Other	256,085	2.4	237,649	2.5	
Total consumer real estate	863,215	8.1	808,204	8.5	
Total real estate	4,698,804	44.0	4,275,540	44.9	
Consumer and other:					
Consumer installment	371,648	3.4	350,827	3.7	
Other	6,581	0.1	7,289	0.1	
Total consumer and other	378,229	3.5	358,116	3.8	
Unearned discounts	(22,489)	(0.2)	(25,032)	(0.3))
Total loans	\$10,679,377	100.0	% \$9,515,700	100.0	%

Loans increased \$1.2 billion, or 12.2%, compared to December 31, 2013. The majority of the Corporation's loan portfolio is comprised of commercial and industrial loans and real estate loans. Commercial and industrial loans made up 52.7% and 51.6% of total loans at June 30, 2014 and December 31, 2013, respectively, while real estate loans made up 44.0% and 44.9% of total loans, respectively, at those dates. Real estate loans include both commercial and consumer balances. The Corporation acquired \$673.0 million of loans in connection with the acquisition of WNB during the second quarter of 2014.

Commercial and industrial loans increased \$717.8 million, or 14.6%, during the first six months of 2014. The Corporation acquired approximately \$438.5 million of commercial and industrial loans in connection with the acquisition of WNB. The Corporation's commercial and industrial loans are a diverse group of loans to small, medium and large businesses. The purpose of these loans varies from supporting seasonal working capital needs to term financing of equipment. While some short-term loans may be made on an unsecured basis, most are secured by the assets being financed with collateral margins that are consistent with the Corporation's loan policy guidelines. The commercial and industrial loan portfolio also includes commercial leases and purchased shared national credits ("SNC"s) which are discussed in more detail below.

Purchased shared national credits are participations purchased from upstream financial organizations and tend to be larger in size than the Corporation's originated portfolio. The Corporation's purchased SNC portfolio totaled \$654.4 million at June 30, 2014, increasing \$68.1 million, or 11.6%, from \$586.2 million at December 31, 2013. At June 30, 2014, 55.8% of outstanding purchased SNCs was related to the energy industry. The remaining purchased SNCs were diversified throughout various other industries, with no other single industry exceeding 10% of the total purchased SNC portfolio. Additionally, almost all of the outstanding balance of purchased SNCs was included in the commercial and industrial portfolio, with the remainder included in the real estate categories. SNC participations are originated in the normal course of business to meet the needs of the Corporation's customers. As a matter of policy, the Corporation

generally only participates in SNCs for companies headquartered in or which have significant operations within the Corporation's market areas. In addition, the Corporation must have direct access to the company's management, an existing banking relationship or the expectation of broadening the relationship with other banking products and services within the following 12 to 24 months. SNCs are reviewed at least quarterly for credit quality and business development successes.

Real estate loans increased \$423.3 million, or 9.9%, during the first six months of 2014. The Corporation acquired approximately \$228.8 million of real estate loans (including approximately \$136.0 million of commercial real estate, approximately \$73.4 million

Table of Contents

of real estate construction and approximately \$19.4 million of consumer real estate) in connection with the acquisition of WNB. Real estate loans include both commercial and consumer balances. Commercial real estate loans totaled \$3.8 billion at June 30, 2014 and represented 81.6% of total real estate loans. The majority of this portfolio consists of commercial real estate mortgages, which includes both permanent and intermediate term loans. The Corporation's primary focus for its commercial real estate portfolio has been growth in loans secured by owner-occupied properties. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Consequently, these loans must undergo the analysis and underwriting process of a commercial and industrial loan, as well as that of a real estate loan.

The consumer loan portfolio, including all consumer real estate and consumer installment loans, totaled \$1.2 billion at both June 30, 2014 and December 31, 2013. Consumer real estate loans, increased \$55.0 million, or 6.8% , from December 31, 2013. Combined, home equity loans and lines of credit made up 63.7% and 65.0% of the consumer real estate loan total at June 30, 2014 and December 31, 2013, respectively. The Corporation offers home equity loans up to 80% of the estimated value of the personal residence of the borrower, less the value of existing mortgages and home improvement loans. In general, the Corporation no longer originates 1-4 family mortgage loans. Consumer installment loans, increased \$20.8 million, or 5.9%, from December 31, 2013. The consumer installment loan portfolio primarily consists of automobile loans, unsecured revolving credit products, personal loans secured by cash and cash equivalents, and other similar types of credit facilities.

Non-Performing Assets

Non-performing assets and accruing past due loans are presented in the table below. Troubled debt restructurings on non-accrual status are reported as non-accrual loans. Troubled debt restructurings on accrual status are reported separately.

	June 30, 2014	December 31, 2013		
Non-accrual loans:				
Commercial and industrial	\$34,664	\$26,733		
Commercial real estate	22,134	27,035		
Consumer real estate	2,179	2,207		
Consumer and other	654	745		
Total non-accrual loans	59,631	56,720		
Restructured loans	—	1,137		
Foreclosed assets:				
Real estate	8,935	11,916		
Other	—	—		
Total foreclosed assets	8,935	11,916		
Total non-performing assets	\$68,566	\$69,773		
Ratio of non-performing assets to:				
Total loans and foreclosed assets	0.64	% 0.73		%
Total assets	0.26	0.29		
Accruing past due loans:				
30 to 89 days past due	\$36,539	\$31,297		
90 or more days past due	7,876	7,635		
Total accruing past due loans	\$44,415	\$38,932		
Ratio of accruing past due loans to total loans:				
30 to 89 days past due	0.34	% 0.33		%
90 or more days past due	0.07	% 0.08		
Total accruing past due loans	0.41	% 0.41		%

Non-performing assets include non-accrual loans, troubled debt restructurings and foreclosed assets. Non-performing assets at June 30, 2014 decreased \$1.2 million from December 31, 2013. Non-accrual commercial and industrial loans

included one credit relationship in excess of \$5 million totaling \$16.4 million at June 30, 2014 and one credit relationship in excess of \$5 million totaling \$6.3 million at December 31, 2013. Non-accrual real estate loans primarily consist of land development, 1-4 family residential construction credit relationships and loans secured by office buildings and religious facilities. Non-accrual commercial real estate loans included one credit relationship in excess of \$5 million totaling \$6.9 million at June 30, 2014 and one credit relationship in excess of \$5 million totaling \$7.3 million at December 31, 2013, respectively. One credit relationship totaling \$6.0 million at June 30, 2014 and \$7.9 million at December 31, 2013, was included in both non-accrual commercial and industrial

Table of Contents

loans (\$2.9 million at June 30, 2014 and \$4.7 million at December 31, 2013) and non-accrual commercial real estate loans (\$3.1 million at June 30, 2014 and \$3.2 million at December 31, 2013).

Generally, loans are placed on non-accrual status if principal or interest payments become 90 days past due and/or management deems the collectibility of the principal and/or interest to be in question, as well as when required by regulatory requirements. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. Subsequent receipts on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Classification of a loan as non-accrual does not preclude the ultimate collection of loan principal or interest.

Foreclosed assets represent property acquired as the result of borrower defaults on loans. Foreclosed assets are recorded at estimated fair value, less estimated selling costs, at the time of foreclosure. Write-downs occurring at foreclosure are charged against the allowance for loan losses. Regulatory guidelines require the Corporation to reevaluate the fair value of foreclosed assets on at least an annual basis. The Corporation's policy is to comply with the regulatory guidelines. Write-downs are provided for subsequent declines in value and are included in other non-interest expense along with other expenses related to maintaining the properties. Write-downs of foreclosed assets totaled \$994 thousand and \$657 thousand, during the six months ended June 30, 2014 and 2013, respectively. There were no significant concentrations of any properties, to which the aforementioned write-downs relate, in any single geographic region.

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. At June 30, 2014 and December 31, 2013, the Corporation had \$8.5 million and \$13.8 million in loans of this type which are not included in any one of the non-accrual, restructured or 90 days past due loan categories. At June 30, 2014, potential problem loans consisted of four credit relationships. Of the total outstanding balance at June 30, 2014, 40.7% related to a customer in manufacturing, 32.7% related to a municipality and 19.1% related to a customer in commercial real estate/real estate development. Weakness in these organizations' operating performance and condition has caused the Corporation to heighten the attention given to these credits.

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 probable 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. The Corporation's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Corporation's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, classified and criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools. See Note 4 - Loans in the accompanying notes to consolidated financial statements included elsewhere in this report for further details regarding the Corporation's methodology for estimating the appropriate level of the allowance for loan losses.

The table below provides, as of the dates indicated, an allocation of the allowance for loan losses by loan type; however, allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories:

June 30, 2014	December 31, 2013
------------------	----------------------

Edgar Filing: CULLEN/FROST BANKERS, INC. - Form 10-Q

Commercial and industrial	\$55,672	\$52,790
Commercial real estate	22,046	22,590
Consumer real estate	4,659	5,230
Consumer and other	6,427	5,010
Unallocated	9,482	6,818
Total	\$98,286	\$92,438

58

Table of Contents

The reserve allocated to commercial and industrial loans at June 30, 2014 increased \$2.9 million compared to December 31, 2013. The increase was primarily related to increases in the historical valuation allowance, the environmental risk adjustment, and reserves allocated for highly leveraged credit relationships partly offset by decreases in the distressed industries allocation and allocations for specific loans and an increase in the adjustment for recoveries. Historical valuation allowances increased \$7.7 million from \$29.4 million at December 31, 2013 to \$37.1 million at June 30, 2014. The increase in historical valuation allowances was primarily due to increases in the historical loss allocation factors applied to certain categories of non-classified and classified commercial and industrial loans and an increase in the volume of non-classified commercial and industrial loans. The environmental risk adjustment increased \$1.9 million from \$5.5 million at December 31, 2013 to \$7.4 million at June 30, 2014. Although the environmental risk adjustment factor decreased at June 30, 2014 compared to December 31, 2013, the dollar amount of the environmental risk adjustment increased as a result of the aforementioned increases in the base historical loss allocation factors to which the environment risk adjustment factor is applied. The reserve allocated for highly leveraged credit relationships increased \$1.2 million from \$4.5 million at December 31, 2013 to \$5.8 million at June 30, 2014 primarily due to an increase in the volume of such credit relationships. The adjustment for recoveries increased \$1.1 million from \$3.6 million at December 31, 2013 to \$4.7 million at June 30, 2014 primarily due to the higher level of recoveries, on an annualized basis, experienced in the first six months of 2014 relative to annual recoveries for 2013. The distressed industries allocation related to commercial and industrial loans decreased \$3.8 million from \$7.8 million at December 31, 2013 to \$4.0 million at June 30, 2014. The decrease was primarily related to improvements in the weighted-average risk grades of certain segments of the contractors industry to a level below that of the weighted-average risk grade for all pass-grade loans within the overall loan portfolio segment. As a result, additional distressed industry allocations were no longer necessary for these segments of the contractors industry. Allocations for specific loans decreased \$3.5 million from \$4.1 million at December 31, 2013 to \$613 thousand at June 30, 2014. Classified commercial and industrial loans (loans having a risk grade of 11, 12 or 13) totaled \$116.2 million at June 30, 2014 compared to \$120.2 million at December 31, 2013.

The reserve allocated to commercial real estate loans decreased \$544 thousand from \$22.6 million at December 31, 2013 to \$22.0 million at June 30, 2014. The decrease was primarily related to decreases in allocations for specific loans and the distressed industries allocation partly offset by an increase in historical valuation allowances and an increase in the reserve allocated for highly leveraged credit relationships. Allocations for specific loans decreased \$2.0 million from \$2.8 million at December 31, 2013 to \$776 thousand at June 30, 2014. The distressed industries allocation related to commercial real estate loans decreased \$367 thousand. As mentioned above, the decrease was primarily related to improvements in the weighted-average risk grades of certain segments of the contractors industry. Historical valuation allowances increased \$1.2 million from \$13.0 million at December 31, 2013 to \$14.2 million at June 30, 2014 primarily due to an increase in the volume of pass grade commercial real estate loans. The reserve allocated for highly leveraged credit relationships increased \$593 thousand from \$619 thousand at December 31, 2013 to \$1.2 million at June 30, 2014 primarily due to an increase in the volume of such credit relationships. Classified commercial real estate loans totaled \$64.5 million at June 30, 2014 compared to \$80.8 million at December 31, 2013. The reserve allocated to consumer real estate loans at June 30, 2014 decreased \$571 thousand compared to December 31, 2013 primarily due to a decrease in historical valuation allowances which decreased \$563 thousand from \$2.6 million at December 31, 2013 to \$2.1 million at June 30, 2014. The decrease was primarily related to a decrease in the historical loss allocation factor applied to pass grade consumer real estate loans. A decrease in the adjustment for recoveries combined with an increase in the allocation for loans not reviewed by concurrence was mostly offset by a decrease in the environmental risk adjustment.

The reserve allocated to consumer and other loans at June 30, 2014 increased \$1.4 million compared to December 31, 2013. The increase was primarily related to an increase in the historical valuation allowances due to an increase in the historical loss allocation factor applied to consumer and other loans and an increase in the volume of such loans combined with an increase in the environmental risk adjustment.

The unallocated portion of the allowance for loan losses represents general valuation allowances that are not allocated to specific loan portfolio segments. See Note 4 – Loans in the accompanying notes to consolidated financial statements for information regarding the components of the unallocated portion of the allowance. The unallocated portion of the

allowance for loan losses at June 30, 2014 increased \$2.7 million compared to December 31, 2013 due to increases in the allocation for general macroeconomic risk (up \$1.6 million), the reserves for credit and collateral exceptions (up \$764 thousand) and the reserves allocated for policy exceptions (up \$337 thousand). The increase in the allocation for general macroeconomic risk is reflective of loan growth that is occurring in a positively trending but uncertain economic environment. The overall level of classified commercial and industrial and commercial real estate loans decreased approximately \$20.3 million, or 10.1%, at June 30, 2014 compared to December 31, 2013 while the overall weighted-average risk grades of these portfolios was 6.26 at June 30, 2014 compared to 6.40 at December 31, 2013.

Table of Contents

Activity in the allowance for loan losses is presented in the following table.

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Balance at beginning of period	\$95,156	\$93,589	\$92,438	\$104,453
Provision for loan losses	4,924	3,575	11,524	9,575
Charge-offs:				
Commercial and industrial	(3,028)	(3,586)	(5,395)	(20,738)
Commercial real estate	(935)	(415)	(2,726)	(681)
Consumer real estate	(105)	(159)	(126)	(495)
Consumer and other	(2,269)	(2,374)	(4,756)	(4,551)
Total charge-offs	(6,337)	(6,534)	(13,003)	(26,465)
Recoveries:				
Commercial and industrial	1,894	703	2,565	1,328
Commercial real estate	810	287	1,023	882
Consumer real estate	78	174	122	234
Consumer and other	1,761	1,606	3,617	3,393
Total recoveries	4,543	2,770	7,327	5,837
Net charge-offs	(1,794)	(3,764)	(5,676)	(20,628)
Balance at end of period	\$98,286	\$93,400	\$98,286	\$93,400

Ratio of allowance for loan losses to:

Total loans	0.92	%	1.01	%	0.92	%	1.01	%
Non-accrual loans	164.82		107.71		164.82		107.71	
Ratio of annualized net charge-offs to average total loans	0.07		0.16		0.12		0.45	

The provision for loan losses increased \$1.3 million, or 37.7% during the three months ended June 30, 2014 and increased \$1.9 million, or 20.36%, during the six months ended June 30, 2014 compared to the same periods in 2013. Net charge-offs as a percentage of average loans (on an annualized basis) totaled 0.12% during the first six months of 2014 decreasing 33 basis points compared to 0.45% during the first six months of 2013. During the first six months of 2013, the Corporation recognized a \$15.0 million charge-off related to a single commercial and industrial loan relationship. The loan was not past due or previously considered to be a non-performing, impaired or potential problem loan; however, in April 2013, the borrower entered into bankruptcy proceedings. The level of the provision for loan losses during the first six months of 2013 was impacted by this charge-off.

The ratio of the allowance for loan losses to total loans was 0.92% at June 30, 2014 compared to 0.97% at December 31, 2013. The acquisition of WNB during the second quarter of 2014 did not significantly impact management's determination of the allowance for loan losses at June 30, 2014. Management believes the recorded amount of the allowance for loan losses is appropriate based upon management's best estimate of probable losses that have been incurred within the existing portfolio of loans. Should any of the factors considered by management in evaluating the appropriate level of the allowance for loan losses change, the Corporation's estimate of probable loan losses could also change, which could affect the level of future provisions for loan losses.

Capital and Liquidity

Capital. Shareholders' equity totaled \$2.8 billion and \$2.5 billion at June 30, 2014 and December 31, 2013. In addition to net income of \$127.7 million, other sources of capital during the six months ended June 30, 2014 included \$149.0 million in common stock issued in connection with the acquisition of WNB, \$20.1 million in proceeds from stock option exercises and related tax benefits of \$1.7 million, other comprehensive income, net of tax, of \$20.0 million and \$4.7 million related to stock-based compensation. Uses of capital during the six months ended June 30, 2014 included \$66.7 million of dividends paid on preferred and common stock.

The accumulated other comprehensive income/loss component of shareholders' equity totaled a net, after-tax, unrealized gain of \$160.5 million at June 30, 2014 compared to a net, after-tax, unrealized gain of \$140.4 million at

December 31, 2013. The increase was primarily due to a \$43.3 million net after-tax increase in the net unrealized gain on securities available for sale and a \$873 thousand net after-tax decrease in the net actuarial loss of the Corporation's defined benefit post-retirement benefit plans partly offset by a \$12.1 million net after-tax decrease in the accumulated net gain on effective cash flow hedges and a \$11.9 million net after-tax decrease in the net unrealized gain on securities transferred to held to maturity.

Table of Contents

Under current regulatory requirements, amounts reported as accumulated other comprehensive income/loss related to securities available for sale, effective cash flow hedges and defined benefit post-retirement benefit plans do not increase or reduce regulatory capital and are not included in the calculation of risk-based capital and leverage ratios. Regulatory agencies for banks and bank holding companies utilize capital guidelines designed to measure Tier 1 and total capital and take into consideration the risk inherent in both on-balance sheet and off-balance sheet items. See Note 8 - Capital and Regulatory Matters in the accompanying notes to consolidated financial statements included elsewhere in this report.

On February 15, 2013, the Corporation issued and sold 6,000,000 shares, or \$150 million in aggregate liquidation preference, of its 5.375% Non-Cumulative Perpetual Preferred Stock, Series A, par value \$0.01 and liquidation preference \$25 per share ("Series A Preferred Stock"). The net proceeds from the offering were used to fund an accelerated share repurchase. See Note 8 – Capital and Regulatory Matters in the accompanying notes to consolidated financial statements included elsewhere in this report.

The Corporation paid quarterly dividends of \$0.50 and \$0.51 per common share during the first and second quarters of 2014 and quarterly dividends of \$0.48 and \$0.50 per common share during the first and second quarters of 2013. This equates to a common stock dividend payout ratio of 51.5% and 49.9% during the first and second quarters of 2014 and 52.1% and 53.0 during the first and second quarters of 2013. 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. The ability of the Corporation to declare or pay dividends on, or purchase, redeem or otherwise acquire, shares of its capital stock is subject to certain restrictions during any such extension period.

Under the terms of the Series A Preferred Stock, the ability of the Corporation to declare or pay dividends on, or purchase, redeem or otherwise acquire, shares of its common stock or any securities of the Corporation that rank junior to the Series A Preferred Stock is subject to certain restrictions in the event that the Corporation does not declare and pay dividends on the Series A Preferred Stock for the most recent dividend period.

From time to time, the Corporation's board of directors has authorized stock repurchase plans. Stock repurchase plans allow the Corporation to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Corporation with shares of common stock necessary to satisfy obligations related to stock compensation awards. The aforementioned accelerated share repurchase was part of a stock repurchase program that was authorized by the Corporation's board of directors in December 2012 to buy up to \$150.0 million of the Corporation's common stock. During 2013, the Corporation repurchased 2,236,748 shares (1,905,077 shares in the first quarter and 331,671 during the third quarter) under the stock repurchase plan. No shares were repurchased under stock repurchase plans during the first six months of 2014. See Part II, Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds, included elsewhere in this report, for details of stock repurchases during the quarter.

Basel III Capital Rules. In July 2013, Cullen/Frost's and Frost Bank's primary federal regulator, the Federal Reserve, published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, including Cullen/Frost and Frost Bank, compared to the current U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach, which was derived from Basel I capital accords of the Basel Committee, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee's 2004 "Basel II" capital accords. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules. The Basel III Capital Rules are effective for Cullen/Frost and Frost Bank on January 1, 2015 (subject to a phase-in period). Management believes that, as of June 30, 2014, Cullen/Frost and Frost

Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis if such requirements were currently effective. See the section captioned “Supervision and Regulation” in Item 1. Business of the Corporation’s 2013 Form 10-K for more information on the Basel III Capital Rules.

Liquidity. Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate market opportunities. The ability of a financial institution to meet its current financial obligations is a function of its balance sheet structure, its ability to liquidate assets and its access to alternative sources of funds. The objective of the Corporation’s liquidity management is to manage cash flow and liquidity reserves so that they are adequate to fund the Corporation’s operations and to meet obligations and other commitments on a timely basis and at a reasonable cost. The Corporation seeks to achieve this objective and ensure that funding needs are met by maintaining an appropriate level of liquid funds through asset/

Table of Contents

liability management, which includes managing the mix and time to maturity of financial assets and financial liabilities on the Corporation's balance sheet. The Company's liquidity position is enhanced by its ability to raise additional funds as needed in the wholesale markets.

Asset liquidity is provided by liquid assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash, interest-bearing deposits in banks, securities available for sale, maturities and cash flow from securities held to maturity, and federal funds sold and resell agreements.

Liability liquidity is provided by access to funding sources which include core deposits and correspondent banks in the Corporation's natural trade area that maintain accounts with and sell federal funds to Frost Bank, as well as federal funds purchased and repurchase agreements from upstream banks and deposits obtained through financial intermediaries.

The liquidity position of the Corporation is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Liquidity risk management is an important element in the Corporation's asset/liability management process. The Corporation regularly models liquidity stress scenarios to assess potential liquidity outflows or funding problems resulting from economic disruptions, volatility in the financial markets, unexpected credit events or other significant occurrences deemed problematic by management. These scenarios are incorporated into the Corporation's contingency funding plan, which provides the basis for the identification of the Corporation's liquidity needs. As of June 30, 2014, management is not aware of any events that are reasonably likely to have a material adverse effect on the Corporation's liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, including the Basel III liquidity framework, which, if implemented, would have a material adverse effect on the Corporation.

Since Cullen/Frost is a holding company and does not conduct operations, its primary sources of liquidity are dividends upstreamed from Frost Bank and borrowings from outside sources. Banking regulations may limit the amount of dividends that may be paid by Frost Bank. See Note 8 - Capital and Regulatory Matters in the accompanying notes to consolidated financial statements included elsewhere in this report regarding such dividends. At June 30, 2014, Cullen/Frost had liquid assets, including cash and resell agreements, totaling \$289.6 million.

Accounting Standards Updates

See Note 18 - Accounting Standards Updates in the accompanying notes to consolidated financial statements included elsewhere in this report for details of recently issued accounting pronouncements and their expected impact on the Corporation's financial statements.

Table of Contents

Consolidated Average Balance Sheets and Interest Income Analysis - Quarter To Date

(Dollars in thousands - taxable-equivalent basis)

	June 30, 2014			June 30, 2013			
	Average Balance	Interest Income/Expense	Yield/Cost	Average Balance	Interest Income/Expense	Yield/Cost	
Assets:							
Interest-bearing deposits	\$4,183,819	\$2,681	0.26	% \$2,309,653	\$1,498	0.26	%
Federal funds sold and resell agreements	21,153	23	0.43	24,302	29	0.48	
Securities:							
Taxable	3,972,037	22,114	2.28	5,619,568	25,485	1.86	
Tax-exempt	4,762,916	65,729	5.59	3,307,588	48,001	5.86	
Total securities	8,734,953	87,843	4.09	8,927,156	73,486	3.36	
Loans, net of unearned discounts	10,080,362	111,805	4.45	9,207,289	104,790	4.56	
Total Earning Assets and Average Rate Earned	23,020,287	202,352	3.54	20,468,400	179,803	3.55	
Cash and due from banks	531,691			552,237			
Allowance for loan losses	(96,054)			(93,847)			
Premises and equipment, net	339,440			306,625			
Accrued interest and other assets	1,033,544			998,754			
Total Assets	\$24,828,908			\$22,232,169			
Liabilities:							
Non-interest-bearing demand deposits:							
Commercial and individual	\$8,017,924			\$6,795,334			
Correspondent banks	351,838			304,613			
Public funds	365,776			352,387			
Total non-interest-bearing demand deposits	8,735,538			7,452,334			
Interest-bearing deposits:							
Private accounts							
Savings and interest checking	4,107,532	227	0.02	3,529,731	375	0.04	
Money market deposit accounts	7,022,660	1,789	0.10	6,394,561	2,709	0.17	
Time accounts	959,639	501	0.21	981,273	642	0.26	
Public funds	391,242	50	0.05	413,095	156	0.15	
Total interest-bearing deposits	12,481,073	2,567	0.08	11,318,660	3,882	0.14	
Total deposits	21,216,611			18,770,994			
Federal funds purchased and repurchase agreements	529,664	34	0.03	514,221	29	0.02	
Junior subordinated deferrable interest debentures	128,278	601	1.87	123,712	1,690	5.46	
Subordinated notes payable and other notes	100,000	224	0.90	100,000	236	0.94	
Federal Home Loan Bank advances	—	—	—	—	—	—	
Total Interest-Bearing Funds and Average Rate Paid	13,239,015	3,426	0.10	12,056,593	5,837	0.19	
Accrued interest and other liabilities	206,668			278,292			
Total Liabilities	22,181,221			19,787,219			

Edgar Filing: CULLEN/FROST BANKERS, INC. - Form 10-Q

Shareholders' Equity	2,647,687			2,444,950		
Total Liabilities and Shareholders' Equity	\$24,828,908			\$22,232,169		
Net interest income		\$198,926			\$173,966	
Net interest spread			3.44 %			3.36 %
Net interest income to total average earning assets			3.48 %			3.43 %

For these computations: (i) average balances are presented on a daily average basis, (ii) information is shown on a taxable-equivalent basis assuming a 35% tax rate, (iii) average loans include loans on non-accrual status, and (iv) average securities include unrealized gains and losses on securities available for sale while yields are based on average amortized cost.

Table of Contents

Consolidated Average Balance Sheets and Interest Income Analysis - Year To Date

(Dollars in thousands - taxable-equivalent basis)

	June 30, 2014			June 30, 2013			
	Average Balance	Interest Income/ Expense	Yield/ Cost		Average Balance	Interest Income/ Expense	Yield/ Cost
Assets:							
Interest-bearing deposits	\$4,002,662	\$5,085	0.26	%	\$2,255,128	\$2,851	0.25
Federal funds sold and resell agreements	20,307	43	0.43		20,341	51	0.51
Securities:							
Taxable	4,171,337	43,517	2.13		5,727,489	52,862	1.90
Tax-exempt	4,607,513	127,254	5.58		3,280,537	94,485	5.82
Total securities	8,778,850	170,771	3.95		9,008,026	147,347	3.34
Loans, net of unearned discounts	9,830,339	217,618	4.46		9,158,225	208,304	4.59
Total Earning Assets and Average Rate Earned	22,632,158	393,517	3.51		20,441,720	358,553	3.56
Cash and due from banks	549,105				565,899		
Allowance for loan losses	(95,234)				(99,472)		
Premises and equipment, net	328,512				311,955		
Accrued interest and other assets	1,004,846				1,002,519		
Total Assets	\$24,419,387				\$22,222,621		
Liabilities:							
Non-interest-bearing demand deposits:							
Commercial and individual	\$7,704,819				\$6,759,181		
Correspondent banks	353,849				319,940		
Public funds	387,296				362,615		
Total non-interest-bearing demand deposits	8,445,964				7,441,736		
Interest-bearing deposits:							
Private accounts							
Savings and interest checking	4,030,991	447	0.02		3,533,484	753	0.04
Money market deposit accounts	6,991,786	3,593	0.10		6,347,703	5,442	0.17
Time accounts	951,336	968	0.21		988,181	1,381	0.28
Public funds	445,717	120	0.05		436,104	314	0.15
Total interest-bearing deposits	12,419,830	5,128	0.08		11,305,472	7,890	0.14
Total deposits	20,865,794				18,747,208		
Federal funds purchased and repurchase agreements	516,768	61	0.02		523,416	59	0.02
Junior subordinated deferrable interest debentures	126,008	1,162	1.84		123,712	3,363	5.44
Subordinated notes payable and other notes	100,000	446	0.89		100,000	474	0.95
Federal Home Loan Bank advances	—	—	—		2	—	6.00
Total Interest-Bearing Funds and Average Rate Paid	13,162,606	6,797	0.10		12,052,602	11,786	0.20
Accrued interest and other liabilities	210,456				290,341		
Total Liabilities	21,819,026				19,784,679		

Edgar Filing: CULLEN/FROST BANKERS, INC. - Form 10-Q

Shareholders' Equity	2,600,361			2,437,942		
Total Liabilities and Shareholders' Equity	\$24,419,387			\$22,222,621		
Net interest income		\$386,720			\$346,767	
Net interest spread			3.41 %			3.36 %
Net interest income to total average earning assets			3.45 %			3.44 %

For these computations: (i) average balances are presented on a daily average basis, (ii) information is shown on a taxable-equivalent basis assuming a 35% tax rate, (iii) average loans include loans on non-accrual status, and (iv) average securities include unrealized gains and losses on securities available for sale while yields are based on average amortized cost.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The disclosures set forth in this item are qualified by the section captioned “Forward-Looking Statements and Factors that Could Affect Future Results” included in Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report.

Refer to the discussion of market risks included in Item 7A. Quantitative and Qualitative Disclosures About Market Risk in the 2013 Form 10-K. There has been no significant change in the types of market risks faced by the Corporation since December 31, 2013.

The Corporation utilizes an earnings simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of various interest rate scenarios on projected net interest income and net income over the next 12 months. The model measures the impact on net interest income relative to a flat-rate case scenario of hypothetical fluctuations in interest rates over the next 12 months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet. The impact of interest rate derivatives, such as interest rate swaps, caps and floors, is also included in the model. Other interest rate-related risks such as prepayment, basis and option risk are also considered.

For modeling purposes, as of June 30, 2014, the model simulations projected that 100 and 200 basis point ratable increases in interest rates would result in positive variances in net interest income of 0.4% and 1.3%, respectively, relative to the flat-rate case over the next 12 months, while a decrease in interest rates of 25 basis points would result in a negative variance in net interest income of 3.2% relative to the flat-rate case over the next 12 months. The June 30, 2014 model simulations were impacted by the assumption, for modeling purposes, that the Corporation will begin to pay interest on demand deposits (those not already receiving an earnings credit rate) in the third quarter of 2014, as further discussed below. As of June 30, 2013, the model simulations projected that a 100 basis point increase in interest rates would result in a negative variance in net interest income of 0.4% and a 200 basis point increase in interest rates would result in a positive variance in net interest income of 0.4%, relative to the flat case over the next 12 months, while a decrease in interest rates of 25 basis points would result in a negative variance in net interest income of 2.5% relative to the flat case over the next 12 months. The June 30, 2013 model simulations were impacted by the assumption, for modeling purposes, that the Corporation will begin to pay interest on demand deposits in the third quarter of 2013. The likelihood of a decrease in interest rates beyond 25 basis points as of June 30, 2014 and 2013 was considered to be remote given prevailing interest rate levels.

The model simulations as of June 30, 2014 indicate that the Corporation's balance sheet has become more asset sensitive in comparison to June 30, 2013. The increased asset sensitivity is primarily due to a decrease in the relative proportion of interest earning assets invested in fixed rate securities and an increase in the relative proportion of interest earning assets invested in variable rate interest-bearing deposits, which generally reprice as market interest rates change. The growth in the Corporation's balance sheet was partly funded by significant deposit growth during 2013 and during the first six months of 2014. Additionally, during the second quarter of 2014, the Corporation acquired WNB Bancshares, Inc. (See Note 2 - Mergers and Acquisitions included in the notes to consolidated financial statements elsewhere in this report). In connection with the acquisition, the Corporation acquired cash and cash equivalents totaling \$879.7 million and loans totaling \$673.0 million, which impacted average cash and cash equivalents and average loans by approximately \$151 million and \$115 million, respectively, during the six months ended June 30, 2014. The Corporation also acquired deposits totaling \$1.6 billion, which impacted average deposits by approximately \$278 million during the six months ended June 30, 2014. The acquisition of WNB did not significantly impact the Corporation's sensitivity to interest rate changes relative to its exposure prior to the acquisition.

As mentioned above, financial regulatory reform legislation entitled the “Dodd-Frank Wall Street Reform and Consumer Protection Act” (the “Dodd-Frank Act”) repealed the federal prohibition on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts beginning July 21, 2011. Although the ultimate impact of this legislation on the Corporation has not yet been determined, the Corporation may begin to incur interest costs associated with demand deposits in the future as market conditions warrant. If this were to occur, the Corporation’s balance sheet would likely become less asset sensitive and

possibly liability sensitive. Because the interest rate that will ultimately be paid on these demand deposits depends upon a variety of factors, some of which are beyond the Corporation's control, the Corporation assumed an aggressive pricing structure for the purposes of the model simulations discussed above with interest payments beginning in the third quarter of 2014. Should the actual interest rate paid on demand deposits be less than the rate assumed in the model simulations, or should the interest rate paid for demand deposits become an administered rate with less direct correlation to movements in general market interest rates, the Corporation's balance sheet could be more asset sensitive than the model simulations might otherwise indicate.

As of June 30, 2014, the effects of a 200 basis point increase and a 25 basis point decrease in interest rates on the Corporation's derivative holdings would not result in a significant variance in the Corporation's net interest income.

Table of Contents

The effects of hypothetical fluctuations in interest rates on the Corporation's securities classified as "trading" under ASC Topic 320, "Investments—Debt and Equity Securities," are not significant, and, as such, separate quantitative disclosure is not presented.

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Corporation's management, with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report. No change in the Corporation's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the last fiscal quarter that materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Table of Contents

Part II. Other Information

Item 1. Legal Proceedings

The Corporation and its subsidiaries 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 the Corporation's financial statements.

Item 1A. Risk Factors

There has been no material change in the risk factors disclosed under Item 1A. of the Corporation's 2013 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information with respect to purchases made by or on behalf of the Corporation or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Corporation's common stock during the three months ended June 30, 2014. Dollar amounts in thousands.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares (or Approximate Dollar Value) That May Yet Be Purchased Under the Plan at the End of the Period
April 1, 2014 to April 30, 2014	—	\$—	—	\$—
May 1, 2014 to May 31, 2014	—	—	—	—
June 1, 2014 to June 30, 2014	—	—	—	—
Total	—	\$—	—	—

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Description
31.1	Rule 13a-14(a) Certification of the Corporation's Chief Executive Officer
31.2	Rule 13a-14(a) Certification of the Corporation's Chief Financial Officer
32.1+	Section 1350 Certification of the Corporation's Chief Executive Officer
32.2+	Section 1350 Certification of the Corporation's Chief Financial Officer
101	Interactive Data File

This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Table of Contents

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Cullen/Frost Bankers, Inc.
(Registrant)

Date: July 30, 2014

By: /s/ Phillip D. Green
Phillip D. Green
Group Executive Vice President
and Chief Financial Officer
(Duly Authorized Officer, Principal
Financial
Officer and Principal Accounting
Officer)