MIDSOUTH BANCORP INC
Form 10-K
March 16, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016
Commission File number 1-11826

MIDSOUTH BANCORP, INC.
(Exact name of registrant as specified in its charter)

Louisiana	72-1020809
(State of Incorporation)	(I.R.S. EIN Number)

102 Versailles Boulevard, Lafayette, Louisiana 70501
(Address of principal executive offices)
Registrant's telephone number, including area code: (337) 237-8343
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.10 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: none
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.
Yes No þ
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 þ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No
Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a nonaccelerated filer, or a smaller reporting company. A large accelerated filer An accelerated filer þ A nonaccelerated filer A 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 þ
The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of the registrant at June 30, 2016 was approximately $61,919,903 based upon the closing market price per share of the registrant’s common stock as reported on The New York Stock Exchange, Inc. as of such date. As of March 16, 2017 there were 11,374,518 outstanding shares of MidSouth Bancorp, Inc. common stock.
DOCUMENTS INCORPORATED BY REFERENCE
Portions of the Company’s Proxy Statement for its 2017 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

MIDSOUTH BANCORP, INC.
2016 Annual Report on Form 10-K
TABLE OF CONTENTS

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements included in this Report and the documents incorporated by reference herein, other than statements of historical fact, are forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the regulations thereunder), which are intended to be covered by the safe harbors created thereby. Forward-looking statements include, but are not limited to certain statements under the captions “Business,” “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “will,” “would,” “could,” “should,” “guidan “continue,” “project,” “forecast,” “confident,” and similar expressions are typically used to identify forward-looking statements. These statements are based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Any forward-looking statements are not guarantees of our future performance and are subject to risks and uncertainties and may be affected by various factors that may cause actual results, developments and business decisions to differ materially from those in the forward-looking statements. Some of the factors that may cause actual results, developments and business decisions to differ materially from those contemplated by such forward-looking statements include the factors discussed under the caption “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Report and the following:

- changes in interest rates and market prices that could affect the net interest margin, asset valuation, and expense levels;
- changes in local economic and business conditions, including, without limitation, changes related to the oil and gas industries that could adversely affect customers and their ability to repay borrowings under agreed upon terms, adversely affect the value of the underlying collateral related to their borrowings, and reduce demand for loans;
- increased competition for deposits and loans which could affect compositions, rates and terms;
- changes in the levels of prepayments received on loans and investment securities that adversely affect the yield and value of the earning assets;
- a deviation in actual experience from the underlying assumptions used to determine and establish our allowance for loan losses (“ALLL”), which could result in greater than expected loan losses;
- changes in the availability of funds resulting from reduced liquidity or increased costs;
- the timing and impact of future acquisitions, the success or failure of integrating acquired operations, and the ability to capitalize on growth opportunities upon entering new markets;
- the ability to acquire, operate, and maintain effective and efficient operating systems;
- increased asset levels and changes in the composition of assets that would impact capital levels and regulatory capital ratios;
- loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;
- legislative and regulatory changes, including the impact of regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) and other changes in banking, securities and tax laws and regulations and their application by our regulators, changes in the scope and cost of Federal Deposit Insurance Corporation (“FDIC”) insurance and other coverage;
- regulations and restrictions resulting from our participation in government sponsored programs such as the U.S. Treasury’s Small Business Lending Fund, including potential retroactive changes in such programs;
- changes in accounting principles, policies, and guidelines applicable to financial holding companies and banking;
- acts of war, terrorism, cyber intrusion, weather, or other catastrophic events beyond our control; and
- the ability to manage the risks involved in the foregoing.

We can give no assurance that any of the events anticipated by the forward-looking statements will occur or, if any of them does, what impact they will have on our results of operations and financial condition. We disclaim any intent or obligation to publicly update or revise any forward-looking statements, regardless of whether new information becomes available, future developments occur or otherwise.

Part I

Item 1 - Business

Overview

The Company was incorporated in 1984 as a Louisiana corporation and is a registered financial holding company headquartered in Lafayette, Louisiana. Its operations have been conducted primarily through its wholly owned bank subsidiary MidSouth Bank, N.A. The Bank, a national banking association, was chartered and commenced operations in 1985. As of December 31, 2016, the Bank operated through a network of 57 offices located in Louisiana and Texas.

Unless otherwise indicated or unless the context requires otherwise, all references in this report to “the Company,” “we,” “us,” “our,” or similar references, mean MidSouth Bancorp, Inc. and our subsidiaries, including our banking subsidiary, MidSouth Bank, N.A., on a consolidated basis. References to “MidSouth Bank” or the “Bank” mean our wholly owned banking subsidiary, MidSouth Bank, N.A.

Products and Services

The Bank is community oriented and focuses primarily on offering commercial and consumer loan and deposit services to small and middle market businesses, their owners and employees, and other individuals in our markets. Our community banking philosophy emphasizes personalized service and building broad customer relationships. Deposit products and services offered by the Bank include interest-bearing and noninterest-bearing checking accounts, investment accounts, cash management services, and electronic banking services, including remote deposit capturing services, internet banking, and debit and credit cards. Most of the Bank’s deposit accounts are FDIC-insured up to the maximum allowed, and the Bank customers have access to a world-wide ATM network of more than 55,000 surcharge-free ATMs.

Loans offered by the Bank include commercial and industrial loans, commercial real estate loans (both owner-occupied and non-owner occupied), other loans secured by real estate and consumer loans. We commenced operations during a severe economic downturn in Louisiana more than 30 years ago. Our survival and growth in the ensuing years has instilled in us a conservative operating philosophy. Our conservative attitude impacts our credit and funding decisions, including underwriting loans primarily based on the cash flows of the borrower (rather than just relying on collateral valuations) and focusing lending efforts on working capital and equipment loans to small and mid-sized businesses along with owner-occupied properties.

Our conservative operating philosophy extends to managing the various risks we face. We maintain a separate risk management group to help identify and manage these various risks. This group, which reports directly to the Chairman of our Audit Committee, not to other members of the senior management team, includes our audit, compliance and loan review functions and is staffed with experienced accounting and legal professionals.

We are committed to an exceptional level of customer care. We maintain our own in-house call center so that customers enjoy live interaction with employees of the Bank rather than an automated telephone system. Additionally, we provide our employees with the training and technological tools to improve customer care. We also conduct focus groups within the communities we serve and strive to create a two-way dialog to ensure that we are offering the banking products and services that our customers and communities need.

Markets

We operate in Louisiana and central and east Texas along the Interstate 10, Interstate 49, Highway 90, Interstate 45, Interstate 20 and Interstate 35 corridors. As of December 31, 2016, our market area in Louisiana included 42 offices and is bound by Lafourche Parish to the south, East Baton Rouge Parish to the east, Caddo Parish to the north and Calcasieu Parish to the west. Our market areas in Texas include 15 offices located in the Beaumont, Houston, Conroe, Magnolia, College Station and Texarkana areas. For additional information regarding our properties, see Item 2 – Properties of this Report.

Oil and gas is the key industry within our markets. However, medical, technology and research companies continue to develop within these markets thereby diversifying the economy. Additionally, numerous major universities located within our market areas, including Louisiana State University, University of Houston, Rice University, Texas A&M University and University of Louisiana at Lafayette, provide a substantial number of jobs and help to contribute to the educated work force within our markets.

We believe our financial condition, coupled with our scalable operational capabilities, will facilitate future growth, both organically and through acquisition, including potential growth in new market areas.

Competition

We face strong competition in our market areas from both traditional and nontraditional financial services providers, such as commercial banks; savings banks; credit unions; finance companies; mortgage, leasing, and insurance companies; money market mutual funds; brokerage houses; and branches that provide credit facilities. Several of the financial services competitors in our market areas are substantially larger and have far greater resources; however, we have effectively competed by building long-term customer relationships. Customer loyalty has been built through our continued focus on quality customer care enhanced by technology and effective delivery systems.

Other factors, including economic, legislative, and technological changes, also impact our competitive environment. Management continually evaluates competitive challenges in the financial services industry and develops appropriate responses consistent with our overall market strategy.

Employees

As of December 31, 2016, the Bank employed approximately 535 full-time equivalent employees. The Company had no employees who are not also employees of the Bank. Through the Bank, employees receive customary employee benefits, which include an employee stock ownership plan; a 401(K) plan; and life, health and disability insurance plans. Our directors, officers, and employees are important to the success of the Company and play a key role in business development by actively participating in the communities served by the Company. The Company considers the relationship of the Bank with its employees as a whole to be good.

Additional Information

More information on the Company and the Bank is available on the Bank’s website at www.midsouthbank.com. The Company is not incorporating by reference into this Report the information contained on its website; therefore, the content of the website is not a part of this Report. Copies of this Report and other reports filed or furnished by the Company pursuant to Section 13(a) or 15(d) of the Exchange Act, including exhibits, are available free of charge on the Company’s website under the “Investor Relations” link as soon as reasonably practicable after they have been filed or furnished electronically to the Securities and Exchange Commission (“SEC”). Copies of these filings may also be obtained free of charge on the SEC’s website at www.sec.gov.

Supervision and Regulation

Under Federal Reserve policy, we are expected to act as a source of financial strength for, and to commit resources to support, the Bank. This support may be required at times when, absent such Federal Reserve policy, we may not be inclined to provide such support. In addition, any capital loans by a financial holding company to any of its banking subsidiaries are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a financial holding company's bankruptcy, any commitment by a financial holding company to a federal bank regulatory agency to maintain the capital of a banking subsidiary will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Regulatory Reform

The financial crisis of 2008, including the downturn of global economic, financial and money markets and the threat of collapse of numerous financial institutions, and other recent events have led to the adoption of numerous new laws and regulations that apply to, and focus on, financial institutions. The most significant of these new laws is the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which was adopted on July 21, 2010 and, in part, is intended to implement significant structural reforms to the financial services industry. The Dodd-Frank Act is discussed in more detail below.

Bank Holding Companies and Financial Holding Companies

Historically, the activities of bank holding companies were limited to the business of banking and activities closely related or incidental to banking. Bank holding companies were generally prohibited from acquiring control of any company that was not a bank and from engaging in any business other than the business of banking or managing and controlling banks. The Gramm-Leach-Bliley Act, which took effect on March 12, 2000, dismantled many Depression-era restrictions against affiliation between banking, securities and insurance firms by permitting bank holding companies to engage in a broader range of financial activities, so long as certain safeguards are observed. Specifically, bank holding companies may elect to become "financial holding companies" that may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental to a financial activity. Thus, with the enactment of the Gramm-Leach-Bliley Act, banks, security firms and insurance companies find it easier to acquire or affiliate with each other and cross-sell financial products. The Gramm-Leach-Bliley Act permits a single financial services organization to offer a more complete array of financial products and services than historically was permitted.

A financial holding company is essentially a bank holding company with significantly expanded powers. Under the Gramm-Leach-Bliley Act, in addition to traditional lending activities, the following activities are among those that are deemed "financial in nature" for financial holding companies: securities underwriting, dealing in or making a market in securities, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, activities which the Federal Reserve Board determines to be closely related to banking, and certain merchant banking activities.

We elected to become a financial holding company in November 2012. As a financial holding company, we have very broad discretion to affiliate with securities firms and insurance companies, make merchant banking investments, and engage in other activities that the Federal Reserve Board has deemed financial in nature. In order to continue as a financial holding company, we must continue to be well-capitalized, well-managed and maintain compliance with the Community Reinvestment Act (the "CRA"). Depending on the types of financial activities that we may elect to engage in, under the Gramm-Leach-Bliley Act's functional regulation principles, we may become subject to supervision by additional government agencies. The election to be treated as a financial holding company increases our ability to offer financial products and services that historically we were either unable to provide or were only able to provide on a limited basis. As a result, we will face increased competition in the markets for any new financial products and services that we may offer. Likewise, an increased amount of consolidation among banks and securities firms or banks and insurance firms could result in a growing number of large financial institutions that could compete aggressively with us.

Dodd-Frank Act

In July 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including changes that will affect all bank holding companies, financial holding companies and banks, including us and the Bank, including the following provisions:

- Insurance of Deposit Accounts. The Dodd-Frank Act changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital. The Dodd-Frank Act also made permanent the $250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000.
- Payment of Interest on Demand Deposits. 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.
- Creation of the Consumer Financial Protection Bureau. The Dodd-Frank Act centralized significant aspects of consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the "CFPB"), which is discussed in more detail below.
- Debit Card Interchange Fees. The Dodd-Frank Act amended the Electronic Fund Transfer Act to, among other things, require that debit card interchange fees be reasonable and proportional to the actual cost incurred by the issuer with respect to the transaction. In June 2011, the Federal Reserve Board adopted regulations setting the maximum permissible interchange fee as the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction, with an additional adjustment of up to one cent per transaction if the issuer implements additional fraud-prevention standards. Although issuers that have assets of less than $10 billion are exempt from the Federal Reserve Board's regulations that set maximum interchange fees, these regulations could significantly impact the interchange fees that financial institutions with less than $10 billion in assets, such as the Bank, are able to collect.

In addition, the Dodd-Frank Act implements other far-reaching changes to the financial regulatory landscape, including provisions that:

- restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of national banks from availing themselves of such preemption;
- impose comprehensive regulation of the over-the-counter derivatives market, subject to significant rulemaking processes, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself;

- require depository institutions with total consolidated assets of more than $10 billion to conduct regular stress tests and require large, publicly traded bank holding companies and financial holding companies to create a risk committee responsible for the oversight of enterprise risk management;
- require loan originators to retain 5% of any loan sold or securitized, unless it is a “qualified residential mortgage,” subject to certain exceptions;
- prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the Volcker Rule); and
- implement corporate governance revisions that apply to all public companies, not just financial institutions.

While much of the Dodd-Frank Act has been implemented in the form of final rules from the banking agencies, the full extent of the impact such requirements will have on our operations continues to be unclear. In addition, the change in administration in the U.S. has added further uncertainty as to the implementation, scope and timing of additional rules implementing the Dodd-Frank Act, and it is possible that existing rules may be modified or repealed. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain aspects of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to us and our investors, even if only in the short-term.

Capital Requirements

We are subject to various regulatory capital requirements administered by the Federal Reserve and the Office of the Comptroller of the Currency (the “OCC”). Failure to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action (described below), we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting policies. Our capital amounts and classification are also subject to judgments by the regulators regarding qualitative components, risk weightings, and other factors. For further detail on capital and capital ratios, see the discussion under Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Regulatory Capital Requirement in Effect through December 31, 2014

Under the risk-based capital requirements for bank holding companies and financial holding companies in effect through December 31, 2014, the minimum requirement for the ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) was 8%. At least half of the total capital (as defined below) was to be composed of common stockholders’ equity, retained earnings, qualifying perpetual preferred stock (in a limited amount in the case of cumulative preferred stock), minority interests in the equity accounts of consolidated subsidiaries, and qualifying trust preferred securities, less goodwill and certain intangibles (“Tier 1 Capital”). The remainder of total capital could consist of qualifying subordinated debt and redeemable preferred stock, qualifying cumulative perpetual preferred stock and allowance for loan losses (“Tier 2 Capital,” and together with Tier 1 Capital, “Total Capital”).

The Federal Reserve has established minimum leverage ratio guidelines for bank holding companies and financial holding companies. As of December 31, 2014, these requirements provided for a minimum leverage ratio of Tier 1 Capital to adjusted average quarterly assets (“Leverage Ratio”) equal to 3% for bank holding companies and financial holding companies that meet specified criteria, including having the highest regulatory rating. All other bank holding companies and financial holding companies were generally required to maintain a leverage ratio of at least 4%. The capital guidelines also provided that bank holding companies and financial holding companies experiencing internal growth or making acquisitions would be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the guidelines provided that the Federal Reserve would continue to consider a “tangible tier 1 leverage ratio” (deducting all intangibles) in evaluating proposals for expansion or to engage in new activity.

The Bank is subject to similar capital requirements adopted by the OCC. The risk-based capital requirements identify concentrations of credit risk and certain risks arising from non-traditional activities, and the management of those risks, as important factors to consider in assessing an institution’s overall capital adequacy. Other factors taken into consideration by federal regulators include: interest rate exposure; liquidity, funding and market risk; the quality and level of earnings; the quality of loans and investments; the effectiveness of loan and investment policies; and management's overall ability to monitor and control financial and operational risks, including the risks presented by concentrations of credit and non-traditional activities.

Basel III Capital Framework Effective January 1, 2015

In July 2013, the Federal Reserve and the OCC issued final rules establishing a new comprehensive capital framework for U.S. banking organizations that implement the Basel III capital framework and certain provisions of the Dodd-Frank Act. The final rules seek to strengthen the components of regulatory capital, increase risk-based capital requirements, and make selected changes to the calculation of risk-weighted assets. The final rules, among other things:

- revise minimum capital requirements and adjust prompt corrective action thresholds;
- revise the components of regulatory capital and create a new capital measure called "Common Equity Tier 1," which must constitute at least 4.5% of risk-weighted assets;
- specify that Tier 1 Capital consists only of Common Equity Tier 1 and certain "Additional Tier 1 Capital" instruments meeting specified requirements;
- apply most deductions/adjustments to regulatory capital measures to Common Equity Tier 1 and not to other components of capital, potentially requiring higher levels of Common Equity Tier 1 in order to meet minimum ratio requirements;
- increase the minimum Tier 1 Capital ratio requirement from 4% to 6%;
- retain the existing risk-based capital treatment for 1-4 family residential mortgage exposures;
- permit most banking organizations, including the Company, to retain, through a one-time permanent election, the existing capital treatment for accumulated other comprehensive income;
- implement a new capital conservation buffer of Common Equity Tier 1 capital, generally required to make capital distributions and pay executive bonuses, equal to 2.5% of risk-weighted assets in addition to the 4.5% Common Equity Tier 1 capital ratio and phased in over a three -year period that began on January 1, 2016;
- increase capital requirements for past-due loans, high volatility commercial real estate exposures, and certain short-term loan commitments;
- require the deduction of mortgage servicing assets and deferred tax assets that exceed 10% of Common Equity Tier 1 capital in each category and 15% of Common Equity Tier 1 capital in the aggregate; and
- remove references to credit ratings consistent with the Dodd-Frank Act and establish due diligence requirements for securitization exposures.

The final rules became effective as of January 1, 2015, for most banking organizations including the Company and the Bank, subject to a transition period for several aspects of the final rules, including the new minimum capital ratio requirements, the capital conservation buffer, and the regulatory capital adjustments and deductions. Requirements to maintain higher levels of capital could adversely impact our return on equity. We believe we will continue to exceed all estimated well-capitalized regulatory requirements under these new rules on a fully phased-in basis.

At December 31, 2016, our Common Equity Tier 1 to risk-weighted assets ratio was 8.81%, our Tier 1 Capital to risk-weighted assets ratio was 13.02%, our Total Capital to risk-weighted assets ratio was 14.28% and our Leverage Ratio was 10.11%. Since our total consolidated assets are below $15 billion, our $21.5 million aggregate principal amount of trust preferred securities issued prior to May 19, 2011, are included in our Tier 1 and Total Capital calculations.

The Volcker Rule

The Dodd-Frank Act required the federal bank regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the "Volcker Rule." On December 10, 2013, the Federal Reserve and other federal agencies issued final rules to implement the Volcker Rule. In relevant part, these final rules would have prohibited banking entities from owning collateralized debt obligations (CDOs) backed by trust preferred securities (TruPS), effective July 21, 2015. However, subsequent to these final rules the U.S. financial regulatory agencies issued an interim rule to exempt CDOs backed by TruPS from the Volker Rule and the final rule, provided that (a) the CDO was established prior to May 19, 2010, (b) the banking entity reasonably believes that the CDO's offering proceeds were used to invest primarily in TruPS issued by banks with less than $15 billion in assets, and (iii) the banking entity acquired the CDO investment on or before December 10, 2013. At December 31, 2016, we did not have any CDOs backed by TruPS.

The Durbin Amendment

The Dodd-Frank Act included provisions which restrict interchange fees to those which are "reasonable and proportionate" for certain debit card issuers, and limit the ability of networks and issuers to restrict debit card transaction routing. This statutory provision is known as the “Durbin Amendment.” The Federal Reserve issued final rules implementing the Durbin Amendment on June 29, 2011. In the final rules, interchange fees for debit card transactions were capped at $0.21 plus five basis points in order to be eligible for a safe harbor such that the fee is conclusively determined to be reasonable and proportionate. Another related rule also permits an additional $0.01 per transaction “fraud prevention adjustment” to the interchange fee if certain Federal Reserve standards are implemented, including an annual review of fraud prevention policies and procedures. With respect to network exclusivity and merchant routing restrictions, it is now required that all debit cards participate in at least two unaffiliated networks so that the transactions initiated using those debit cards will have at least two independent routing channels. While the interchange fee restrictions contained in the Durbin Amendment, and the rules promulgated thereunder, only apply to debit card issuers with $10 billion or more in total consolidated assets, these regulations could significantly affect the interchange fees that financial institutions with less than $10 billion in assets, including the Bank, are able to collect.

Prompt Corrective Action
The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) established a system of prompt corrective action to resolve the problems of undercapitalized institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and are required to take certain mandatory supervisory actions, and are authorized to take other discretionary actions, with respect to institutions in the three undercapitalized categories. The severity of the action will depend upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have set the relevant capital level for each category.

An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal regulatory agency. A bank holding company and financial holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to certain limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5.0% of an undercapitalized subsidiary's assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. In addition, the appropriate federal regulatory agency may treat an undercapitalized institution in the same manner as it treats a significantly undercapitalized institution if it determines that those actions are necessary.

At December 31, 2016, the Bank had the requisite capital level to qualify as “well capitalized” under the regulatory framework for prompt corrective action.

Insurance of Accounts and FDIC Insurance Assessments
The Bank’s deposits are insured by the Deposit Insurance Fund (the “DIF”) of the FDIC up to the standard maximum insurance amount for each deposit insurance ownership category. Since January 1, 2013, the basic limit on FDIC deposit insurance coverage has been $250,000 per depositor. Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

The DIF is funded by assessments on banks and other depository institutions. As required by the Dodd-Frank Act, in February 2011, the FDIC approved a final rule that changed the assessment base for DIF assessments from domestic deposits to average consolidated total assets minus average tangible equity (defined as Tier 1 capital). In addition, as also required by the Dodd-Frank Act, the FDIC has adopted a new large-bank pricing assessment scheme, set a current target “designated reserve ratio” (described in more detail below) of 2% for the DIF, and established a lower assessment rate schedule when the reserve ratio reaches 1.15% and, in lieu of dividends, provides for a lower assessment rate schedule when the reserve ratio reaches 2% and 2.5%.

An institution’s assessment rate depends upon the institution’s assigned risk category, which is based on supervisory evaluations, regulatory capital levels and certain other factors. Initial base assessment rates ranged from 2.5 to 45 basis points. The FDIC may make the following further adjustments to an institution’s initial base assessment rates: decreases for long-term unsecured debt, including most senior unsecured debt and subordinated debt; increases for holding long-term unsecured debt or subordinated debt issued by other insured depository institutions; and increases for broker deposits in excess of 10% of domestic deposits for insurances not well rated and well capitalized. As of December 31, 2016, our risk category required a quarterly payment of approximately 8.06 basis points per $100 of assessable deposits.

The Dodd-Frank Act transferred to the FDIC increased discretion with regard to managing the required amount of reserves for the DIF, or the "designated reserve ratio." Among other changes, the Dodd-Frank Act (i) raised the minimum designated reserve ratio to 1.35% and removed the upper limit on the designated reserve ratio, (ii) requires that the designated reserve ratio reach 1.35% by September 2020 and (iii) requires the FDIC to offset the effect on institutions with total consolidated assets of less than $10 billion by raising the designated reserve ratio from 1.15% to 1.35%. The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis. In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act.

On June 16, 2015, the FDIC proposed changes to the deposit insurance assessments for small insured banks having total assets of less than $10 billion which have been insured for at least five years, based upon experience with bank failures. The changes, among other matters, revise the financial ratios method of determining assessments to reflect a statistical model estimating the probability of failure over three years and updating the financial measures used in the financial ratios method consistent with the statistical model. The proposed rule was revised in January 2016. On April 26, 2016, the FDIC adopted the rule, amending pricing for deposit insurance assessments for small insured banks effective the quarter after the reserve ratio reached 1.15%. The FDIC finalized rules in March 2016 requiring banks with over $10 billion in assets to be responsible for the recapitalization of the DIF to 1.35% of insured deposits after achieving a 1.15% reserve ratio. As of June 30, 2016, the FDIC announced that the reserve ratio had reached 1.15%.

Allowance for Loan and Lease Losses

The Allowance for Loan and Lease Losses (the "ALLL") represents one of the most significant estimates in the Bank's financial statements and regulatory reports. Because of its significance, the Bank has established a system by which it develops, maintains, and documents a comprehensive, systematic, and consistently applied process for determining the amounts of the ALLL and the provision for loan and lease losses. The Interagency Policy Statement on the ALLL encourages all banks and federal savings institutions to ensure controls are in place to consistently determine the ALLL in accordance with generally accepted accounting principles in the United States, the federal savings association's stated policies and procedures, management's best judgment and relevant supervisory guidance. The Bank's estimate of credit losses reflects consideration of significant factors that affect the collectibility of the portfolio as of the evaluation date.

Safety and Soundness Standards

The Federal Deposit Insurance Act, as amended by the FDICIA and the Riegle Community Development and Regulatory Improvement Act of 1994, requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. The federal bank regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards pursuant to FDICIA, as amended. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation and fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the “prompt corrective action” provisions of FDICIA. See “Prompt Corrective Action” above. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties. The federal regulatory agencies also proposed guidelines for asset quality and earnings standards.

Interagency Appraisal and Evaluation Guidelines

In December 2010, the federal banking agencies issued the Interagency Appraisal and Evaluation Guidelines. This guidance, which updated guidance originally issued in 1994, sets forth the minimum regulatory standards for appraisals. It incorporates previous regulatory issuances affecting appraisals, addresses advances in information technology used in collateral evaluation, and clarifies standards for use of analytical methods and technological tools in developing evaluations. This guidance also requires institutions to utilize strong internal controls to ensure reliable appraisals and evaluations and to monitor and periodically update valuations of collateral for existing real estate loans and transactions.

Community Reinvestment Act

Under the CRA, the Bank has an obligation to help meet the credit needs of the entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA requires the appropriate federal regulator, in connection with its examination of an insured institution, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications, such as applications for a merger or the establishment of a branch. An unsatisfactory rating may be used as the basis for the denial of an application by the federal banking regulator. The Bank received a satisfactory rating in its most recent CRA examination.

Restrictions on Transactions with Affiliates

We are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on: the amount of a bank’s loans or extensions of credit to affiliates; a bank’s investment in affiliates; assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve; the amount of loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and a bank’s guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total permitted amount of the above transactions is limited in amount, as to any one affiliate, to 10.0% of a bank’s capital and surplus and, as to all affiliates combined, to 20.0% of a bank’s capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid the taking of low-quality assets.

We are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The Dodd-Frank Act changed the definition of “covered transaction” in Sections 23A and 23B and limitations on asset purchases from insiders. With respect to the definition of “covered transaction,” the Dodd-Frank Act defines that term to include the acceptance of debt obligations issued by an affiliate as collateral for a bank’s loan or extension of credit to another person or company. In addition, a “derivative transaction” with an affiliate is now deemed to be a “covered transaction” to the extent that such a transaction causes a bank or its subsidiary to have a credit exposure to the affiliate. The Dodd-Frank Act also provides that the Bank may not “purchase an asset from, or sell an asset to” a Bank insider (or their related interests) unless (1) the transaction is conducted on market terms, and (2) if the proposed transaction represents more than 10% of the capital stock and surplus of the Bank, it has been approved in advance by a majority of the Bank’s non-interested directors.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal stockholders and their related interests. These extensions of credit must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and must not involve more than the normal risk of repayment or present other unfavorable features.

Incentive Compensation

The Federal Reserve, the OCC and the FDIC have issued regulatory guidance (the “Incentive Compensation Guidance”) intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The Federal Reserve reviews, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not “large, complex banking organizations.” The findings are included in reports of examination, and deficiencies are incorporated into the organization’s supervisory ratings. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

The Dodd-Frank Act requires the SEC and the federal bank regulatory agencies to establish joint regulations or guidelines that require financial institutions with assets of at least $1 billion to disclose the structure of their incentive compensation practices and prohibit such institutions from maintaining compensation arrangements that encourage inappropriate risk-taking by providing excessive compensation, or that could lead to material financial loss to the financial institution. The SEC and federal bank regulatory agencies re-proposed regulations in 2016 (initially proposed in 2011) and previously issued guidance on sound incentive compensation policies, but have not yet finalized any regulations. If these or other regulations are adopted in a form similar to that initially proposed, they will impose limitations on the manner in which we may structure compensation for our executives. These proposed regulations incorporate the three principles discussed in the Incentive Compensation Guidance.

USA Patriot Act of 2001

In October 2001, the USA Patriot Act of 2001 (the "Patriot Act") was enacted in response to the terrorist attacks in New York, Pennsylvania, and Washington, D.C. that occurred on September 11, 2001. The Patriot Act impacts financial institutions in particular through its anti-money laundering and financial transparency laws. The Patriot Act amended the Bank Secrecy Act and the rules and regulations of the Office of Foreign Assets Control to establish regulations which, among others, set standards for identifying customers who open an account and promote cooperation with law enforcement agencies and regulators in order to effectively identify parties that may be associated with, or involved in, terrorist activities or money laundering.

Privacy

Financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing personal financial information with nonaffiliated third parties except for third parties that market the institutions' own products and services.

Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to consumers. The Bank has established policies and procedures designed to safeguard its customers' personal financial information and to ensure compliance with applicable privacy laws.

Consumer Protection

The Dodd-Frank Act created the CFPB, a federal regulatory agency that is responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than $10 billion of assets and, to a lesser extent, smaller institutions. The Dodd-Frank Act gives the CFPB authority to supervise and regulate providers of consumer financial products and services, establishes the CFPB's power to act against unfair, deceptive or abusive practices, and gives the CFPB rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth-in-Lending Act and the Real Estate Settlement Procedures Act).

As a smaller institution (i.e., with assets of $10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Company by the Federal Reserve and to the Bank by the OCC. However, the CFPB may include its own examiners in regulatory examinations by a smaller institution's prudential regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies and financial holding companies, could influence how the Federal Reserve and OCC apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise impact of the CFPB's consumer protection activities cannot be forecasted.

Stress Testing

As required by the Dodd-Frank Act, the federal banking agencies have implemented stress testing requirements for certain financial institutions, including bank holding companies, financial holding companies and state chartered banks, with more than $10 billion in total consolidated assets. Although these requirements do not apply to institutions with less than $10 billion in total consolidated assets, the federal banking agencies emphasize that all banking organizations, regardless of size, should have the capacity to analyze the potential impact of adverse market conditions or outcomes on the organization's financial condition. Based on existing regulatory guidance, the Company and the Bank will be expected to consider the institution's interest rate risk management, commercial real estate concentrations and other credit-related information, and funding and liquidity management during this analysis of adverse outcomes.

Other Regulations

Interest and other charges collected or contracted for by the Bank are subject to federal laws concerning interest rates. The Bank's loan operations are also subject to federal laws applicable to credit transactions, such as the:

- Federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed, or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

The deposit operations of the Bank are subject to the following:

- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- the Truth in Savings Act, which requires disclosure of yields and costs of deposits and deposit accounts.

Effect of Governmental Monetary Policies

Our earnings are affected by the monetary and fiscal policies of the United States government and its agencies, as well as general domestic economic conditions. The Federal Reserve's power to implement national monetary policy has had, and is likely to continue to have, an important impact on the operating results of financial institutions. The Federal Reserve affects the levels of bank loans, investments, and deposits through its control over the issuance of U.S. government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is difficult to predict the nature, timing or impact of future changes in monetary and fiscal policies.

Item 1A – Risk Factors

An investment in our stock involves a number of risks. Investors should carefully consider the following risks as well as the other information in this Report and the documents incorporated by reference before making an investment decision. The realization of any of the risks described below could have a material adverse effect on the Company and the price of our common stock.

Risks Relating to Our Business

Our industry and business may be adversely affected by conditions in the financial markets and economic conditions generally.

In recent years, we have faced a challenging and uncertain economic environment, including a major recession in the U.S. economy. A return of recessionary conditions and/or further deterioration of national economic conditions could adversely affect the financial condition and operating performance of financial institutions. Specifically, declines in real estate values and sales volumes and increased unemployment levels may result in higher than expected loan delinquencies, increases in levels of non-performing and classified assets and a decline in demand for products and services offered by financial institutions. While economic conditions in the markets in which we operate, as well as in the U.S. and worldwide, have improved since the recession, there can be no assurance that this improvement will continue. Uncertainty regarding continuing economic improvement may result in changes in consumer and business spending, borrowing and savings habits, which could cause us to incur losses and may adversely affect our results of operations and financial condition.

Our market areas are heavily dependent on, and we have significant credit exposure to, the oil and gas industry.

The economy in a large portion of our market areas is heavily dependent on the oil and gas industry. Many of our customers provide transportation and other services and products that support oil and gas exploration and production activities. We define an energy loan as any loan where the borrower's ability to repay is disproportionately impacted by a prolonged downturn in energy prices. Under this definition, the Bank includes direct Commercial and Industrial (C&I) loans to energy borrowers, as well as Commercial Real Estate loans, Residential Real Estate loans and loans to energy-related borrowers where the loan's primary collateral is cash and marketable securities. Although this definition has resulted in a lack of comparability with some other energy-related banks, management believes it to be the prudent approach to monitoring and managing the Bank's energy exposure. As of December 31, 2016, we had approximately $237.4 million in loans to borrowers in the oil and gas industry, as defined above, representing approximately 18.5% of our total loans outstanding as of that date. The average loan size is approximately $458,000, and the average loan size per relationship is roughly $609,000. The oil and gas industry, especially in Louisiana and Texas, has been subject to significant volatility, including the “oil bust” of the 1980s that severely impacted the economies of many of our market areas and, more recently, volatility in oil and gas prices and material declines in the level of drilling and production activity in Texas, Louisiana and other areas of the U.S. Decisions by certain members of the

Organization of Petroleum Exporting Countries to maintain higher crude oil production levels have led to increased global oil supplies, which, when coupled with the continued exporting restrictions on the U.S. oil and gas industry and weaker global demand, has resulted in significant declines in domestic market oil prices. Decreased market oil prices have compressed margins for many U.S.-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. As of December 31, 2016, the price per barrel of crude oil was approximately $54 compared to approximately $38, $53 and $98 as of December 31, 2015, December 31, 2014, and December 31, 2013, respectively. These adverse developments in the oil and gas industry have had negative effects on the economies of our market areas in general, including adverse effects on commercial and residential real estate values and the general level of economic activity. If oil prices remain at these low levels for an extended period, the Bank could experience weaker oil and gas related loan demand and increased losses within its oil and gas loan portfolio. Furthermore, a prolonged period of low oil prices could also have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Louisiana and Texas. Accordingly, if there is further deterioration in the oil and gas industry it could have a material adverse effect on our business, prospects, financial condition and results of operations.

We may suffer losses in our loan portfolio in excess of our allowance for loan losses.
We have experienced increases in the levels of our non-performing assets and loan charge-offs in recent periods. Our total non-performing assets amounted to $65.0 million, or 3.35% of our total assets, at December 31, 2016, and we had $5.2 million of net loan charge-offs and a $10.6 million provision for loan losses for the year ended December 31, 2016. At December 31, 2016, the ratios of our ALLL to non-performing loans and to total loans outstanding were 38.78% and 1.90%, respectively. Additional increases in our non-performing assets or loan charge-offs could have a material adverse effect on our financial condition and results of operations.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. These practices include analysis of a borrower’s prior credit history, financial statements, tax returns and cash flow projections, valuation of collateral based on reports of independent appraisers and verification of liquid assets. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we still may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our ALLL. We create an ALLL in our accounting records, based on, among other considerations, the following:

- industry historical losses as reported by the FDIC;
- historical experience with our loans;
- evaluation of economic conditions;
- regular reviews of the quality mix, including our distribution of loans by risk grade within our portfolio, and size of our overall loan portfolio;
- regular reviews of delinquencies; and
- the quality of the collateral underlying our loans.

Although we maintain an ALLL at a level that we believe is adequate to absorb losses inherent in our loan portfolio, changes in economic, operating and other conditions, including conditions which are beyond our control such as a sharp decline in real estate values and changes in interest rates, may cause our actual loan losses to exceed our current allowance estimates. Additions to the ALLL could result in a decrease in net earnings and capital and could hinder our ability to grow. Further, if our actual loan losses exceed the amount reserved, it could have a material adverse effect on our financial condition and results of operations.

We cannot predict the effect of recent or future legislative and regulatory initiatives.

Financial institutions have been the subject of substantial legislative and regulatory changes and may be the subject of further legislation or regulation in the future, including: (i) changes in banking, securities and tax laws and regulations and their application by our regulators, including pursuant to the Dodd-Frank Act, as discussed above in Item 1 under the heading "Business – Supervision and Regulation"; and (ii) changes in the scope and cost of FDIC insurance and other coverage, none of which is within our control. Significant new laws or regulations or changes in, or repeals of, existing laws or regulations may cause our results of operations to differ materially from those we currently anticipate. In addition, the cost and burden of compliance with applicable laws and regulations have significantly increased and could adversely affect our ability to operate profitably. Further, federal monetary policy significantly affects credit conditions for us, as well as for our borrowers, particularly as implemented by the Federal Reserve Board, primarily through open market operations in U.S. government securities, the discount rate for bank borrowings and reserve requirements. A material change in any of these conditions could have a material impact on us or our borrowers, and therefore on our business, prospects, financial condition and results of operations.

The 2016 national election results have introduced additional uncertainty into future implementation and enforcement of the Dodd-Frank Act and other financial sector regulatory requirements. Such additional regulation and supervision may increase our costs and limit our ability to pursue business opportunities. The effects of such recently enacted, and proposed, legislation and regulatory programs on us cannot reliably be determined at this time.

The short-term and long-term impact of the changing regulatory capital requirements is uncertain.
Effective January 1, 2015, the Basel III Capital Rules that substantially changed the regulatory risk-based capital rules applicable to the Company and the Bank began to phase in. The Basel III Capital Rules include new minimum risk-based capital and leverage ratios and modify the capital and asset definitions for purposes of calculating those ratios. Among other things, as of January 1, 2015, the Basel III Capital Rules established a new common equity Tier 1 minimum capital requirement of 4.5%, a higher minimum Tier 1capital to risk-weighted assets requirement of 6.0% and a higher total capital to risk-weighted assets of 8.0%. In addition, the Basel III Capital Rules provide, to be considered "well-capitalized," a new common equity Tier 1 capital requirement of 6.5% and a higher Tier 1 capital to risk-weighted assets requirement of 8.0% that are effective as of January 1, 2015. Moreover, the Basel III Capital Rules limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of an additional 2.5% of common equity Tier 1 capital in addition to the 4.5% minimum common equity Tier 1 requirement and the other amounts necessary to the minimum risk-based capital requirements that will be phased in and fully effective in 2019.

The application of the more stringent capital requirements described above could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in additional regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements under the Basel III Capital Rules could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in us modifying our business strategy and could limit our ability to pay dividends.

The CFPB may reshape the consumer financial laws through rulemaking and enforcement of the prohibitions against unfair, deceptive and abusive business practices, which may directly impact the business operations of depository institutions offering consumer financial products or services, including the Bank.
The CFPB has broad rulemaking authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer to consumers covered financial products and services. The CFPB has also been directed to write rules identifying practices or acts that are unfair, deceptive or abusive in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. The concept of what may be considered to be an "abusive" practice is new under the law. While the Bank will not be supervised by the CFPB, it will still be subject to the regulations and policies promulgated by the CFPB and may be examined by the OCC for compliance therewith. The costs and limitations related to complying with any new regulations established by the CFPB have yet to be fully determined and could be material. Further, the limitations and restrictions that will be placed upon the Bank with respect to its consumer product offerings and services may also produce significant, material effects on the Bank's (and our) profitability.

We have a concentration of exposure to a number of individual borrowers. Given the size of these loan relationships relative to capital levels and earnings, a significant loss on any one of these loans could materially and adversely affect us.
We have a concentration of exposure to a number of individual borrowers. Our largest exposure to one borrowing relationship as of December 31, 2016, was approximately $18.1 million, which is 8.4% of our total capital. In addition, as of December 31, 2016, the aggregate exposure to the ten largest borrowing relationships was approximately $116.6 million, which was 9.1% of loans and 54.4% of total capital. As a result of this concentration, a change in the financial condition of one or more of these borrowers could result in significant loan losses and have a

material adverse effect on our financial condition and results of operations.

A significant percentage of our deposits are attributable to a relatively small number of customers. The loss of all or some of these customers or a significant decline in their deposit balances may have a material adverse effect on our liquidity and results of operations.

As of December 31, 2016, our 20 largest depositors accounted for approximately 16.1% of total deposits, of which our top five depositors accounted for approximately 8.4% of total deposits. The ability to attract these types of deposits has a positive effect on our net interest margin as they provide a relatively low cost of funds to the Bank. While we believe we have strong, long-term relationships with each of these customers, the loss of one or more of our 20 largest deposit customers, or a significant decline in the deposit balances would adversely affect our liquidity and require us to attract new deposits, purchase federal funds or borrow funds on a short-term basis to replace such deposits, possibly at interest rates higher than those currently paid on such deposits. This could increase our total cost of funds and could result in a decrease in our net interest income and net earnings. If we were unable to develop alternative funding sources, we may have difficulty funding loans or meeting other deposit withdrawal requirements.

We occasionally purchase non-recourse loan participations from other banks based in part on information provided by the selling bank.

From time to time, we purchase loan participations from other banks in the ordinary course of business, usually without recourse to the selling bank. As of December 31, 2016, we had approximately $46.8 million in purchased loan participations, or approximately 3.6% of our total loan portfolio. When we purchase loan participations, we apply the same underwriting standards as we would to loans that we directly originate and seek to purchase only loans that would satisfy these standards. However, we are not as familiar with the borrower and may rely on information provided to us by the selling bank and typically must rely on the selling bank’s administration of the loan relationship. We therefore have less control over, and may incur more risk with respect to, loan participations that we purchase from selling banks as compared to loans that we originate.

Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.

Most of our commercial business and commercial real estate loans are made to small business or middle market customers. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and have a heightened vulnerability to economic conditions. If general economic conditions in the markets in which we operate negatively impact this important customer sector, our results of operations and financial condition and the value of our common stock may be adversely affected. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers’ businesses may hinder their ability to repay their loans with us, which could have a material adverse effect on our financial condition and results of operations.

Our loan portfolio includes a substantial percentage of commercial and industrial loans, which may be subject to greater risks than those related to residential loans.

Our loan portfolio includes a substantial percentage of commercial and industrial loans. Commercial and industrial loans generally carry larger loan balances and historically have involved a greater degree of financial and credit risks than residential first mortgage loans. Repayment of our commercial and industrial loans is often dependent on cash flow of the borrower, which may be unpredictable, and collateral securing these loans may fluctuate in value. Our commercial and industrial loans are primarily made based on the cash flow of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most often, this collateral consists of accounts receivable, inventory, equipment, or real estate. 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. Other collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. At December 31, 2016, commercial and industrial loans totaled approximately 35.8% of our total loan portfolio. Adverse changes in local economic conditions impacting our business borrowers could have a material adverse effect on our business, prospects, financial condition and results of operations.

We have a high concentration of loans secured by real estate, and an adverse change in the real estate market could have a material effect on our financial condition and results of operations.

A significant portion of our loan portfolio is dependent on real estate. At December 31, 2016, approximately 57.6% of our loans had real estate as a primary or secondary component of collateral. The collateral in each case provides an alternate source of repayment if the borrower defaults and may deteriorate in value during the time the credit is extended. An adverse change in the economy affecting values of real estate in our primary markets could significantly impair the value of real estate collateral and the ability to sell real estate collateral upon foreclosure. Furthermore, it is likely that we would be required to increase the provision for loan losses. A related risk in connection with loans secured by real estate is the effect of unknown or unexpected environmental contamination, which could make the real estate effectively unmarketable or otherwise significantly reduce its value as collateral. If we were required to liquidate real estate collateral securing a loan to satisfy the debt during a period of reduced real estate values or to increase the allowance for loan losses, it could have a material adverse effect on our financial condition and results of operations.

We may face risks with respect to future expansion and acquisition opportunities.

We have expanded our business in part through acquisitions and will continue to look at future acquisitions as a way to further increase our growth. However, we cannot assure you that we will be successful in completing any future acquisitions. Further, failure to realize the potential expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from an acquisition could have a material adverse effect on our business, prospects, financial condition and results of operations.

We may seek merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale or expanded services. We cannot say with any certainty that we will be able to consummate, or if consummated, successfully integrate future acquisitions, or that we will not incur disruptions or unexpected expenses in integrating such acquisitions. In attempting to make such acquisitions, we anticipate competing with other financial institutions, many of which have greater financial and operational resources. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

- potential exposure to unknown or contingent liabilities of the target company;
- expansion into new markets that may have different characteristics than our current markets and may otherwise present management challenges;
- exposure to potential asset quality issues of the target company;
- difficulty and expense of integrating the operations and personnel of the target company;
- potential disruption to our business;
- potential diversion of management’s time and attention;
- the possible loss of key employees and customers of the target institution;
- difficulty in estimating the value of the target company; and
- potential changes in banking, accounting or tax laws or regulations that may affect the target institution.

We are subject to environmental liability risk associated with our lending activities.
A significant portion of the Bank’s loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property’s value or limit the Bank’s ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Our future earnings could be adversely affected by non-cash charges for goodwill impairment, if a future test of goodwill indicates that goodwill has been impaired.
As prescribed by Accounting Standards Codification (“ASC”) Topic 350, “Intangibles — Goodwill and Other,” we undertake an annual review of the goodwill asset balance reflected in our financial statements. We conduct an annual review in the fourth quarter of each year, unless there has been a triggering event prescribed by applicable accounting rules that warrants an earlier interim testing for possible goodwill impairment. After our most recent annual review in the fourth quarter of 2016, we concluded there was no goodwill impairment as of such date. As of December 31, 2016, we had $42.2 million in goodwill. Future goodwill impairment tests may result in future non-cash charges, which could adversely affect our earnings for any such future period.

Changes in the fair value of our securities may reduce our stockholders’ equity and net income.
At December 31, 2016, $341.9 million of our securities (at fair value) were classified as available-for-sale. At such date, the aggregate net unrealized loss on our available-for-sale securities was $2.5 million. We increase or decrease stockholders’ equity by the amount of change from the unrealized gain or loss (the difference between the estimated fair value and the amortized cost) of our available-for-sale securities portfolio, net of the related tax, under the

category of accumulated other comprehensive income/loss. Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholders' equity, as well as book value per common share and tangible book value per common share. This decrease will occur even though the securities are not sold. In the case of debt securities, if these securities are never sold and there are no credit impairments, the decrease will be recovered over the life of the securities. In the case of equity securities which have no stated maturity, the declines in fair value may or may not be recovered over time.

We monitor the fair value of our entire securities portfolio as part of our ongoing other than temporary impairment ("OTTI") evaluation process. No assurance can be given that we will not need to recognize OTTI charges related to securities in the future. In addition, as a condition to membership in the Federal Home Loan Bank of Dallas ("FHLB-Dallas"), we are required to purchase and hold a certain amount of FHLB-Dallas stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB-Dallas. At December 31, 2016, we had stock in the FHLB-Dallas totaling approximately $3.4 million. The FHLB-Dallas stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. For the year ended December 31, 2016, we did not recognize an impairment charge related to our FHLB-Dallas stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB-Dallas may not require us to recognize an impairment charge with respect to such holdings.

Loss of key officers or employees may disrupt relationships with certain customers.
As a community bank, our business is primarily relationship-driven in that many of our key employees have extensive customer relationships. In addition, our success has been and will continue to be greatly influenced by the ability to retain existing senior management and, with expansion, to attract and retain qualified additional senior and middle management. We do not have employment agreements with any of our executive officers, except Mr. C.R. Cloutier, our President and Chief Executive Officer. Loss of a key employee with such customer relationships may lead to the loss of business if the customers were to follow that employee to a competitor. While we believe our relationships with our key personnel are good, we cannot guarantee that all of our key personnel will remain with our organization. Loss of such key personnel, should they enter into an employment relationship with one of our competitors, could result in the loss of some of our customers.

Additionally, the inability to recruit and retain qualified senior and middle management in the future could have an adverse effect on our business and financial results. The scope and content of U.S. banking regulators' policies on incentive compensation, as well as changes to these policies, could adversely affect our ability to hire, retain and motivate our key employees in the future.

A natural disaster, especially one affecting one of our market areas, could adversely affect us.
Since most of our business is conducted in Louisiana and Texas, most of our credit exposure is in those states. Historically, Louisiana and Texas have been vulnerable to natural disasters. Therefore, we are susceptible to the risks of natural disasters, such as hurricanes, floods and tornadoes. Natural disasters could harm our operations directly through interference with communications, including the interruption or loss of our websites, which would prevent us from gathering deposits, originating loans and processing and controlling our flow of business, as well as through the destruction of facilities and our operational, financial and management information systems. A natural disaster or recurring power outages may also impair the value of our largest class of assets, our loan portfolio, as uninsured or underinsured losses, including losses from business disruption, may reduce borrowers' ability to repay their loans. Disasters may also reduce the value of the real estate securing our loans, impairing our ability to recover on defaulted loans through foreclosure and making it more likely that we would suffer losses on defaulted loans. Although we have implemented several back-up systems and protections (and maintain business interruption insurance), these measures may not protect us fully from the effects of a natural disaster. The occurrence of natural disasters in our market areas could have a material adverse effect on our business, prospects, financial condition and results of operations.

Our profitability is vulnerable to interest rate fluctuations.
Our profitability is dependent to a large extent on net interest income, which is the difference between our interest income on interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Conversely, when interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income. Furthermore, some of our variable interest rate loans have minimum fixed interest rates ("floors") that are currently above the contractual variable interest rate. If interest rates rise, the interest income from our variable interest rate loans with floors may not increase as quickly as interest expense on our liabilities, which would negatively impact our net interest income.

The banking industry has experienced a prolonged period of unusually low interest rates. The Federal Reserve began raising rates in late 2015 and their benchmark rate and market rates increased during 2016. However, there is substantial uncertainty regarding the extent to which interest rates may increase in 2017 and future periods and what the future effects of any such increases will be. There is no assurance that recent expectations of increasing interest rates in future periods will be realized.

In periods of increasing interest rates, loan originations may decline, depending on the performance of the overall economy, which may adversely affect income from lending activities. Also, increases in interest rates could adversely affect the market value of fixed income assets. In addition, an increase in the general level of interest rates may affect the ability of certain borrowers to pay the interest and principal on their obligations.

Non-performing assets take significant time to resolve and adversely affect our results of operations and financial condition.

Non-performing assets adversely affect our net earnings in various ways. Until economic and market conditions improve, we expect to incur provisions for loan losses relating to an increase in non-performing assets. We generally do not record interest income on non-performing loans or other real estate owned, thereby adversely affecting our earnings, and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we mark the related asset to the then fair market value of the collateral less estimated selling costs, which may result in a loss. An increase in the level of non-performing assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile. While we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of non-performing assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. There can be no assurance that we will not experience future increases in non-performing assets.

The soundness of other financial institutions could adversely affect us.
Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse effect on our business, prospects, financial condition and results of operations.

We operate within a highly regulated environment and our business and results are affected by the regulations to which we are subject.
We operate within a highly regulated environment. The regulations to which we are subject will continue to have an impact on our operations and the degree to which we can grow and be profitable. Certain regulators, to which we are subject, have significant power in reviewing our operations and approving our business practices. In recent years the Bank, as well as other financial institutions, has experienced increased regulation and regulatory scrutiny, often requiring additional resources. In addition, investigations or proceedings brought by regulatory agencies may result in judgments, settlements, fines, penalties, or other results adverse to us. There is no assurance that any change to the regulatory requirements to which we are subject, or the way in which such regulatory requirements are interpreted or enforced, will not have a negative effect on our ability to conduct our business and our results of operations.

We rely heavily on technology and computer systems. The negative effects of computer system failures and unethical individuals with the technological ability to cause disruption of service could adversely affect our reputation and our ability to generate deposits.
Our ability to compete depends on our ability to continue to adapt and deliver technology on a timely and cost-effective basis to meet customers' demands for financial services. We provide our customers the ability to bank online and many customers now remotely submit deposits to us through remote-capture systems. The secure transmission of confidential information over the Internet is a critical element of these services. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security problems. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation and our ability to generate deposits.

We rely on third parties to provide key components of our business infrastructure.
Third parties provide key components of our business operations such as data processing, recording and monitoring transactions, online banking interfaces and services, Internet connections and network access. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including those resulting from disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher volumes, cyber-attacks and security breaches at a vendor, failure of a vendor to provide services for any reason or poor performance of services, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third party vendor could also hurt our operations if those difficulties interfere with the vendor’s ability to serve us. Furthermore, our vendors could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints. Replacing these third party vendors could also create

significant delay and expense. Accordingly, use of such third parties creates an unavoidable inherent risk to our business operations.

Consumers may decide not to use banks to complete their financial transactions.
Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

Risks Relating to an Investment in Our Common Stock

Share ownership may be diluted by the issuance of additional shares of common stock in the future.
Our stock incentive plan provides for the granting of stock incentives to directors, officers, and employees. As of December 31, 2016, there were 298,995 shares issued under options and 14,764 shares in restricted stock granted under that plan. Likewise, approximately 136,093 shares may be issued in the future to directors, officers, and employees under our existing equity incentive plans. In addition, in 2009, as part of our participation in the Treasury's Capital Purchase Program ("CPP"), we issued a stock purchase warrant that currently entitles the holder to purchase 104,384 shares of our common stock at an exercise price of $14.37 per share. It is probable that options and/or warrants will be exercised during their respective terms if the stock price exceeds the exercise price of the particular option or warrant. The incentive plan also provides that all issued options automatically and fully vest upon a change in control. If the options are exercised, share ownership will be diluted.

Additionally, share ownership of our common stock will be diluted from shares issued upon conversion of the Series C Preferred Stock issued in the PSB acquisition. As of December 31, 2016, there were 91,098 shares of Series C Preferred Stock issued and outstanding. Holders may convert the Series C Preferred Stock at any time into shares of the Company's common stock at a conversion price of $18.00 per share, subject to customary antidilution adjustments. In addition, on or after the fifth anniversary of the closing date, the Company will have the option to require conversion of the Series C Preferred Stock if the closing price of the Company's common stock for 20 trading days within any period of 30 consecutive trading days, exceeds 130% of the conversion price.

In addition, our articles of incorporation authorize the issuance of up to 30,000,000 shares of common stock and 5,000,000 shares of preferred stock, but do not provide for preemptive rights to the stockholders; therefore, stockholders will not automatically have the right to subscribe for additional shares. As a result, if we issue additional shares to raise additional capital or for other corporate purposes, you may be unable to maintain your pro rata ownership in the Company.

The holders of our preferred stock and trust preferred securities have rights that are senior to those of stockholders and that may impact our ability to pay dividends on our common stock and net income available to our common stockholders.
At December 31, 2016, we had outstanding $22.2 million of trust preferred securities. These securities are senior to shares of common stock. As a result, we must make payments on our trust preferred securities before any dividends can be paid on our common stock. Moreover, in the event of our bankruptcy, dissolution, or liquidation, the obligations outstanding with respect to our trust preferred securities must be satisfied before any distributions can be made to our stockholders. While we have the right to defer dividends on the trust preferred securities for a period of up to five years, if any such election is made, no dividends may be paid to our common or preferred stockholders

during that time.

In addition, with respect to the $32.0 million in Series B Preferred Stock outstanding that was issued to the Treasury in the SBLF Transaction, we are required to pay cumulative dividends on the Series B Preferred Stock at an annual rate. The dividend rate was set at 1.00% beginning in the fourth quarter of 2013 due to attaining the target 10% growth rate in qualified small business loans during the second quarter of 2013. Beginning February 25, 2016, the dividend rate increased to 9% per annum. The $10.0 million in Series C Preferred Stock that was issued in connection with the PSB acquisition calls for the non-cumulative payment of dividends at an annual rate of 4.0%. Dividends paid on our Series B Preferred Stock or Series C Preferred Stock will also reduce the net income available to our common stockholders and our earnings per common share. We may not declare or pay dividends on our common stock or repurchase shares of our common stock without first having paid all accrued preferred dividends that are due.

Only a limited trading market exists for our common stock, which could lead to price volatility.

Our common stock is listed for trading on the NYSE under the trading symbol “MSL,” but there is low trading volume in our common stock. The limited trading market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which might occur in a more active trading market of our common stock. Future sales of substantial amounts of common stock in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of our common stock. In addition, even if a more active market in our common stock develops, we cannot assure you that such a market will continue.

Our directors and executive management own a significant number of shares of stock, allowing further control over business and corporate affairs.
Our directors and executive officers beneficially own approximately 2.2 million shares, or 19.2%, of our outstanding common stock as of December 31, 2016. As a result, in addition to their day-to-day management roles, they will be able to exercise significant influence on our business as stockholders, including influence over election of the Board and the authorization of other corporate actions requiring shareholder approval. In deciding on how to vote on certain proposals, our stockholders should be aware that our directors and executive officers may have interests that are different from, or in addition to, the interests of our stockholders generally.

Provisions of our articles of incorporation and by-laws, Louisiana law, and state and federal banking regulations could delay or prevent a takeover by a third party.
Our articles of incorporation and by-laws could delay, defer, or prevent a third party takeover, despite possible benefit to the stockholders, or otherwise adversely affect the price of our common stock. Our governing documents:

- permit directors to be removed by stockholders only for cause and only upon an 80% vote;
- require 80% of the voting power for stockholders to amend the by-laws, call a special meeting, or amend the articles of incorporation, in each case if the proposed action was not approved by the Board;
- authorize a class of preferred stock that may be issued in series with terms, including voting rights, established by the Board without stockholder approval;
- authorize approximately 30 million shares of common stock and 5 million shares of preferred stock that may be issued by the Board without shareholder approval;
- classify our Board with staggered three year terms, preventing a change in a majority of the Board at any annual meeting;
- require advance notice of proposed nominations for election to the Board and business to be conducted at a shareholder meeting; and
- require 80% of the voting power for stockholders to approve business combinations not approved by the Board.

These provisions would likely preclude a third party from removing incumbent directors and simultaneously gaining control of the Board by filling the vacancies thus created with its own nominees. Under the classified Board provisions, it would take at least two elections of directors for any individual or group to gain control of the Board. Accordingly, these provisions could discourage a third party from initiating a proxy contest, making a tender offer or otherwise attempting to gain control. These provisions may have the effect of delaying consideration of a shareholder proposal until the next annual meeting unless a special meeting is called by the Board or the chairman of the Board. Moreover, even in the absence of an attempted takeover, the provisions make it difficult for stockholders dissatisfied with the Board to effect a change in the Board’s composition, even at annual meetings.

Also, we are subject to the provisions of the Louisiana Business Corporation Law (“LBCL”), which provides that we may not engage in certain business combinations with an “interested shareholder” (generally defined as the holder of 10.0% or more of the voting shares) unless (1) the transaction was approved by the Board before the interested shareholder became an interested shareholder or (2) the transaction was approved by at least two-thirds of the outstanding voting shares not beneficially owned by the interested shareholder and 80% of the total voting power or

(3) certain conditions relating to the price to be paid to the stockholders are met.

The LBCL also addresses certain transactions involving “control shares,” which are shares that would have voting power with respect to the Company within certain ranges of voting power. Control shares acquired in a control share acquisition have voting rights only to the extent granted by a resolution approved by our stockholders. If control shares are accorded full voting rights and the acquiring person has acquired control shares with a majority or more of all voting power, stockholders of the issuing public corporation have dissenters’ rights as provided by the LBCL.

Our future ability to pay dividends and repurchase stock is subject to restrictions.
Since we are a holding company with no significant assets other than the Bank, we have no material source of income other than dividends received from the Bank. Therefore, our ability to pay dividends to our stockholders will depend on the Bank’s ability

to pay dividends to us. Moreover, banks and financial holding companies are both subject to certain federal and state regulatory restrictions on cash dividends. We are also restricted from paying dividends if we have deferred payments of the interest on, or an event of default has occurred with respect to, our trust preferred securities, Series B Preferred Stock or Series C Preferred Stock. Additionally, terms and conditions of our outstanding shares of preferred stock place certain restrictions and limitations on our common stock dividends and repurchases of our common stock.

A shareholder’s investment is not an insured deposit.
An investment in our common stock is not a bank deposit and is not insured or guaranteed by the FDIC or any other government agency. Your investment in our common stock will be subject to investment risk and you may lose all or part of your investment.

Item 1B – Unresolved Staff Comments

None.

Item 2 - Properties

We lease our principal executive and administrative offices and principal facility in Lafayette, Louisiana under a lease expiring July 31, 2021. In addition to our principal facility, we also have eight other branches located in Lafayette, Louisiana, three in New Iberia, Louisiana, four in Baton Rouge, Louisiana, three in Natchitoches, Louisiana, two in Alexandria, Louisiana, two in Lake Charles, Louisiana, two in Houma, Louisiana, and one branch in each of the following Louisiana cities: Breaux Bridge, Cecilia, St. Martinville, Larose, Jeanerette, Opelousas, Carencro, Morgan City, Jennings, Sulphur, Thibodaux, Robeline, Toledo Bend, Greenwood, Zwolle, Many and Mansfield. We also have an operations office in Breaux Bridge, Louisiana. Thirty-two of these offices are owned and eleven are leased.

Additionally, in our Texas market area we have two full service branches located in each of the following Texas cities: Beaumont and Houston. Our additional full service branches in the Texas market area are located in Vidor, Conroe, Magnolia, College Station, Dallas, Mesquite, Rockwall, Greenville, White Rock, Tyler and Texarkana. Of these offices, eleven are owned and four are leased.

Item 3 - Legal Proceedings

The Bank has been named as a defendant in various other legal actions arising from normal business activities in which damages of various amounts are claimed. While the amount, if any, of ultimate liability with respect to such matters cannot be currently determined, management believes, after consulting with legal counsel, that any such liability will not have a material adverse effect on the Company’s consolidated financial position, results of operations, or cash flows. However, in the event of unexpected future developments in these matters, if the ultimate resolution of any such matter is unfavorable, the result may be material to the Company’s consolidated financial position, consolidated results of operations or consolidated cash flows.

Item 4 – Mine Safety Disclosures

Not applicable.

Executive Officers of the Registrant

The names, ages as of December 31, 2016, and positions of our current executive officers are listed below along with their business experience during the past five years.

C. R. Cloutier, 69 – President, Chief Executive Officer and Director of the Company and Senior Executive Advisor and Director of the Bank. Mr. C.R. Cloutier previously served as President and Chief Executive Officer of the Bank since 1984. In November 2016, he transitioned to the position of Senior Executive Advisor of the Bank.

Troy Cloutier, 43 – Senior Executive Vice President and Chief Banking Officer of the Company since February 2011. In November 2016, he was promoted to President and Chief Executive Officer of the Bank. Prior to his appointment as President and Chief Executive Officer of the Bank, Mr. Cloutier had been with MidSouth Bank for 23 years and previously served as Chief Banking Officer of the Bank. Troy Cloutier is the son of C. R. Cloutier.

James R. McLemore, 57 – Senior Executive Vice President and Chief Financial Officer of the Company and the Bank since July 2009.

Jeffery L. Blum, 48 – Senior Executive Vice President and Chief Credit Officer of the Company and the Bank since August 2014. Prior to joining the Company and the Bank, Mr. Blum worked for Whitney Bank since 1993, having most recently served as Morgan City area president.

All executive officers are appointed for one year terms expiring at the first meeting of the Board of Directors after the annual stockholders meeting next succeeding his or her election and until his or her successor is elected and qualified.

PART II

Item 5 - Market for Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities

As of February 28, 2017, there were 944 common stockholders of record. The Company's common stock trades on the NYSE under the symbol "MSL." The high and low sales price for the past eight quarters has been provided in the Selected Quarterly Financial Data tables that are included with this filing under Item 8 and is incorporated herein by reference.

Cash dividends totaling $4.1 million were declared to common stockholders during 2016. The regular quarterly dividend of $0.09 per share was paid for all four quarters of 2016, for a total of $0.36 per share for the year. Cash dividends totaling $4.1 million were declared to common stockholders during 2015. The regular quarterly dividend of $0.09 per share was paid for all four quarters of 2015, for a total of $0.36 per share for the year.

Under the Louisiana law, we may not pay a dividend if (i) we are insolvent or would thereby be made insolvent, or (ii) the declaration or payment thereof would be contrary to any restrictions contained in our articles of incorporation. Our primary source of funds for dividends is the dividends we receive from the Bank; therefore, our ability to declare dividends is highly dependent upon future earnings, financial condition, and results of operation of the Bank as well as applicable legal restrictions on the Bank's ability to pay dividends and other relevant factors. The Bank currently has the ability to declare dividends to us without prior approval of our primary regulators. However, the Bank's ability to pay dividends to us will be prohibited if the result would cause the Bank's regulatory capital to fall below minimum requirements. Additionally, dividends to us cannot exceed a total of the Bank's current year and prior two years' earnings, net of dividends paid to us in those years.

Pursuant to the terms of our Series B Preferred Stock, Series C Preferred Stock, and the terms of our trust preferred securities, we are prohibited from paying dividends on our common stock during any period in which we have deferred interest payments on either the Series B Preferred Stock, Series C Preferred Stock or the trust preferred securities.

The following graph compares the cumulative total return on our common stock over a period beginning December 31, 2011 with (1) the cumulative total return on the stocks included in the Russell 3000 and (2) the cumulative total return on the stocks included in the SNL Securities, LC (“SNL”) $1B - $5B Bank Index. The comparison assumes an investment in our common stock on the indices of $100 at December 31, 2011 and assumes that all dividends were reinvested during the applicable period.

MidSouth Bancorp, Inc.

	Period Ending					
Index	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
MidSouth Bancorp, Inc.	100.00	128.18	142.79	141.32	76.13	118.13
Russell 3000	100.00	116.42	155.47	175.00	175.84	198.23
SNL Bank $1B-$5B	100.00	123.31	179.31	187.48	209.86	301.92

The stock price information shown above is based on historical data and should not be considered indicative of future price performance.

Item 6 – Five Year Summary of Selected Financial Data

	At and For the Year Ended December 31,				
	2016	2015	2014	2013	2012
	(dollars in thousands, except per share data)				
Interest income	$79,128	$81,897	$83,487	$83,203	$61,022
Interest expense	(5,690)	(5,581)	(5,807)	(6,539)	(5,840)
Net interest income	73,438	76,316	77,680	76,664	55,182
Provision for loan losses	(10,600)	(13,900)	(5,625)	(3,050)	(2,050)
Noninterest income	19,008	20,321	24,422	19,319	14,944
Noninterest expenses	(68,550)	(67,137)	(70,009)	(72,606)	(54,655)
Earnings before income taxes	13,296	15,600	26,468	20,327	13,421
Income tax expense	(3,857)	(4,583)	(7,358)	(6,151)	(3,779)
Net earnings	$9,439	$11,017	$19,110	$14,176	$9,642
Preferred dividend requirement	(2,861)	(687)	(698)	(1,332)	(1,547)
Net earnings available to common stockholders	$6,578	$10,330	$18,412	$12,844	$8,095
Basic earnings per common share	$0.58	$0.91	$1.63	$1.14	$0.77
Diluted earnings per common share	$0.58	$0.90	$1.58	$1.12	$0.77
Dividends per common share	$0.36	$0.36	$0.35	$0.31	$0.28
Total loans	$1,284,082	$1,263,645	$1,284,431	$1,137,554	$1,046,940
Total assets	1,943,340	1,927,733	1,936,740	1,851,160	1,851,728
Total deposits	1,579,430	1,550,850	1,585,234	1,518,803	1,551,904
Long-term obligations	47,591	48,018	48,444	57,087	58,512
Selected ratios:					
Loans to assets	66.08%	65.55%	66.32%	61.45%	56.54%
Loans to deposits	81.30%	81.48%	81.02%	74.90%	67.46%
Deposits to assets	81.27%	80.45%	81.85%	82.05%	83.81%
Return on average assets	0.34%	0.53%	0.97%	0.69%	0.58%
Return on average common equity	3.73%	6.00%	11.43%	8.64%	6.05%

Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this discussion and analysis is to highlight changes in the financial condition of the Company and on its results of operations during 2016, 2015 and 2014. This discussion and analysis is intended to highlight and supplement information presented elsewhere in this annual report on Form 10-K, particularly the consolidated financial statements and related notes appearing in Item 8.

Overview

We are a financial holding company, headquartered in Lafayette, Louisiana, that through our community banking subsidiary, MidSouth Bank, N.A., operates 57 offices in Louisiana and Texas. We had approximately $1.9 billion in consolidated assets as of December 31, 2016. We derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Approximately 73.7% of our total deposits are interest-bearing. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. The resulting ratio of that difference as a percentage of our average earning assets represents our net interest margin. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread. In addition to earning interest on our loans and investments, we earn income through fees and other charges to our customers. We have also included a discussion of the various components of this noninterest income, as well as of our noninterest expense.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We maintain this allowance by charging a provision for loan losses against our operating earnings for each period. We have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses.

Our financial results over the past several years have been impacted by disruptions in the national economy and the resulting financial uncertainty that affected the banking industry. The recent sharp decline in oil prices added additional pressure on the financial performance of the Company during 2016. We are closely monitoring our oil and gas loan portfolio, and we will also continue to apply conservative underwriting practices that have served us well over our thirty year history. We began as an energy leader during the oil downturn of the 80's, and we have a strong thirty year track record of lending to this industry. We have seen many ups and downs in the oil and gas industry over the years and continue to communicate with our customers who provide valuable insight on the present energy cycle. If oil prices remain at these low levels for an extended period, we could experience weaker oil and gas related loan demand and increased losses within the oil and gas loan portfolio.

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the financial statements accompanying or incorporated by reference in this report. We encourage you to read this discussion and analysis in conjunction with our consolidated financial statements and the notes thereto and other statistical information included and incorporated by reference in this annual report on Form 10-K.

Critical Accounting Policies

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements. Our significant accounting policies are described in the notes to the consolidated financial statements included in this report. The accounting principles we follow and the methods of applying these principles conform to accounting principles generally accepted in the United States of America (“GAAP”) and general banking practices. Our most critical accounting policy relates to the determination of the allowance for loan losses, which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. The determination of the adequacy of the allowance involves significant judgment and complexity and is based on many factors. If the financial condition of our borrowers were to deteriorate, resulting in an impairment of their ability to make payments, the estimates would be updated and additional provisions for loan losses may be required. See Asset Quality – Allowance for Loan Losses and Note 1 and Note 3 of the notes to the consolidated financial statements.

Another of our critical accounting policies relates to the valuation of goodwill, intangible assets and other purchase accounting adjustments. We account for acquisitions in accordance with ASC Topic No. 805, which requires the use of the purchase method of accounting. Under this method, we are required to record assets acquired and liabilities assumed at their fair value, including intangible assets. Determination of fair value involves estimates based on internal valuations of discounted cash flow analyses performed, third party valuations, or other valuation techniques that involve subjective assumptions. Additionally, the term of the useful lives and appropriate amortization periods of intangible assets is subjective. Resulting goodwill from an acquisition under the purchase method of accounting represents the excess of the purchase price over the fair value of net assets acquired. Goodwill is not amortized, but is evaluated for impairment annually or more frequently if deemed necessary. If the fair value of an asset exceeds the carrying amount of the asset, no charge to goodwill is made. If the carrying amount exceeds the fair value of the asset, goodwill will be adjusted through a charge to earnings. In evaluating the goodwill on our consolidated balance sheet for impairment at December 31, 2016, we first assessed qualitative factors to determine whether it is more likely than not that the fair value of our acquired assets is less than the carrying amount of the acquired assets, as allowed under ASU 2011-08, Intangibles- Goodwill and Other (Topic 350): Testing Goodwill for Impairment. After making the assessment based on several factors, which included but was not limited to the current economic environment, the economic outlook in our markets, our financial performance and common stock value as compared to our peers, we determined it is more likely than not that the fair value of our acquired assets is greater than the carrying amount and, accordingly, no impairment of goodwill was recorded for the year ended December 31, 2016.

Given the instability of the economic environment, it is reasonably possible that the methodology of the assessment of potential loan losses and goodwill impairment could change in the near-term or could result in impairment going forward.

Another of our critical accounting policies relates to deferred tax assets and liabilities. We record deferred tax assets and deferred tax liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax benefits, such as net operating loss carry forwards, are recognized to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the assets and liabilities are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. In the event the future tax consequences of differences between the financial reporting bases and the tax bases of our assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such assets is required. A valuation allowance is provided when it is more likely than not that a portion or the full amount of the deferred tax asset will not be realized. In assessing the ability to realize the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies. A deferred tax liability is not recognized for portions of the allowance for loan losses for income tax purposes in excess of the financial statement balance. Such a deferred tax liability will only be recognized when it becomes apparent that those temporary differences will reverse in the foreseeable future. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent more likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

Results of Operations

Net income available to common stockholders for the year ended December 31, 2016 totaled $6.6 million compared to $10.3 million for the year ended December 31, 2015, or a decrease of $3.7 million. Diluted earnings per share were $0.58 for the year ended December 31, 2016, compared to $0.90 for 2015. The decrease resulted primarily from a $4.2 million decrease in revenues. 2015 net earnings included $1.2 million in gain on sales of securities and $160,000 of income from a death benefit on bank owned life insurance. Excluding these non-operating revenues, net earnings available to common shareholders decreased $2.8 million in year-over-year comparison. A $2.8 million decrease in operating revenues, a $2.2 million increase dividends on preferred stock, and a $1.4 million increase in noninterest expenses were partially offset by a $3.3 million decrease in loan loss provision and a $726,000 decrease in income tax expense.

Total consolidated assets remained constant at $1.9 billion for the years ended December 31, 2016 and December 31, 2015. Deposits totaled $1.6 billion at December 31, 2016 and December 31, 2015. Our stable core deposit base, which excludes time deposits, grew $46.2 million and accounted for 90.4% of deposits at December 31, 2016 compared to 89.1% of deposits at year end 2015. Time deposits decreased $17.6 million for the year ended December 31, 2016. Net loans totaled $1.3 billion at December 31, 2016 compared to $1.2 billion at December 31, 2015. Net loans increased $15.1 million, or 1.2%, for the year ended December 31, 2016.

Our Tier 1 leverage capital ratio was 10.11% at December 31, 2016 compared to 10.10% at December 31, 2015. Tier 1 risk-weighted capital and total risk-weighted capital ratios were 13.02% and 14.28% at December 31, 2016, compared to 13.25% and 14.50% at December 31, 2015, respectively. The Tier 1 common equity ratio at December 31, 2016 was 8.81%, compared to 8.91% at December 31, 2015. Return on average common equity was 3.73% for 2016 compared to 6.00% for 2015. Return on average assets was 0.34% compared to 0.53% for the same periods, respectively.

Nonperforming assets totaled $65.0 million at December 31, 2016, an increase of $10.6 million over the $54.4 million reported for year-end 2015. The increase resulted from a $12.7 million increase in nonperforming loans. Nonaccrual loans totaled $62.6 million at December 31, 2016 compared to $50.1 million at December 31, 2015. Loans past due

90 days or more and still accruing interest totaled $268,000 at December 31, 2016 compared to $147,000 at December 31, 2015. Total nonperforming assets to total assets were 3.35% at December 31, 2016 compared to 2.82% at December 31, 2015. Loans classified as troubled debt restructurings (“TDRs”) totaled $25.3 million at December 31, 2016 compared to $21.0 million at December 31, 2015. These totals included $25.1 million and $20.9 million, respectively, of loans reported in nonaccrual loans.

Allowance coverage for nonperforming loans was 38.78% at December 31, 2016 compared to 37.87% at December 31, 2015. Year-to-date net charge-offs were 0.41% of average total loans as of December 31, 2016 compared to 0.47% as of December 31, 2015. The ALL/total loans ratio increased to 1.90% for the year ended December 31, 2016 compared to 1.50% at December 31, 2015.

Table 1
Summary of Return on Equity and Assets

	2016	2015	2014
Return on average assets	0.34 %	0.53 %	0.97 %
Return on average common equity	3.73 %	6.00 %	11.43%
Dividend payout ratio on common stock	62.07%	40.00%	22.15%
Average equity to average assets	11.25%	10.91%	10.71%

NOTE: 2015 return on average assets and return on average common equity were impacted by a $1.2 million net gain on sale of securities and $160,000 in income from a death benefit on bank owned life insurance. Excluding these non-operating items, return on average assets for the year ended December 31, 2015 was 0.48% and return on average common equity for the year ended December 31, 2015 was 5.44%. 2014 return on average assets and return on average common equity were impacted by $3.0 million of executive life insurance proceeds, a $1.1 million gain on sale of ORE, a $394,000 in losses on disposal of fixed assets, a $258,000 loss on redemption of Trust Preferred Securities, $516,000 in efficiency consultant expenses, and $189,000 of expenses related to the loss of an executive officer. Excluding these non-operating items, return on average assets for the year ended December 31, 2014 was 0.83% and return on average common equity for the year ended December 31, 2014 was 9.70%.

Earnings Analysis

Net Interest Income

Our primary source of earnings is net interest income, which is the difference between interest earned on loans and investments and interest paid on deposits and other interest-bearing liabilities. Changes in the volume and mix of earning assets and interest-bearing liabilities combined with changes in market rates of interest greatly affect net interest income. Our net interest margin on a taxable equivalent basis, which is net interest income as a percentage of average earning assets, was 4.20%, 4.34%, and 4.63% for the years ended December 31, 2016, 2015, and 2014, respectively. Tables 2 and 3 analyze the changes in net interest income for the years ended December 31, 2016, 2015, and 2014.

Table 2
Consolidated Average Balances, Interest, and Rates
(in thousands)

	Year Ended December 31, 2016			2015			2014		
	Average Volume	Interest	Average Yield/ Rate	Average Volume	Interest	Average Yield/ Rate	Average Volume	Interest	Average Yield/ Rate
Assets									
Investment securities[1]									
Taxable	$352,865	$7,924	2.25 %	$340,428	$7,559	2.22 %	$366,786	$8,100	2.21 %
Tax exempt[2]	63,260	2,680	4.24 %	74,836	3,342	4.47 %	87,449	4,028	4.61 %
Total investment securities	416,125	10,604	2.55 %	415,264	10,901	2.63 %	454,235	12,128	2.67 %
Federal funds sold	3,364	16	0.47 %	3,578	8	0.22 %	3,032	6	0.20 %
Time and interest bearing deposits in other banks	76,328	399	0.51 %	62,659	164	0.26 %	27,649	70	0.25 %
Other investments	11,254	351	3.12 %	10,471	345	3.29 %	11,590	347	2.99 %
Loans									
Commercial and real estate	1,175,900	62,426	5.31 %	1,185,788	64,470	5.44 %	1,111,702	65,498	5.89 %
Installment	87,825	6,256	7.12 %	106,064	7,163	6.75 %	100,960	6,829	6.76 %
Total loans[3]	1,263,725	68,682	5.43 %	1,291,852	71,633	5.54 %	1,212,662	72,327	5.96 %
Total earning assets	1,770,796	80,052	4.52 %	1,783,824	83,051	4.66 %	1,709,168	84,878	4.97 %
Allowance for loan losses	(20,823)			(15,127)			(8,850)		
Nonearning assets	185,252			188,520			191,761		
Total assets	$1,935,225			$1,957,217			$1,892,079		
Liabilities and stockholders' equity									
NOW, money market, and savings	$1,014,772	$2,913	0.29 %	$943,615	$2,214	0.23 %	$921,631	$2,147	0.23 %
Time deposits	161,926	741	0.46 %	226,188	1,373	0.61 %	228,856	1,368	0.60 %
Total interest-bearing deposits	1,176,698	3,654	0.31 %	1,169,803	3,587	0.31 %	1,150,487	3,515	0.31 %
Securities sold under agreements to repurchase	88,618	943	1.06 %	84,622	961	1.14 %	62,844	795	1.27 %
Federal funds purchased	1	—	— %	1	—	— %	228	2	0.87 %
Short-term FHLB advances	5,669	23	0.40 %	27,959	56	0.20 %	26,946	43	0.16 %
Long-term FHLB advances	25,633	366	1.40 %	26,059	364	1.38 %	26,936	378	1.38 %
Junior subordinated debentures	22,167	704	3.12 %	22,167	613	2.73 %	26,774	1,074	3.96 %
	1,318,786	5,690	0.43 %	1,330,611	5,581	0.42 %	1,294,215	5,807	0.45 %

Total interest-bearing liabilities								
Demand deposits	390,585			405,571			386,664		
Other liabilities	8,214			7,576			8,569		
Stockholders' equity	217,640			213,459			202,631		
Total liabilities and stockholders' equity	$1,935,225			$1,957,217			$1,892,079		
Net interest income and net interest spread		$74,362	4.09 %		$77,470	4.24 %		$79,071	4.52 %
Net interest margin			4.20 %			4.34 %			4.63 %

[1] Securities classified as available-for-sale are included in average balances and interest income figures and reflect interest earned on such securities.
[2] Interest income of $924,000 for 2016, $1,154,000 for 2015, and $1,391,000 for 2014 is added to interest earned on tax-exempt obligations to reflect tax-equivalent yields using a tax rate of 35%.
[3] Interest income includes loan fees of $4,932,000 for 2016, $5,170,000 for 2015, and $5,888,000 for 2014. Nonaccrual loans are included in average balances and income on such loans is recognized on a cash basis.
[4] Net interest income includes accretion income of $1,857,000 for 2016, $2,342,000 for 2015, and $3,647,000 for 2014.

Table 3
Changes in Taxable-Equivalent Net Interest Income
(in thousands)

	2016 Compared to 2015			2015 Compared to 2014		
	Total Increase (Decrease)	Change Attributable to Volume	Rates	Total Increase (Decrease)	Change Attributable to Volume	Rates
Taxable-equivalent interest earned on:						
Investment securities						
Taxable	$365	$278	$87	$(541)	$(585)	$44
Tax-exempt	(662)	(497)	(165)	(686)	(566)	(120)
Federal funds sold	8	—	8	2	2	—
Time and interest-bearing deposits in other banks	235	42	193	94	93	1
Other investments	6	25	(19)	(2)	(35)	33
Loans, including fees	(2,951)	(1,652)	(1,299)	(694)	4,564	(5,258)
Total	(2,999)	(1,804)	(1,195)	(1,827)	3,473	(5,300)
Interest paid on:						
Interest-bearing deposits	67	18	49	72	59	13
Securities sold under agreements to repurchase	(18)	43	(61)	166	253	(87)
Federal funds purchased	—	—	—	(2)	(2)	—
Short-term FHLB advances	(33)	(65)	32	13	2	11
Long-term FHLB advances	2	(3)	5	(14)	(9)	(5)
Junior subordinated debentures	91	—	91	(461)	(159)	(302)
Total	109	(7)	116	(226)	144	(370)
Taxable-equivalent net interest income	$(3,108)	$(1,797)	$(1,311)	$(1,601)	$3,329	$(4,930)

NOTE: Changes due to both volume and rate have generally been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts to the changes in each.

In year-to-date comparison, FTE net interest income decreased $3.1 million primarily due to a $3.0 million decrease in interest income on loans. The average volume of loans decreased $28.1 million in year-over-year comparison, and the average yield on loans decreased 11 basis points, from 5.54% to 5.43%. The average volume of investment securities increased $861,000 in year-over-year comparison, and the average yield on investment securities decreased 8 basis points for the same period. The average yield on total earning assets decreased in year-over-year comparison, from 4.66% at December 31, 2015 to 4.52% at December 31, 2016. The purchase accounting adjustments added 12 basis points to the average yield on loans for the year ended December 31, 2016 and 16 basis points for the year ended December 31, 2015. Excluding purchase accounting adjustments, the average yield on earning assets decreased 11 basis points, from 4.54% at December 31, 2015 to 4.43% at December 31, 2016. Interest expense increased $109,000 in year-over-year comparison. Increases in interest expense included a $67,000 increase in interest expense on deposits and a $91,000 increase in interest expense on junior subordinated debentures. These increases were partially offset by a $33,000 decrease in interest expense on short-term FHLB advances and an $18,000 decrease in interest expense on securities sold under agreements to repurchase. The average rate paid on interest-bearing liabilities was 0.43% for the year ended December 31, 2016 compared to 0.42% for the year ended December 31, 2015. Excluding purchase accounting adjustments, the average rate paid on interest-bearing liabilities increased 1 basis point, from 0.45% for the year ended December 31, 2015 to 0.46% for the year ended December 31, 2016. The FTE net interest margin decreased 14 basis points, from 4.34% for the year ended December 31, 2015 to 4.20% for the year ended December 31, 2016. Excluding purchase accounting adjustments, the FTE net interest margin decreased 11 basis points, from 4.20% to 4.09% for the years ended December 31, 2015 and 2016, respectively, primarily due to a decline in the average rate earned on loans and the decreased average volume of loans.

FTE net interest income decreased $1.6 million from 2014 to 2015 primarily due to a $1.2 million decrease in interest earned on investment securities. The average volume of investment securities decreased $39.0 million in year-over-year comparison.

Interest income on loans decreased $694,000 in year-to-date comparison primarily due to a $1.2 million reduction in purchase accounting adjustments on acquired loans. The average volume of loans increased $79.2 million in year-over-year comparison, and the average yield on loans decreased 42 basis points, from 5.96% to 5.54%. The average yield on total earning assets decreased in year-over-year comparison, from 4.97% at December 31, 2014 to 4.66% at December 31, 2015. The purchase accounting adjustments added 28 basis points to the average yield on loans for the year ended December 31, 2014 and 16 basis points for the year ended December 31, 2015. Excluding purchase accounting adjustments, the average yield on earning assets decreased 23 basis points, from 4.77% at December 31, 2014 to 4.54% at December 31, 2015. Interest expense decreased $226,000 in year-over-year comparison primarily due to the redemption of trust preferred securities in the third quarter of 2014. The average rate paid on interest-bearing liabilities decreased 3 basis points in year-over-year comparison, from 0.45% at December 31, 2014 to 0.42% at December 31, 2015. Excluding purchase accounting adjustments, the average rate paid on interest-bearing liabilities decreased 5 basis points, from 0.50% at December 31, 2014 to 0.45% at December 31, 2015. The FTE net interest margin decreased 29 basis points, from 4.63% for the year ended December 31, 2014 to 4.34% for the year ended December 31, 2015. Excluding purchase accounting adjustments, the FTE net interest margin decreased 19 basis points, from 4.39% to 4.20% for the years ended December 31, 2014 and 2015, respectively, primarily due to a decline in the average rate earned on loans.

Noninterest Income

Noninterest income totaled $19.0 million at December 31, 2016 compared to $20.3 million at December 31, 2015 and $23.0 million at December 31, 2014. Our recurring non-interest income includes service charges and fees on deposit accounts, ATM and debit card income and mortgage lending income.

Table 4 presents noninterest income for the years ended December 31, 2016, 2015 and 2014.

Table 4
Noninterest Income
(in thousands)

	Year Ended December 31,		
	2016	2015	2014
Service charges on deposit accounts	$9,612	$9,523	$9,780
ATM and debit card income	6,579	6,463	7,209
Gain on securities, net	20	1,243	128
Mortgage lending	586	618	410
Increase in cash value of life insurance	315	331	264
Executive officer life insurance proceeds	—	—	3,000
Income from death benefit on BOLI	—	160	—
Credit card income	340	381	355
Letter of credit income	26	80	115
Other	1,530	1,522	1,699
Total noninterest income	$19,008	$20,321	$22,960

Note: 2016 and 2015 income included a reclass from ATM and debit card income to Service charges on deposit accounts in the amounts of $784,000 and $887,000, respectively, for fees that were previously being included in ATM and debit card income.

Income from service charges and fees on deposit accounts, including insufficient funds fees (“NSF” fees), increased $89,000 in 2016. Adjusting for the reclass noted above, service charges and fees on deposit accounts decreased $1.1 million in 2015, primarily due to a lower volume of NSF items processed. ATM and debit card income increased $116,000 in 2016. Adjusting for the reclass noted above, ATM and debit card income increased $141,000 in 2015.

The increase in ATM and debit card income during 2016 and 2015 was a result of an increase in electronic transactions processed. Noninterest income for the year ended December 31, 2016 included $20,000 in gain on sales of securities. Noninterest income for the year ended December 31, 2015 included $1.2 million in gain on sales of securities and $160,000 of income from a death benefit on bank owned life insurance. Noninterest income for the year ended December 31, 2014 included executive officer life insurance proceeds of $3.0 million and $128,000 in gain on sales of securities. Excluding these non-operating income items, other noninterest income decreased $135,000 in 2016 and increased $89,000 in 2015. The $135,000 decrease in 2016 primarily consisted of a $54,000 decrease in letter of credit income, a $41,000 decrease in Visa merchant income and a $32,000 decrease in mortgage program fee income. The $89,000 increase in 2015 primarily consisted of a $208,000 increase in mortgage program fee income, which was partially offset by a $121,000 decrease in third party investment advisory income.

Noninterest Expense

Noninterest expense totaled $68.6 million for the year ended December 31, 2016 compared to $67.1 million and $68.5 million for the years ended December 31, 2015 and 2014, respectively. Our recurring non-interest expense consists of salaries and employee benefits, occupancy expense, ATM and debit card expense and other operating expenses.

Table 5 presents noninterest expense for the years ended December 31, 2016, 2015 and 2014.

Table 5
Noninterest Expense
(in thousands)

	Year Ended December 31,		
	2016	2015	2014
Salaries and employee benefits	$32,932	$32,036	$33,847
Occupancy expense	14,630	15,052	15,064
ATM and debit card	3,239	2,951	2,889
Legal and professional fees	1,855	1,560	1,802
FDIC premiums	1,601	1,513	1,050
Marketing	1,523	1,564	1,658
Corporate development	1,572	1,531	1,420
Data processing	1,963	1,888	1,940
Printing and supplies	760	923	1,114
Expenses on ORE, net	389	267	(820)
Amortization of core deposit intangibles	1,107	1,106	1,106
Other	6,979	6,746	7,477
Total noninterest expense	$68,550	$67,137	$68,547

Total noninterest expense increased 2.1%, or $1.4 million, from 2015 to 2016 and decreased 2.1%, or $1.4 million, from 2014 to 2015. Non-operating expenses in 2014 consisted of $394,000 in losses on disposal of fixed assets, a $258,000 loss on redemption of Trust Preferred Securities, $516,000 in efficiency consultant expenses, $189,000 of expenses related to the death of an executive officer and a $1.1 million gain on sale of ORE. Excluding these non-operating expenses, total noninterest expense decreased $1.1 million from 2014 to 2015.

Excluding non-operating expenses, salaries and employee benefits increased $896,000, or 2.8%, in 2016. The number of employees on a full-time equivalent ("FTE") basis decreased by one during 2016, from 536 at year end 2015 to 535 at year end 2016. The increase in salaries and benefits costs during 2016 was partially due to $143,000 of sign-on bonuses related to recruiting new talent to the organization, including new producers in Texas and a new Chief Information Officer. Also contributing to the increase in salaries and employee benefits costs was $223,000 of severance benefits accrued and a $349,000 increase in group health costs. Salaries and employee benefits decreased $1.7 million, or 5.0%, in 2015. Through attrition and efficiency efforts, we reduced the number of FTE employees by 13 during 2015, from 549 at year end 2014 to 536 at year end 2015. The reduction in workforce contributed to a $636,000 decrease in group health costs in 2015. Also contributing to the decrease in salaries and employee benefits costs during 2015 was a $553,000 reduction in incentives related to the Annual Incentive Compensation Plan ("AICP"). Since the Company did not achieve its 2015 goals as set forth in the AICP, no benefits were paid out under the plan for 2015.

Excluding non-operating expenses, occupancy expenses decreased $422,000 in 2016 and decreased $12,000 in 2015. The decrease in 2016 was primarily the result of lower lease expense and lower depreciation expense. Premises and equipment additions and leasehold improvements totaled approximately $5.8 million, $5.4 million and $5.6 million for the years 2016, 2015, and 2014, respectively.

ATM and debit card processing fees increased $288,000 in 2016 and was primarily driven by a $231,000 increase in losses on ATM/debit card processing. Losses on ATM/debit card processing for the year ended December 31, 2015 included a $55,000 insurance reimbursement for losses sustained in 2014. Excluding this insurance reimbursement, losses on ATM/debit card processing increased $176,000 in 2016. ATM and debit card processing fees increased $62,000 in 2015 primarily due to an increased volume of electronic transactions processed.

Excluding non-operating expenses, legal and professional fees increased $295,000 in 2016 and increased $274,000 in 2015. The increase in 2016 was due to a $127,000 increase in legal fees, an $86,000 increase in consulting fees and an $85,000 increase in outsourcing costs. The increase in legal fees is primarily due to the increase in our non-performing loans. The increase in operating legal and professional fees during 2015 was primarily due to a $114,000 increase in consulting fees, an $86,000 increase in outsourcing costs and a $57,000 increase in legal fees.

FDIC premiums increased $88,000 in 2016 and $463,000 in 2015 and was primarily due to an increase in our non-performing loans, one of the factors considered in the premium calculation.

Excluding the fluctuations discussed above, other noninterest expense increased $268,000 in 2016 and included increases of $191,000 in recruiting expense and $75,000 in data processing costs. The increased expenses were partially offset by a $163,000 decrease in the cost of printing and supplies.

Excluding non-operating expenses and the fluctuations discussed above, other noninterest expense decreased $640,000 in 2015 and included decreases of $236,000 in credit reporting expense, $191,000 in the cost of printing and supplies and $190,000 in postage and freight.

Income Taxes

Income tax expense decreased $726,000 in 2016 and decreased $2.8 million in 2015 and approximated 29%, 29%, and 28% of income before taxes in 2016, 2015 and 2014, respectively. The impact of nontaxable municipal interest income and other tax considerations resulted in lower effective tax rates for each of the three years presented in the Consolidated Statement of Earnings included in Item 8 of this filing. For the year ended December 31, 2014, executive officer life insurance proceeds of $3.0 million further lowered the effective tax rate. The notes to the consolidated financial statements provide additional information regarding income tax considerations.

Balance Sheet Analysis

Investment Securities

Total investment securities increased $5.1 million in 2016, from $435.0 million in 2015 to $440.1 million at December 31, 2016. The increase resulted primarily from $104.5 million in purchases, which were offset by $86.3 million in maturities and calls of securities and $6.8 million in sales of securities. Average duration of the portfolio was approximately 3.2 years as of December 31, 2016 and the average taxable-equivalent yield was 2.55%. For the year ended December 31, 2015, average duration of the portfolio was 3.8 years and the average taxable-equivalent yield was 2.63%. Unrealized net losses before tax effect in the securities available-for-sale portfolio were $2.5 million at December 31, 2016, compared to unrealized net gains before tax effect in the securities available-for-sale portfolio of $784,000 at December 31, 2015. These amounts resulted from interest rate fluctuations.

At December 31, 2016, approximately $296.9 million, or 86.8%, of the securities available-for-sale portfolio represented mortgage-backed securities and CMOs. All of the mortgage-backed securities and CMOs are government agency sponsored with the exception of two privately issued CMOs with a current market value of $18,000. Risk due to changes in interest rates on mortgage-backed pools is monitored by monthly reviews of prepayment speeds, duration, and purchase yields as compared to current market yields on each security. CMOs totaled $223.3 million and represented pools that each had a book value of less than 10% of stockholders' equity at December 31, 2016. The mutual fund in the securities available-for-sale portfolio is a CRA Qualified Investment Fund. The CRA Fund is a market-rate bond fund that invests in high credit quality fixed income securities whose proceeds are designed to positively impact communities throughout the United States. The fair value of the security at December 31, 2016 totaled $2.1 million. The fair value of our corporate debt securities at December 31, 2016 totaled $13.8 million. Of this total, $2.6 million represented senior debt instruments and $11.2 represented subordinated debt instruments. An additional 8.5% of the available-for-sale portfolio consisted of municipal securities. At December 31, 2016, approximately $57.7 million, or 58.8%, of the held-to-maturity portfolio represented mortgage-backed securities and CMOs. The remainder of the held-to-maturity portfolio, approximately $40.5 million, consisted of municipal securities.

Additional information on our investment securities portfolio is provided in Note 3 of the notes to consolidated financial statements.

Table 6
Carrying Value of Investment Securities
December 31,
(in thousands)

	2016	2015	2014	2013	2012
Available-for-sale securities					
U. S. Government sponsored enterprises	$—	$—	$10,227	$11,265	$13,424
Obligations of state and political subdivisions	29,141	31,493	44,605	59,978	87,421
GSE mortgage-backed securities	73,578	87,038	109,103	145,965	178,819
Collateralized mortgage obligations: residential	220,202	192,088	60,839	70,887	101,986
Collateralized mortgage obligations: commercial	3,082	5,448	24,545	27,346	29,761
Other asset-backed securities	—	—	24,343	25,489	12,742
Collateralized debt obligation	—	—	1,218	735	464
Mutual funds	2,059	2,092	2,104	—	—
Corporate debt securities	13,811	—	—	—	—
Total available-for-sale securities	$341,873	$318,159	$276,984	$341,665	$424,617
Held-to-maturity securities					
Obligations of state and political subdivisions	$40,515	$43,737	$45,914	$47,377	$42,900
GSE mortgage-backed securities	44,375	55,696	67,268	78,272	89,383
Collateralized mortgage obligations: residential	8,969	10,803	12,709	14,189	5,009
Collateralized mortgage obligations: commercial	4,352	6,556	15,310	15,685	16,232
Total held-to-maturity securities	$98,211	$116,792	$141,201	$155,523	$153,524
Total investment securities	$440,084	$434,951	$418,185	$497,188	$578,141

Table 7
Investment Securities Portfolio
Debt Security Maturities and Average Taxable-Equivalent Yields
For the Year Ended December 31, 2016
(dollars in thousands)

	Within 1 Year		After 1 but Within 5 Years		After 5 but Within 10 Years		After 10 Years		
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total
Securities available-for-sale:									
Obligations of state and political subdivisions[1]	$2,179	5.50%	$9,969	5.92%	$3,624	4.64%	$13,369	4.18%	$29,141
GSE mortgage-backs and CMOs: residential	—	— %	11	5.06%	35,178	3.23%	258,591	2.64%	293,780
CMOs: commercial	—	—	—	— %	—	—	3,082	1.99%	3,082
Corporate debt securities	—	— %	1,560	6.13%	12,251	6.14%	—	— %	13,811
Total fair value	$2,179		$11,540		$51,053		$275,042		$339,814

	Within 1 Year		After 1 but Within 5 Years		After 5 but Within 10 Years		After 10 Years		
Held-to-Maturity:	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total
Obligations of state and political subdivisions[1]	$347	2.99%	$6,427	2.70%	$8,181	3.35%	$25,560	3.47%	$40,515
GSE mortgage-backs and CMOs: residential	—	— %	—	— %	24,656	2.83%	28,688	2.04%	53,344
CMOs: commercial	—	— %	—	— %	—	— %	4,352	2.22%	4,352
Total cost	$347		$6,427		$32,837		$58,600		$98,211

[1] Tax exempt yields are expressed on a fully taxable equivalent basis.

Loan Portfolio

The loan portfolio increased $20.4 million, or 1.6%, during 2016 primarily as a result of increased demand for real estate loans, particularly construction loans. Increases of $26.0 million, $10.0 million and $8.8 million were in the construction, commercial real estate and residential real estate portfolios, respectively. These increases were partially offset by a $28.3 million decrease in our consumer loan portfolio.

Our loan portfolio is diversified throughout our Louisiana and Texas markets, with a focus on C&I and CRE loans. Our C&I and CRE loans are primarily underwritten on cash flow analyses versus collateral valuations. The C&I portfolio consists primarily of term loans or revolving lines of credit which are generally structured with annual maturity. The term loans are generally structured with fixed rates and three to five year maturities. The CRE portfolio consists primarily of credits that have fifteen to twenty year amortization terms with rates fixed primarily for three years, but up to five years. We believe the shorter term structure of our C&I and CRE credits allows greater flexibility in controlling interest rate risk.

The loan portfolio at December 31, 2016 consisted of approximately 33.6% in fixed rate loans, with the majority maturing within five years. Approximately 66.4% of the portfolio earns a variable rate of interest, the greater majority of which adjusts simultaneous with changes in the Prime rate and a smaller portion that adjusts on a scheduled repricing date. The mix of variable and fixed rate loans provides some protection from changes in market rates of interest. Additionally, we have established rate floors, primarily for our commercial loans, that provided some protection to our net interest margin during the current sustained low interest rate environment.

Table 8
Composition of Loans
December 31,
(in thousands)

	2016	2015	2014	2013	2012
Commercial, financial, and agricultural	$459,574	$454,028	$467,147	$403,976	$315,655
Real estate – construction	100,959	74,952	68,577	82,691	75,334
Real estate – commercial	481,155	471,141	467,172	397,135	414,384
Real estate – residential	157,872	149,064	154,602	146,841	142,858
Installment loans to individuals	82,660	111,009	119,328	97,459	90,561
Lease financing receivable	1,095	1,968	4,857	5,542	5,769
Other	767	1,483	2,748	3,910	2,379
Total loans	$1,284,082	$1,263,645	$1,284,431	$1,137,554	$1,046,940

Table 9
Loan Maturities and Sensitivity to Interest Rates
For the Year Ended December 31, 2016
(in thousands)

	Fixed and Variable Rate Loans at Stated Maturities				Amounts Over One Year With		
	1 Year or Less	1 Year – 5 Years	Over 5 years	Total	Predetermined Rates	Floating Rates	Total
Commercial, financial, and agricultural	$195,927	$194,479	$69,168	$459,574	$126,801	$136,846	$263,647
Real estate – construction	54,372	21,822	24,765	100,959	14,930	31,657	46,587
Real estate – commercial	61,780	73,424	345,951	481,155	53,483	365,892	419,375
Real estate – residential	13,246	33,158	111,468	157,872	66,090	78,536	144,626
Installment loans to individuals	27,228	49,079	6,353	82,660	50,341	5,091	55,432
Lease financing receivable	43	1,052	—	1,095	1,052	—	1,052
Other	560	118	89	767	118	89	207
Total	$353,156	$373,132	$557,794	$1,284,082	$312,815	$618,111	$930,926

Asset Quality

Credit Risk Management

We manage credit risk by observing written, board approved policies that govern all underwriting activities. Our Chief Credit Officer (“CCO”) is responsible for credit underwriting as well as management of classified and criticized assets for the Bank. The role of CCO includes on-going review and development of lending policies, commercial credit analysis, centralized consumer underwriting, loan operations documentation and funding, and overall credit risk management procedures. The current risk management process requires that each individual loan officer review his or her portfolio on a quarterly basis and assign recommended credit ratings on each loan. These efforts are supplemented by independent reviews performed by the loan review officer and other validations performed by the internal audit department. The results of the reviews are reported directly to the Audit Committee of the Board of Directors. We believe the conservative nature of our underwriting practices has resulted in strong credit quality in our loan portfolio. Completed loan applications, credit bureau reports, financial statements, and a committee approval process remain a part of credit decisions. Documentation of the loan decision process is required on each credit application, whether approved or denied, to ensure thorough and consistent procedures. Additionally, we have historically recognized and disclosed significant problem loans quickly and taken prompt action to address material weaknesses in those credits.

Our loan review process also includes monitoring and reporting of loan concentrations whereby individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity are evaluated for each major standard industry classification segment. At December 31, 2016, one industry segment concentration, the oil and gas industry, aggregated more than 10% of our loan portfolio. We define an energy loan as any loan where the borrower's ability to repay is disproportionately impacted by a prolonged downturn in energy prices. Under this definition, the Bank includes direct C&I loans to energy borrowers, as well as CRE loans, Residential Real Estate loans and loans to energy-related borrowers where the loan's primary collateral is cash and marketable securities. Although this definition has resulted in a lack of comparability with some other energy-related banks, management believes it to be the prudent approach to monitoring and managing the Bank's energy exposure. Our exposure in the oil and gas industry, as defined above, totaled approximately $237.4 million, or 18.5% of total loans. The average loan size is approximately $458,000, and the average loan size per relationship is roughly $609,000. Of the $237.4 million to borrowers in the oil and gas industry, $31.9 million or 13.4% were on nonaccrual status at December 31, 2016. We are closely monitoring the effects of the sharp decline in oil prices on our energy related loan portfolio. MidSouth Bank began as an energy lender during the oil downturn of the 1980’s and we have a strong thirty year track record of lending to this industry. We continue to communicate with our customers who provide valuable insight on the present energy cycle. In light of the downturn in oil prices, we expensed provisions during the last three years to establish a special reserve for potential future energy loan losses that have not yet been identified. We felt it was a prudent risk management strategy to establish a reserve of $2.5 million. During the fourth quarter of 2016, $2.0 million of the reserve was used to partially offset a $2.9 million energy-related impairment identified during the fourth quarter of 2016. At December 31, 2016, the balance in this reserve totaled $500,000. Combined with $11.1 million in specific and general reserves allocated to energy-related loans, the energy reserve as a percentage of total energy loans was 4.9% at December 31, 2016. Energy-related charge-offs during 2016 totaled $1.6 million.

We also monitor our exposure to CRE loans. At December 31, 2016, CRE loans (including commercial construction and multifamily loans) totaled approximately $559.4 million, 48% of which are secured by owner-occupied commercial properties. Our non-owner occupied CRE loans as a percentage of our risk-based capital totaled 136% at December 31, 2016. A total of $28.7 million, or 5.1%, in loans secured by commercial real estate was on nonaccrual status at December 31, 2016.

Nonperforming Assets

Table 10 contains information about nonperforming assets, including loans past due 90 days or greater (“90 days or >”) and still accruing.

Table 10
Asset Quality Information
December 31,
(dollars in thousands)

	2016	2015	2014	2013	2012
Loans on nonaccrual	$62,580	$50,051	$10,701	$5,099	$8,276
Loans past due 90 days or > and still accruing	268	147	187	178	1,986
Total nonperforming loans	62,848	50,198	10,888	5,277	10,262
Other real estate owned	2,175	4,187	4,234	6,687	7,496
Other assets repossessed	16	38	—	20	151
Total nonperforming assets	$65,039	$54,423	$15,122	$11,984	$17,909
Troubled debt restructurings, accruing (1)	$152	$164	$176	$179	$3,905
Nonperforming loans to total loans + ORE + other foreclosed assets	5.06 %	4.29 %	1.17 %	1.05 %	1.70 %
Nonperforming assets to total assets	3.35 %	2.82 %	0.78 %	0.65 %	0.97 %
ALLL to nonperforming loans	38.78 %	37.87 %	103.10 %	166.36 %	71.82 %
ALLL to total loans	1.90 %	1.50 %	0.87 %	0.77 %	0.70 %

(1)Does not include $25.1 million, $20.9 million, $234,000, $233,000 and $232,000 of TDRs reported in nonaccrual loans at December 31, 2016, 2015, 2014, 2013 and 2012, respectively.

Nonperforming assets totaled $65.0 million at December 31, 2016, an increase of $10.6 million over the $54.4 million reported for year-end 2015. The increase resulted from a $12.5 million increase in nonaccrual loans, which included the addition of three CRE relationships totaling $9.0 million unrelated to energy that were placed on nonaccrual status during the year and two energy related credit relationships totaling $8.1 million that were placed on nonaccrual status during 2016. The allowance coverage for nonperforming loans increased during 2016, from 37.87% at December 31, 2015 to 38.78% at December 31, 2016. Classified assets, including ORE, increased $57.6 million or 75.2%, from $76.6 million at December 31, 2015 to $134.2 million at December 31, 2016. The increase in classified assets was primarily due to the downgrades of several energy-related credits during 2016. Year-to-date net charge-offs were 0.41% of average total loans as of December 31, 2016 compared to 0.47% as of December

31, 2015. The ALL/total loans ratio improved by 40 basis points to 1.90% at December 31, 2016 compared to 1.50% at December 31, 2015 as a result of a $10.6 million provision for loan losses recorded during the year ended December 31, 2016.

Loans classified as TDRs totaled $25.3 million at December 31, 2016 compared to $21.0 million at December 31, 2015. These totals included $25.1 million and $20.9 million, respectively, of loans reported in nonaccrual loans. Additional information regarding impaired loans and TDRs is included in the notes to the consolidated financial statements.

Consumer and commercial loans are placed on nonaccrual status when principal or interest is 90 days past due, or sooner if the full collectibility of principal or interest is doubtful, except if the underlying collateral fully supports both the principal and accrued interest and the loan is in the process of collection. Our policy provides that retail (consumer) loans that become 120 days delinquent be routinely charged off. Loans classified for regulatory purposes but not included in Table 10 do not represent material amounts that we have serious doubts as to the ability of the borrower to comply with loan repayment terms. Further information regarding loan policy is provided in the notes to the consolidated financial statements.

Allowance for Loan Losses

Provisions totaling $10.6 million, $13.9 million, and $5.6 million, for the years 2016, 2015, and 2014, respectively, were considered necessary to bring the allowance for loan losses to a level we believe sufficient to cover probable losses in the loan portfolio. In light of the downturn in oil prices, we established a special reserve during fourth quarter of 2014 for potential future energy loan losses that have not yet been identified. Table 11 analyzes activity in the allowance for 2016, 2015, 2014, 2013, and 2012.

Table 11
Summary of Loan Loss Experience
For the Year Ended December 31,
(dollars in thousands)

	2016	2015	2014	2013	2012
Balance at beginning of year	$19,011	$11,226	$8,779	$7,370	$7,276
Charge-offs:					
Commercial, financial, and agricultural	4,366	4,936	2,843	935	1,054
Real estate – construction	—	105	1	—	—
Real estate – commercial	218	183	93	18	550
Real estate – residential	24	87	273	129	126
Installment loans to individuals	1,407	1,263	706	824	526
Lease financing receivable	—	—	—	—	—
Other	—	—	—	—	—
Total charge-offs	6,015	6,574	3,916	1,906	2,256
Recoveries:					
Commercial, financial, and agricultural	459	235	164	80	181
Real estate – construction	—	3	—	8	18
Real estate – commercial	123	26	407	29	1
Real estate – residential	5	12	47	39	2
Installment loans to individuals	189	183	120	109	98
Lease financing receivable	—	—	—	—	—
Other	—	—	—	—	—
Total recoveries	776	459	738	265	300
Net charge-offs	5,239	6,115	3,178	1,641	1,956
Additions to allowance charged to operating expenses	10,600	13,900	5,625	3,050	2,050

Balance at end of year	$24,372	$19,011	$11,226	$8,779	$7,370
Net charge-offs to average loans	0.41 %	0.47 %	0.26 %	0.15 %	0.26 %
Year-end allowance to year-end loans	1.90 %	1.50 %	0.87 %	0.77 %	0.70 %

Table 12
Allocation of Loan Loss by Category
December 31,
(dollars in thousands)

	2016		2015		2014		2013		2012	
	Amount	% of loans to total loans	Amount	% of loans to total loans	Amount	% of loans to total loans	Amount	% of loans to total loans	Amount	% of loans to total loans
Commercial, financial, and agricultural	$16,057	35.8	$11,268	35.9	$5,729	36.4	$3,906	35.5	$1,535	30.1
Real estate - construction	585	7.8	819	5.9	954	5.3	1,046	7.3	2,147	7.2
Real estate - commercial	5,384	37.5	4,614	37.3	2,402	36.4	1,389	34.9	2,166	39.6
Real estate - residential	940	12.3	816	11.8	810	12.0	1,141	12.9	936	13.6
Installment loans to individuals	1,395	6.4	1,468	8.8	1,311	9.3	1,273	8.6	543	8.7
Lease financing receivable	5	0.1	14	0.2	16	0.4	21	0.5	41	0.6
Other	6	0.1	12	0.1	4	0.2	3	0.3	2	0.2
	$24,372	100.0	$19,011	100.0	$11,226	100.0	$8,779	100.0	$7,370	100.0

Quarterly evaluations of the allowance for loan losses are performed in accordance with GAAP and regulatory guidelines. The allowance is comprised of specific reserves assigned to each impaired loan for which probable loss has been identified as well as general reserves to maintain the allowance at an acceptable level for other loans in the portfolio where historical loss experience is available that indicates certain probable losses may exist. Factors considered in determining provisions include estimated losses in significant credits; known deterioration in concentrations of credit; historical loss experience; trends in nonperforming assets; volume, maturity and composition of the loan portfolio; off-balance sheet credit risk; lending policies and control systems; national and local economic conditions; the experience, ability and depth of lending management; and the results of examinations of the loan portfolio by regulatory agencies and others. The processes by which we determine the appropriate level of the allowance, and the corresponding provision for probable credit losses, involves considerable judgment; therefore, no assurance can be given that future losses will not vary from current estimates. Additional information regarding the allowance for loan losses is included in the notes to the consolidated financial statements.

Funding Sources

Deposits
As of December 31, 2016, total deposits increased $28.6 million, or 1.8%, to $1.6 billion following a decrease of $34.4 million in 2015. Noninterest-bearing deposits increased $40.7 million to $414.9 million and represented 26.3% of total deposits at December 31, 2016, compared to 24.1% at December 31, 2015 and 24.7% at December 31, 2014. Interest-bearing deposits in money market and savings accounts increased $8.4 million and NOW account deposits decreased $2.9 million. Time deposits, which are comprised mostly of certificates of deposits (“CDs”), decreased $17.6 million in 2016. The decrease in total deposits during 2015 resulted primarily from decreases of $81.7 million and $16.6 million in time deposits and noninterest-bearing deposits, respectively. These decreases were partially offset by an increase of $58.2 million in money market and savings accounts and a $5.7 million increase in NOW accounts. Core deposits, defined as all deposits other than time deposits, remained strong at 90.4% of total deposits at year-end 2016 compared to 89.1% of total deposits at year-end 2015. Core deposits totaled 84.1% of total deposits at year-end 2014. To manage the net interest margin and core deposit balances, we typically offer low- to mid-market rates on CDs. Additional information on deposits appears in the tables below and in the notes to the consolidated financial statements.

Table 13
Summary of Average Deposits
(in thousands)

	2016		2015		2014	
	Average Amount	Average Yield	Average Amount	Average Yield	Average Amount	Average Yield
Noninterest-bearing demand deposits	$390,585	—	$405,571	—	$386,664	—
Interest-bearing deposits:						
Savings, NOW, and money market	1,014,772	0.29 %	943,615	0.23 %	921,631	0.23 %
Time deposits	161,926	0.46 %	226,188	0.61 %	228,856	0.60 %
Total	$1,567,283	0.23 %	$1,575,374	0.23 %	$1,537,151	0.23 %

Table 14
Maturity Schedule Time Deposits of $250,000 or More
December 31,
(in thousands)

	2016	2015	2014
3 months or less	$9,785	$10,765	$11,795
Over 3 months through 6 months	7,730	8,689	9,098
Over 6 months through 12 months	9,052	10,932	59,642
Over 12 months	5,244	7,059	4,534
Total	$31,811	$37,445	$85,069

Borrowed Funds

As of December 31, 2016, we had securities sold under repurchase agreements totaling $94.5 million and no federal funds purchased. At December 31, 2015, we had $86.0 million in securities sold under repurchase agreements and no federal funds purchased. Retail repurchase agreements, included in securities sold under agreements to repurchase, increased $8.5 million, from $73.5 million at December 31, 2015 to $82.0 million at December 31, 2016. Also included in securities sold under agreements to repurchase is a $12.5 million reverse repurchase agreement we entered into with Citigroup Markets, Inc. ("CGMI") in July of 2007 to meet liquidity demands. Under the terms of the agreement, interest is payable at a fixed rate of 4.57% for the remainder of the term. The repurchase date is scheduled for August 9, 2017; however, the agreement is subject to call by CGMI quarterly.

Long-term FHLB-Dallas advances totaled $25.4 million, compared to $25.9 million at December 31, 2015. The long-term advances are fixed rate advances with rates ranging from 1.99% to 5.06% and have a range of maturities from January 2017 to January 2019. The short-term FHLB-Dallas advance totaled $25.0 million at December 31, 2015. There were no short-term FHLB-Dallas advances outstanding at December 31, 2016. The short-term FHLB-Dallas advance at December 31, 2015 consisted of one advance with a maturity of 4 months at a fixed interest rate of 0.30%. The FHLB advances are collateralized by a blanket lien on first mortgages and other qualifying loans.

A description of the junior subordinated debentures outstanding as of December 31, 2016 is as follows:

Table 15
Junior Subordinated Debentures
(dollars in thousands)

Date Issued	Maturity Date	Interest Rate	Callable After	Amount
July 31, 2001	July 9, 2031	3 month LIBOR plus 3.30%	July 31, 2006	$5,671
September 20, 2004	September 20, 2034	3 month LIBOR plus 2.50%	September 20, 2009	8,248
October 12, 2006	October 12, 2036	3 month LIBOR plus 1.85%	June 26, 2011	5,155
June 21, 2007	June 21, 2037	3 month LIBOR plus 1.70%	June 15, 2012	3,093

$22,167

During 2014, we paid off the $7.2 million junior subordinated debenture that was issued in February 2001. The early redemption of the 10.20% fixed rate junior subordinated debentures resulted in an after-tax charge of $168,000 in the third quarter of 2014.

Our outstanding debentures currently qualify as Tier 1 capital and are presented in the Consolidated Balance Sheets as junior subordinated debentures. Additional information regarding long-term debt is provided in the notes to the consolidated financial statements.

Regulations adopted as a result of the Dodd-Frank Act have resulted in changes to the regulatory capital treatment of securities similar to our debentures. However, because of the issue date of our debentures and our asset size, we are allowed to continue to include the debentures in our Tier 1 capital.

In 2016, 2015, and 2014, we did not have an average balance in any category of short-term borrowings including retail repurchase agreements, reverse repurchase agreements, federal funds purchased, or FRB discount window that exceeded 30% of our stockholders' equity for such year.

Capital

As described under "Business - Supervision and Regulation," we are required to maintain certain minimum capital levels for the Company and the Bank. Risk-based capital requirements are intended to make regulatory capital more sensitive to the risk profile of an institution's assets. In July 2013, the Federal Reserve and the OCC issued final rules establishing a new comprehensive capital framework for U.S. banking organizations that implement the Basel III capital framework and certain provisions of the Dodd-Frank Act. The final rules seek to strengthen the components of regulatory capital, increase risk-based capital requirements, and make selected changes to the calculation of risk-weighted assets. Details regarding the final rule and changes to capital requirements and prompt corrective action thresholds are included under Part I, Item 1 – Business, Supervision and Regulation. The final rules became effective as of January 1, 2015, for most banking organizations including the Company and the Bank, subject to a transition period for several aspects of the final rules, including the new minimum capital ratio requirements, the capital conservation buffer, and the regulatory capital adjustments and deductions. Requirements to maintain higher levels of capital could adversely impact our return on equity. We believe we will continue to exceed all estimated well-capitalized regulatory requirements under these new rules on a fully phased-in basis.

At December 31, 2016, the Company and the Bank were in compliance with statutory minimum capital requirements. Minimum capital requirements include a total risk-based capital ratio of 8.0%, with Tier 1 capital not less than 6.0%, common equity Tier 1 capital not less than 4.5% and a leverage ratio (Tier 1 capital to total average adjusted assets) of 4.0% based upon the regulators latest composite rating of the institution. As of December 31, 2016, the Company's leverage ratio was 10.11% compared to 10.10% at December 31, 2015. Tier 1 capital to risk weighted assets was 13.02% and 13.25% for 2016 and 2015, respectively. Total capital to risk weighted assets was 14.28% and 14.50%, respectively, for the same periods. Common equity Tier 1 capital to risk weighted assets was 8.81% and 8.91%, respectively, for the same periods. For regulatory purposes, Tier 1 Capital includes $21.5 million of the junior subordinated debentures issued by the Company. For financial reporting purposes, these funds are included as a liability under GAAP. The Bank's leverage ratio was 9.32% and 9.36% at December 31, 2016 and 2015, respectively.

The FDIC Improvement Act of 1991 established a capital-based supervisory system for all insured depository institutions that imposes increasing restrictions on the institution as its capital deteriorates. The Bank was classified as "well capitalized" as of December 31, 2016. No significant restrictions are placed on the Bank as a result of this classification.

As discussed under the heading Balance Sheet Analysis - Securities, $2.5 million in unrealized losses on securities available-for-sale, less a deferred tax asset of $890,000, was recorded as a reduction to stockholders' equity as of

December 31, 2016. In addition, the effective portion of the gain or loss of our derivative instruments designated as cash flow hedges is recorded as a component of other comprehensive income. As of December 31, 2016, a $989,000 gain on our derivative instruments designated as cash flow hedges, less a deferred tax liability of $346,000, was recorded as an addition to stockholders' equity. As of December 31, 2015, $784,000 in unrealized gains on securities available-for-sale, less a deferred tax liability of $275,000, was recorded as an addition to stockholders’ equity. While the net unrealized gain or loss on securities available-for-sale and the fair vale of derivative instruments designated as cash flow hedges are required to be reported as a separate component of stockholders' equity, they do not affect operating results or regulatory capital ratios. The net unrealized gains and losses reported for December 31, 2016 and 2015, however, did affect the equity-to-assets ratio for financial reporting purposes. The ratio of equity-to-assets was 11.03% at December 31, 2016 and 11.06% at December 31, 2015.

Asset/Liability Management and Interest Rate Sensitivity

Interest rate sensitivity is the sensitivity of net interest income and economic value of equity to changes in market rates of interest. The primary objective of our asset and liability management process is to evaluate interest rate sensitivity inherent in our balance sheet components and establish guidelines to manage that risk within acceptable performance levels. Management and our Board of Directors are responsible for determining the appropriate level of acceptable risk based on our strategic focus, regulatory requirements for capital and liquidity, and the market environment. Our Board of Directors established an Asset/Liability management committee ("ALCO"), comprised of certain executive and senior officers of the Bank, to measure and monitor interest rate risk within defined parameters. We utilize an external model for asset and liability management from our core processor. The model captures data directly from our operating system along with additional information regarding rates and prepayment characteristics to construct an analysis that presents differences in repricing, cash flows and the maturity characteristics of earning assets and interest-bearing liabilities for selected time periods.

This data, combined with additional assumptions including repricing rates and payment characteristics, were used to perform instantaneous parallel rate shift, gradual parallel rate shift, and alternate rate shift simulations. Instantaneous parallel rate shifts are known as "rate shocks" because all rates are modeled to change instantaneously by the indicated shock amount. Gradual parallel rate shifts are called "Ramps" and reflect incremental rate increases over a 12 month period. Alternate rate shifts include floor rates that generally provide more realistic projections of changes in net interest income and market risk, although given the current low rate environment deposits costs are overstated in a down 100 basis point scenario as the model does not currently allow for negative interest rates. Results of the simulations were compared to a base case scenario that provided projected net interest income over the next 12 months with no change in the balance sheet. The estimated percentage changes in projected net interest income due to changes in interest rates of alternate down 100 basis points, ramp up 100, parallel up 200, and up 300 basis points as determined through the simulations are detailed below. At December 31, 2016, the interest rate risk model results were within policy guidelines and indicated that our balance sheet is slightly liability sensitive. The results of the interest rate risk modeling are reviewed by ALCO and discussed quarterly at Funds Management committee meetings of our Board of Directors. The model captures data directly from our operating system along with additional information regarding rates and prepayment characteristics to construct an analysis that presents differences in repricing, cash flows and the maturity characteristics of earning assets and interest-bearing liabilities for selected time periods. As a result of an independent non-maturity deposit study commissioned in 2016, we updated our deposit beta assumptions, which are correlation assumptions between deposit rates and market rates, in rising rate scenarios on a consolidated basis from 40% to 60%. The actual deposit betas experienced in a rising rate scenario could be materially different from those assumed in the model, and therefore actual net income could be materially different from estimated net interest income indicated in the table below.

Net Interest Income at Risk in Year 1

Changes in Interest Rates	Estimated Increase / Decrease in NII at December 31, 2016
Shock Up 300 basis points	(8.00)%
Shock Up 200 basis points	(5.87)%
Ramp Up 100 basis points	(1.80)%
Alternate Down 100 basis points	(2.84)%

Liquidity

Bank Liquidity

Liquidity is the availability of funds to meet maturing contractual obligations and to fund operations. The Bank's primary liquidity needs involve its ability to accommodate customers' demands for deposit withdrawals as well as customers' requests for credit. Liquidity is deemed adequate when sufficient cash to meet these needs can be promptly raised at a reasonable cost to the Bank.

Liquidity is provided primarily by three sources: a stable base of funding sources, an adequate level of assets that can be readily converted into cash, and borrowing lines with correspondent banks. Our core deposits are our most stable and important source of funding. Cash deposits at other banks, federal funds sold, and principal payments received on loans and mortgage-backed securities provide additional primary sources of liquidity. Approximately $73.9 million in projected cash flows from securities repayments during 2017 provides an additional source of liquidity.

The Bank also has significant borrowing capacity with the FRB-Atlanta and with the FHLB–Dallas. As of December 31, 2016, we had no borrowings with the FRB-Atlanta. Long-term FHLB-Dallas advances totaled $25.4 million at December 31, 2016 and are fixed rate advances with rates ranging from 1.99% to 5.06% and have a range of maturities from January 2017 to January

2019. The Bank has the ability to post additional collateral of approximately $144.6 million if necessary to meet liquidity needs. Additionally, $180.5 million in loan collateral is pledged under a Borrower-in-Custody line with the FRB-Atlanta. Under existing agreements with the FHLB-Dallas, our borrowing capacity totaled $240.9 million at December 31, 2016. Additional unsecured borrowing lines totaling $53.5 million are available through correspondent banks. We utilize these contingency funding alternatives to meet deposit volatility, which is more likely in the current environment, given unusual competitive offerings within our markets.

Company Liquidity
In August 2011, the Company repaid $20.0 million in Series A Preferred Stock issued in 2009 to the Treasury under the CPP with funds from the Treasury’s SBLF program authorized by Congress under the Small Business Jobs Act of 2010. As a result of the repurchase of the Series A Preferred Stock, all of the TARP limitations affecting the Company were removed. In connection with the SBLF transaction, the Company issued $32.0 million in Series B Preferred Stock to the Treasury. Net of $20.0 million used to repay the Series A Preferred Stock, the remaining $12.0 million was injected into the Bank as additional common equity capital. The dividend rate was set at 1.00% for the fourth quarter of 2013 due to attaining the target 10% growth rate in qualified small business loans during the second quarter of 2013. As a result of qualified small business loan growth as of September 30, 2013, the dividend rate was set at 1.00% for the period from January 1, 2014 through February 25, 2016. On February 25, 2016, the dividend rate increased to 9% per annum.

At the Company level, cash is needed primarily to meet interest payments on the junior subordinated debentures, dividend payments on the Series B and Series C Preferred Stock and dividends on the common stock. We issued $8,248,000 in unsecured junior subordinated debentures in September 2004 and $7,217,000 in February 2001. In August 2014, we paid off the $7.2 million junior subordinated debenture. In December 2012, we acquired $13.9 million in unsecured junior subordinated debentures from PSB Financial Corporation. The terms of the junior subordinated debentures are described in the notes to the consolidated financial statements. Dividends from the Bank totaling $9,000,000 provided additional liquidity for the Company to meet interest and dividend payments in 2016 and continued to build cash reserves for repayment of the Series B Preferred Stock in the future. The Series B Preferred Stock can be paid off in full or in $8 million increments with 30 days' notice to the Treasury and approval from the Federal Reserve Bank. Dividends totaling $9,000,000 were paid by the Bank to the Company in 2015. As of January 1, 2017, the Bank had the ability to pay dividends to the Company of approximately $8.8 million without prior approval from the OCC. At December 31, 2016, the parent company had approximately $16.7 million cash available for general corporate purposes, including injecting capital into the Bank. As a publicly traded company, the Company also has the ability, subject to market conditions, to issue additional shares of common stock, preferred stock and other securities to provide funds as needed for operations and future growth of the Company and the Bank.

Dividends
The primary source of cash dividends on the Company's common stock is dividends from the Bank. The Bank has the ability to declare dividends to the Company of up to $8.8 million as of December 31, 2016 without prior approval of the OCC. However, the Bank’s ability to pay dividends would be prohibited if the result would cause the Bank’s regulatory capital to fall below minimum requirements.

Cash dividends totaling $4.1 million and were declared to common stockholders during 2016 and 2015.

Off Balance Sheet Arrangements and Other Contractual Obligations
In the normal course of business we use various financial instruments with off-balance sheet risk to meet the financing needs of customers and to reduce exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the financial statements. We did not have an average balance in any category of short-term borrowings detailed below in 2016, 2015, or 2014 that exceeded 30% of our

stockholders’ equity for such year. Additional information regarding contractual obligations appears in the notes to the consolidated financial statements. The following table presents significant contractual obligations as of December 31, 2016.

Table 16
Contractual Obligations
December 31, 2016
(in thousands)

	Payment due by period				
	Total	1 year or less	> 1-3 years	> 3-5 years	More than 5 years
Time deposits	$152,210	$115,515	$23,686	$13,007	$2
Long-term debt obligations	47,591	15,403	10,021	—	22,167
Retail repurchase agreements	81,961	81,961	—	—	—
Reverse repurchase agreements	12,500	12,500	—	—	—
Operating lease obligations	14,859	1,929	3,684	3,244	6,002
Total	$309,121	$227,308	$37,391	$16,251	$28,171

Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto, presented herein, have been prepared in accordance with GAAP, which generally require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of operations. Unlike most industrial companies, nearly all of our assets and liabilities are financial in nature. As a result, interest rates generally have a greater impact on our performance than do the effects of general levels of inflation. For additional information, see “Funding Sources – Asset Liability Management and Interest Rate Sensitivity.”

Non-GAAP Financial Measures

Certain financial information included in the Management’s Discussion and Analysis of Financial Condition and Results of Operations is determined by methods other than in accordance with GAAP. Table 17 below presents a reconciliation of these non-GAAP financial measures to the most comparable GAAP financial measures. These non-GAAP financial measures include “core net interest income”, “core net interest margin”, “diluted earnings per share, operating” and “operating earnings available to common shareholders”. “Core net interest income” is defined as net interest income excluding net purchase accounting adjustments. “Core net interest margin” is defined as core net interest income expressed as a percentage of average earnings assets. “Diluted earnings per share, operating” is defined as net earnings available to common shareholders adjusted for specified one-time items divided by diluted weighted-average shares. “Operating earnings available to common shareholders” is defined as net income available to common shareholders less tax-effected nonoperating income and expense items, including securities gains/losses.
We use non-GAAP measures because we believe they are useful for evaluating our financial condition and performance over periods of time, as well as in managing and evaluating our business and in discussions about our performance. We also believe these non-GAAP financial measures provide users of our financial information with a meaningful measure for assessing our financial condition as well as comparison to financial results for prior periods. These results should not be viewed as a substitute for results determined in accordance with GAAP, and are not necessarily comparable to non-GAAP performance measures that other companies may use.

Table 17
Reconciliation of Non-GAAP Financial Measures
(in thousands except per share data)

		Year Ended December 31,		
		2016	2015	2014
Core Net Interest Margin				
Net interest income (FTE)		$74,362	$77,470	$79,071
Less purchase accounting adjustments		(1,857)	(2,342)	(3,647)
Core net interest income, net of purchase accounting adjustments	A	$72,505	$75,128	$75,424
Total average earning assets		$1,770,796	$1,783,824	$1,709,168
Add average balance of loan valuation discount		2,799	4,507	6,791
Average earnings assets, excluding loan valuation discount	B	$1,773,595	$1,788,331	$1,715,959
Core net interest margin	A/B	4.09 %	4.20 %	4.39 %
Diluted Earnings Per Share, Operating				
Diluted earnings per share		$0.58	$0.90	$1.58
Effect of efficiency consultant expenses, after-tax		—	—	0.03
Effect of loss on disposal of fixed assets, after-tax		—	—	0.02
Effect of loss on redemption of Trust Preferred Securities, after-tax		—	—	0.02
Effect of gain on sale of other real estate, after-tax		—	—	(0.06)
Executive officer life insurance proceeds, net of related expenses, after-tax		—	—	(0.24)
Effect of net gain on sale of securities, after-tax		—	(0.07)	—
Effect of income from death benefit on bank owned life insurance		—	(0.01)	—
Diluted earnings per share, operating		$0.58	$0.82	$1.35
Operating Earnings Available to Common Shareholders				
Net earnings available to common shareholders		$6,578	$10,330	$18,412
Non-interest income adjustments:				
Effect of efficiency consultant expenses, after-tax		—	—	335
Effect of loss on disposal of fixed assets, after-tax		—	—	256
Effect of loss on redemption of Trust Preferred Securities, after-tax		—	—	168
Effect of gain on sale of other real estate, after-tax		—	—	(700)
Executive officer life insurance proceeds, net of related expenses, after-tax		—	—	(2,840)
Income from death benefit on bank owned life insurance		—	(160)	—
Net gain on sale of securities, after-tax		(13)	(808)	—
Operating earnings available to common shareholders		$6,565	$9,362	$15,631

Item 7A – Quantitative and Qualitative Disclosures about Market Risk

Information regarding market risk appears under the heading “Funding Sources – Asset Liability Management and Interest Rate Sensitivity” under Item 7 – Management’s Discussion and Analysis of Financial Position and Results of Operations included in this filing.

- 47 -

Item 8 – Financial Statements and Supplementary Data

Consolidated Balance Sheets
December 31, 2016 and 2015
(dollars in thousands, except share data)

	2016	2015
Assets		
Cash and due from banks, including required reserves of $6,669 and $8,522, respectively	$31,687	$37,170
Interest-bearing deposits in banks	47,091	48,331
Federal funds sold	3,450	3,700
Securities available-for-sale, at fair value (cost of $344,416 and $317,375 at December 31, 2016 and 2015, respectively)	341,873	318,159
Securities held-to-maturity (estimated fair value of $98,261 and $117,698 at December 31, 2016 and 2015, respectively)	98,211	116,792
Other investments	11,355	11,188
Loans	1,284,082	1,263,645
Allowance for loan losses	(24,372)	(19,011)
Loans, net	1,259,710	1,244,634
Bank premises and equipment, net	68,954	69,105
Accrued interest receivable	7,576	6,594
Goodwill	42,171	42,171
Intangibles	4,621	5,728
Cash surrender value of life insurance	14,335	13,622
Other real estate	2,175	4,187
Other assets	10,131	6,352
Total assets	$1,943,340	$1,927,733
Liabilities and Stockholders’ Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$414,921	$374,261
Interest-bearing	1,164,509	1,176,589
Total deposits	1,579,430	1,550,850
Securities sold under agreements to repurchase	94,461	85,957
Short-term Federal Home Loan Bank advances	—	25,000
Long-term Federal Home Loan Bank advances	25,424	25,851
Junior subordinated debentures	22,167	22,167
Other liabilities	7,482	4,771
Total liabilities	1,728,964	1,714,596
Commitments and contingencies		
Stockholders’ equity:		
Series B Preferred stock, no par value; 5,000,000 shares authorized, 32,000 shares issued and outstanding at December 31, 2016 and 2015	32,000	32,000
Series C Preferred stock, no par value; 100,000 shares authorized, 91,098 and 91,200 shares issued and outstanding at December 31, 2016 and 2015, respectively	9,110	9,120
Common stock, $0.10 par value; 30,000,000 shares authorized, 11,362,716 and 11,362,150 shares issued and outstanding at December 31, 2016 and 2015, respectively	1,136	1,136
Additional paid-in capital	111,166	110,771

Unearned ESOP shares	(1,233)	(1,093)
Accumulated other comprehensive (loss) income	(1,010)	509
Retained earnings	63,207	60,694
Total stockholders' equity	214,376	213,137
Total liabilities and stockholders' equity	$1,943,340	$1,927,733

See notes to consolidated financial statements.

Consolidated Statements of Earnings
Years Ended December 31, 2016, 2015 and 2014
(in thousands, except per share data)

	2016	2015	2014
Interest income:			
Loans, including fees	$68,682	$71,633	$72,327
Investment securities:			
Taxable	7,924	7,559	8,100
Nontaxable	1,756	2,188	2,637
Other interest income	766	517	423
Total interest income	79,128	81,897	83,487
Interest expense:			
Deposits	3,654	3,587	3,515
Short-term borrowings	966	1,017	840
Long-term borrowings	366	364	378
Junior subordinated debentures	704	613	1,074
Total interest expense	5,690	5,581	5,807
Net interest income	73,438	76,316	77,680
Provision for loan losses	10,600	13,900	5,625
Net interest income after provision for loan losses	62,838	62,416	72,055
Noninterest income:			
Service charges on deposit accounts	9,612	9,523	9,780
ATM and debit card income	6,579	6,463	7,209
Gain on securities, net	20	1,243	128
Executive officer life insurance proceeds	—	—	3,000
Other charges and fees	2,797	3,092	2,843
Total noninterest income	19,008	20,321	22,960
Noninterest expenses:			
Salaries and employee benefits	32,932	32,036	33,847
Occupancy expense	14,630	15,052	15,064
ATM and debit card expense	3,239	2,951	2,889
Other	17,749	17,098	16,747
Total noninterest expense	68,550	67,137	68,547
Income before income taxes	13,296	15,600	26,468
Income tax expense	3,857	4,583	7,358
Net earnings	9,439	11,017	19,110
Dividends on preferred stock	2,861	687	698
Net earnings available to common stockholders	$6,578	$10,330	$18,412
Earnings per common share:			
Basic	$0.58	$0.91	$1.63
Diluted	$0.58	$0.90	$1.58

See notes to consolidated financial statements.

- 49 -

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2016, 2015 and 2014
(in thousands)

	2016	2015	2014
Net earnings	$9,439	$11,017	$19,110
Other comprehensive (loss) income, net of tax:			
Unrealized (losses) gains on securities available-for-sale:			
Unrealized holding (losses) gains arising during the year	(3,307)	(2,369)	4,687
Less: reclassification adjustment for net gains on sales of securities available-for-sale	(20)	(1,243)	(128)
Unrealized (losses) gains on securities available-for-sale	(3,327)	(3,612)	4,559
Fair value of derivative instruments designated as cash flow hedges:			
Change in fair value of derivative instruments designated as cash flow hedges during the year	989	—	—
Total other comprehensive (loss) income, before tax	(2,338)	(3,612)	4,559
Income tax effect related to items of other comprehensive (loss) income	819	1,264	(1,596)
Total other comprehensive (loss) income, net of tax	(1,519)	(2,348)	2,963
Total comprehensive income	$7,920	$8,669	$22,073

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2016, 2015 and 2014
(in thousands, except share and per share data)

	Preferred Stock		Common Stock				Accumulated			
	Shares	Amount	Shares	Amount	Surplus	Unearned ESOP Shares	Other Comprehensive (Loss) Income	Treasury Stock	Retained Earnings	Total
Balance December 31, 2013	131,971	$41,997	11,407,196	$1,141	$111,017	$—	$(106)	$(3,286)	$39,986	$190,749
Net earnings	—	—	—	—	—	—	—	—	19,110	19,110
Dividends on Series B preferred stock	—	—	—	—	—	—	—	—	(320)	(320)
Dividends on Series C preferred stock	—	—	—	—	—	—	—	—	(378)	(378)
Dividends on common stock - $0.35 per share	—	—	—	—	—	—	—	—	(3,959)	(3,959)
Conversion of Series C preferred stock to common stock	(6,291)	(629)	34,947	3	626	—	—	—	—	—
	—	—	—	—	—	—	—	(9)	—	(9)

Treasury stock acquired at cost										
Exercise of stock options	—	—	49,560	5	638	—	—	—	—	643
Tax benefit resulting from exercise of stock options, net adjustment	—	—	—	—	21	—	—	—	—	21
Increase in ESOP obligation, net of repayments	—	—	—	—	—	(250)	—	—	—	(250)
Stock option expense	—	—	—	—	442	—	—	—	—	442
Change in accumulated other comprehensive income/loss	—	—	—	—	—	—	2,963	—	—	2,963
Balance December 31, 2014	125,680	41,368	11,491,703	1,149	112,744	(250)	2,857	(3,295)	54,439	209,012
Net earnings	—	—	—	—	—	—	—	—	11,017	11,017
Dividends on Series B preferred stock	—	—	—	—	—	—	—	—	(320)	(320)
Dividends on Series C preferred stock	—	—	—	—	—	—	—	—	(367)	(367)
Dividends on common stock - $0.36 per share	—	—	—	—	—	—	—	—	(4,075)	(4,075)
Conversion of Series C preferred stock to common stock	(2,480)	(248)	13,759	1	247	—	—	—	—	—
Reclassification of treasury stock per the LCBA	—	—	(150,967)	(15)	(3,280)	—	—	3,295	—	—
Exercise of stock options	—	—	7,655	1	98	—	—	—	—	99
Tax benefit resulting from distribution from Directors Deferred Compensation	—	—	—	—	420	—	—	—	—	420

Plan										
Tax benefit for dividends paid to the ESOP	—	—	—	—	187	—	—	—	—	187
Increase in ESOP obligation, net of repayments	—	—	—	—	—	(843)	—	—	—	(843)
Stock option and restricted stock compensation expense	—	—	—	—	355	—	—	—	—	355
Change in accumulated other comprehensive income/loss	—	—	—	—	—	—	(2,348)	—	—	(2,348)
Balance December 31, 2015	123,200	41,120	11,362,150	1,136	110,771	(1,093)	509	—	60,694	213,137
Net earnings	—	—	—	—	—	—	—	—	9,439	9,439
Dividends on Series B preferred stock	—	—	—	—	—	—	—	—	(2,496)	(2,496)
Dividends on Series C preferred stock	—	—	—	—	—	—	—	—	(365)	(365)
Dividends on common stock - $0.36 per share	—	—	—	—	—	—	—	—	(4,065)	(4,065)
Conversion of Series C preferred stock to common stock	(102)	(10)	566	—	10	—	—	—	—	—
Tax benefit resulting from distribution from Directors Deferred Compensation Plan	—	—	—	—	127	—	—	—	—	127
Tax benefit for dividends paid to the ESOP	—	—	—	—	154	—	—	—	—	154
Increase in ESOP obligation, net of repayments	—	—	—	—	—	(140)	—	—	—	(140)

Stock option and restricted stock compensation expense	—	—	—	—	210	—	—	—	—	210
ESOP compensation expense	—	—	—	—	(106)	—	—	—	—	(106)
Change in accumulated other comprehensive income/loss	—	—	—	—	—	—	(1,519)	—	—	(1,519)
Balance December 31, 2016	123,098	$41,110	11,362,716	$1,136	$111,166	$(1,233)	$(1,010)	$—	$63,207	$214,376

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows
Years Ended December 31, 2016, 2015 and 2014
(in thousands)

	2016	2015	2014
Cash flows from operating activities:			
Net earnings	$9,439	$11,017	$19,110
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	5,920	6,168	6,062
Accretion of purchase accounting adjustments	(750)	(1,235)	(2,540)
Provision for loan losses	10,600	13,900	5,625
Deferred tax benefit	(1,582)	(1,785)	(1,489)
Amortization of premiums on securities, net	2,963	2,815	3,047
(Accretion) amortization of other investments	—	(1)	3
Net loss (gain) on sale of other real estate	57	1	(1,061)
Net write down of other real estate owned	130	111	91
Net (gain) loss on sale/disposal of premises and equipment	(35)	(24)	182
Income recognized from death benefit on bank owned life insurance	—	(160)	—
Stock-based compensation expense	210	355	442
Tax benefit from exercise of stock options	—	—	(21)
Tax benefit resulting from distribution from Directors Deferred Compensation Plan	(127)	(420)	—
Tax benefit for dividends paid to ESOP	(154)	(187)	—
Excess of book value over market value of ESOP shares released	(106)	—	—
Gain on sale and liquidation of securities available-for-sale	(20)	(1,243)	(128)
Change in accrued interest receivable	(982)	41	57
Change in accrued interest payable	(9)	(114)	(234)
Change in other assets and liabilities, net	1,289	(54)	612
Net cash provided by operating activities	26,843	29,185	29,758
Cash flows from investing activities:			
Proceeds from maturities and calls of securities available-for-sale	68,696	70,934	48,464
Proceeds from maturities and calls of securities held-to-maturity	17,589	23,288	14,344
Proceeds from sale of securities available-for-sale	6,803	40,277	22,153
Purchases of securities available-for-sale	(104,491)	(156,449)	(1,250)
Purchases of securities held-to-maturity	—	—	(1,104)
Proceeds from redemption of other investments	600	2,180	150
Purchases of other investments	(767)	(3,377)	(580)
Redemption of Capital Securities related to MidSouth Statutory Trust I	—	—	217
Proceeds from bank owned life insurance death benefit	—	498	—
Net change in loans	(25,698)	14,480	(147,642)
Purchases of premises and equipment	(5,823)	(5,374)	(5,588)
Proceeds from sale of premises and equipment	89	83	1,729
Proceeds from sale of other real estate owned	3,170	1,514	3,794
Purchase of other real estate owned	—	(351)	—
Net cash used in investing activities	(39,832)	(12,297)	(65,313)
Cash flows from financing activities:			
Change in deposits	28,615	(34,285)	66,679
Change in securities sold under agreements to repurchase	8,504	23,859	8,182
Borrowings on Federal Home Loan Bank advances	25,000	150,000	120,000
Repayments of Federal Home Loan Bank advances	(50,068)	(150,064)	(120,061)
Repayments of notes payable	—	—	(1,000)

Redemption of MidSouth Statutory Trust I	—	—	(7,217)
Proceeds from exercise of stock options	—	99	643
Tax benefit from exercise of stock options	—	—	21
Tax benefit resulting from distribution from Directors Deferred Compensation Plan	127	420	—
Tax benefit for dividends paid to ESOP	154	187	—
Purchase of treasury stock	—	—	(9)
Payment of dividends on preferred stock	(2,221)	(689)	(704)
Payment of dividends on common stock	(4,095)	(4,086)	(3,838)
Net cash provided by (used in) financing activities	6,016	(14,559)	62,696
Net (decrease) increase in cash and cash equivalents	(6,973)	2,329	27,141
Cash and cash equivalents, beginning of year	89,201	86,872	59,731
Cash and cash equivalents, end of year	$82,228	$89,201	$86,872

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows (continued)
Years Ended December 31, 2016, 2015 and 2014
(in thousands)

	2016	2015	2014
Supplemental cash flow information:			
Interest paid	$5,700	$5,695	$6,041
Income taxes paid	4,473	6,641	8,065
Noncash investing and financing activities:			
Change in accrued common stock dividends	—	(10)	121
Change in accrued preferred stock dividends	640	(3)	(6)
Net change in loan to ESOP	(140)	(843)	(250)
Change in unrealized gains/losses on securities available-for-sale, net of tax	(2,162)	(2,348)	2,963
Transfer of loans to other real estate	1,345	1,228	447
Financed portion of sales of other real estate	—	—	84

See notes to consolidated financial statements

- 52 -

Notes to Consolidated Financial Statements

December 31, 2016, 2015 and 2014

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation—The consolidated financial statements include the accounts of MidSouth Bancorp, Inc. (the "Company") and its wholly owned subsidiaries MidSouth Bank, N.A. (the "Bank"), Financial Services of the South, Inc. (the "Finance Company"), which has liquidated its loan portfolio, and Peoples General Agency ("PGA"). All significant intercompany accounts and transactions have been eliminated in consolidation. We are subject to regulation under the Bank Holding Company Act of 1956. The Bank is primarily regulated by the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC").

We are a financial holding company headquartered in Lafayette, Louisiana operating principally in the community banking business by providing banking services to commercial and retail customers through the Bank. The Bank is community oriented and focuses primarily on offering competitive commercial and consumer loan and deposit services to individuals and small to middle market businesses in Louisiana and central and east Texas.

The accounting principles we follow and the methods of applying these principles conform with accounting principles generally accepted in the United States of America ("GAAP") and with general practices within the banking industry. In preparing the financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ significantly from those estimates. Material estimates common to the banking industry that are particularly susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for loan losses, the valuation of real estate acquired in connection with or in lieu of foreclosure on loans, the assessment of goodwill for impairment, and valuation allowances associated with the realization of deferred tax assets which are based on future taxable income. Given the current instability of the economic environment, it is reasonably possible that the methodology of the assessment of potential loan losses, losses on other real estate owned, goodwill impairment, and other fair value measurements could change in the near term or could result in impairment going forward.

A summary of significant accounting policies follows:

Cash and cash equivalents—Cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits in other banks with original maturities of less than 90 days, and federal funds sold.

Investment Securities—We determine the appropriate classification of debt securities at the time of purchase and reassesses this classification periodically. Trading account securities are held for resale in anticipation of short-term market movements. Debt securities are classified as held-to-maturity when we have the positive intent and ability to hold the securities to maturity. Securities not classified as held-to-maturity or trading are classified as available-for-sale. We had no trading account securities during the three years ended December 31, 2016. Held-to-maturity securities are stated at amortized cost. Available-for-sale securities are stated at fair value, with unrealized gains and losses, net of deferred taxes, reported as a separate component of stockholders' equity.

The amortized cost of debt securities classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity or, in the case of mortgage-backed securities, over the estimated life of the security. Amortization, accretion, and accrued interest are included in interest income on securities. Realized gains and losses on the sale of securities available-for-sale are included in earnings and are determined using the specific-identification method.

Management evaluates investment securities for other than temporary impairment on a quarterly basis. A decline in the fair value of available-for-sale and held-to-maturity securities below cost that is deemed other than temporary is charged to earnings for a decline in value deemed to be credit related and a new cost basis for the security is established. The decline in value attributed to non-credit related factors is recognized in other comprehensive income.

Other Investments—Other investments include Federal Reserve Bank and Federal Home Loan Bank stock, as well as other correspondent bank stocks and our CRA investment, which have no readily determined market value and are carried at cost. Due to the redemption provisions of the investments, the fair value equals cost and no impairment exists.

Loans—Loans that we have the intent and ability to hold for the foreseeable future or until maturity are reported at the principal amount outstanding, net of the allowance for loan losses and any deferred fees or costs on originated loans. Interest income on commercial and real estate mortgage loans is calculated by using the simple interest method on the daily balance of the principal amount outstanding. Unearned income on installment loans is credited to operations based on a method which approximates the interest method. In-house legal counsel and the collections department are responsible for validating loans past due for reporting purposes. Once loans are determined to be past due, the collections department actively works with customers to bring loans back to current status.

We consider a loan to be impaired when, based upon current information and events, we believe it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans classified as special mention, substandard, or doubtful, based on credit risk rating factors, are reviewed for potential impairment. Our impaired loans include troubled debt restructurings and performing and nonperforming major loans in which full payment of principal or interest is not expected. Although our policy requires that non-major homogenous loans, which include all loans under $250,000, be evaluated on an overall basis, our current volume of impaired loans allows us to evaluate each impaired loan individually. We calculate the allowance required for impaired loans based on the present value of expected future cash flows discounted at the loan's effective interest rate, or at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. A loan may be impaired but not on nonaccrual status when available information suggests that it is probable the Bank may not receive all contractual principal and interest, however, the loan is still current and payments are received in accordance with the terms of the loan. Payments received for impaired loans not on nonaccrual status are applied to principal and interest.

All impaired loans are reviewed, at minimum, on a quarterly basis. Reviews may be performed more frequently if material information is available before the next scheduled quarterly review. Existing valuations are reviewed to determine if additional discounts or new appraisals are required. After this review, when comparing the resulting collateral valuation to the outstanding loan balance, if the discounted collateral value exceeds the loan balance no specific allocation is reserved. All loans included in our impairment analysis are subject to the same procedure and review, with no distinction given to the dollar amount of the loan.

Our Special Assets Committee meets monthly to review loans with adverse classifications. Loan officers, loan review officers, and in-house legal counsel contribute updated information on each credit, reviewing potential declines or improvements in the borrower's repayment ability and our collateral position. If deterioration in our collateral position is determined, additional discounts may be applied to the impairment analysis before the new appraisal is received. The committee makes a determination of whether the loans reviewed have reached a point of collateral dependency and sufficient doubt exists as to collectibility. As a matter of policy, loans are placed on nonaccrual status when, in the judgment of committee members, the probability of collection of interest is deemed insufficient to warrant further accrual. For loans placed on nonaccrual status, the accrual of interest is discontinued and subsequent payments received are applied to the principal balance. Interest income is recorded after principal has been satisfied and as payments are received. Additionally, loans may be placed on nonaccrual status when the loan becomes 90 days past due and any of the following conditions exist: it becomes evident that the borrower will not make payments or will not or cannot meet the Bank's terms for the renewal of a matured loan, full repayment of principal and interest is not expected, the loan has a credit risk rating of substandard, the borrower files bankruptcy and an approved plan of reorganization or liquidation is not anticipated in the near future, or foreclosure action is initiated. When a loan is placed on nonaccrual status, previously accrued but unpaid interest for the current year is deducted from interest income. Prior year unpaid interest is charged to the allowance for loan losses. Some loans may continue accruing after 90 days if the loan is in the process of renewing, being paid off, or the underlying collateral fully supports both the principal and accrued interest and the loan is in the process of collection.

Nonaccrual loans may be returned to accrual status if all principal and interest amounts contractually owed are reasonably assured of repayment within a reasonable period and there is a period of at least six months to one year of repayment performance by the borrower depending on the contractual payment terms. When loans are returned to accrual status, interest income that was previously applied to the principal balance is not reversed but is recognized into interest income as an adjustment to the yield over the remaining life of the loan. Our Special Assets Committee must approve the return of loans to accrual status as well as exceptions to any requirements of the non-accrual policy.

Generally, commercial, financial, and agricultural loans; construction loans; commercial real estate loans; consumer loans; and finance leases which become 90 days delinquent are either in the process of collection through repossession or foreclosure or are deemed currently uncollectible. The portion of loans deemed currently uncollectible, due to insufficient collateral, are charged-off against the allowance for loan losses. All loans requested to be charged-off must be specifically authorized by in-house legal counsel and the CEO. Requests may be initiated by collection personnel, bank counsel, loan review, and lending personnel.

Charge-offs will be reviewed by in-house legal counsel and the CEO to ensure the propriety and accuracy of charge-off recommendations. Factors considered when determining loan collectibility and amount to be charged off for all segments in our loan portfolio include delinquent principal or interest repayment, the ability of borrower to make future payments, collateral value of outstanding debt, and the adequacy of guarantors support. It is the responsibility of in-house legal counsel to report all charge-offs to the Board of Directors or its designated Committee for ratification.

Credit Risk Rating—We manage credit risk by observing written underwriting standards and lending policy established by the Board of Directors and management to govern all lending activities. The risk management program requires that each individual loan officer review his or her portfolio on a quarterly basis and assign recommended credit ratings on each loan. These efforts are supplemented by independent reviews performed by a loan review officer and other validations performed by the internal audit department. The results of the reviews are reported directly to the Audit Committee of the Board of Directors. Additionally, Bank concentrations are monitored and reported quarterly for risk rating distributions, major standard industry classification segments, real estate concentrations, and collateral distributions.

Consumer and residential real estate loans are normally graded at inception, and the grade generally remains the same throughout the life of the loan. Loan grades on commercial, financial, and agricultural; construction; commercial real estate; and finance leases may be changed at any time when circumstances warrant, and are at a minimum reviewed quarterly.

Loans can be classified into the following three risk rating groupings: pass, special mention, and substandard/doubtful. Factors considered in determining a risk rating grade include debt service capacity, capital structure/liquidity, management, collateral quality, industry risk, company trends/operating performance, repayment source, revenue diversification/customer concentration, quality of financial information, and financing alternatives. Pass grade signifies the highest quality of loans to loans with reasonable credit risk, which may include borrowers with marginally adequate financial performance, but have the ability to repay the debt. Special mention loans have potential weaknesses that warrant extra attention from the loan officer and other management personnel, but still have the ability to repay the debt. Substandard classification includes loans with well-defined weaknesses with risk of potential loss. Loans classified as doubtful are considered to have little recovery value and are charged off.

Allowance for Loan Losses—The allowance for loan losses is a valuation account available to absorb probable losses on loans. All losses are charged to the allowance for loan losses when the loss actually occurs or when a determination is made that a loss is likely to occur. Recoveries are credited to the allowance for loan losses at the time of recovery. Quarterly, we estimate the probable level of losses in the existing portfolio through consideration of such factors including, but not limited to, past loan loss experience; estimated losses in significant credits; known deterioration in concentrations of credit; trends in nonperforming assets; volume and composition of the loan portfolio, including percentages of special mention, substandard and past due loans; lending policies and control systems; known inherent risks in the portfolio; adverse situations that may affect the borrower’s ability to repay; the estimated value of any underlying collateral; current national and local economic conditions, including the unemployment rate, the price of oil, and real estate absorption time; the experience, ability and depth of lending management; collections personnel experience; and the results of examinations of the loan portfolio by regulatory agencies and others. Based on these estimates, the allowance for loan losses is increased by charges to earnings and decreased by charge-offs (net of recoveries).

The allowance is composed of general reserves and specific reserves. General reserves are determined by applying loss percentages to segments of the portfolio. The loss percentages are based on each segment’s historical loss experience, generally over the past three to five years, and adjustment factors derived from conditions in the Bank’s internal and external environment. All loans considered to be impaired are evaluated on an individual basis to determine specific reserve allocations in accordance with GAAP. Loans for which specific reserves are provided are excluded from the calculation of general reserves.

We have an internal loan review department that is independent of the lending function to challenge and corroborate the loan grade assigned by the lender and to provide additional analysis in determining the adequacy of the allowance for loan losses.

Management and the Board of Directors believe the allowance for loan losses is appropriate at December 31, 2016. While determination of the allowance for loan losses is based on available information at a given point in time, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions or deductions to the allowance based on their judgment and information available to them at the time of their examination.

Premises and Equipment—Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives used to compute depreciation are:

Buildings and improvements	10 - 40 years
Furniture, fixtures, and equipment	3 - 10 years
Automobiles	3 - 5 years

Leasehold improvements are amortized over the estimated useful lives of the improvements or the term of the lease, whichever is shorter.

Other Real Estate Owned—Real estate properties acquired through, or in lieu of, loan foreclosures are initially recorded at fair value less estimated costs to sell based on a current valuation at the time of foreclosure. After foreclosure, valuations are periodically performed by management and a charge to earnings is recorded if the carrying value of a property exceeds its fair value less estimated costs to sell. Revenues and expenses from operations and changes in the valuation allowance are charged to earnings.

Goodwill and Other Intangible Assets—Goodwill represents the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. Goodwill and other intangible assets deemed to have an indefinite useful life are not amortized but instead are subject to review for impairment annually, or more frequently if deemed necessary. Also, in connection with business combinations involving banks and branch locations, we generally record core deposit intangibles representing the value of the acquired core deposit base. Core deposit intangibles are amortized over the estimated useful life of the deposit base, generally on either a straight-line basis not exceeding 15 years or an accelerated basis over 10 years. The remaining useful lives of core deposit intangibles are evaluated periodically to determine whether events and circumstances warrant revision of the remaining period of amortization.

Cash Surrender Value of Life Insurance—Life insurance contracts represent single premium life insurance contracts on the lives of certain officers of the Company. The Company is the beneficiary of these policies. These contracts are reported at their cash surrender value and changes in the cash surrender value are included in other noninterest income.

Derivatives—Derivative financial instruments are recognized as assets and liabilities on the consolidated balance sheets and, as required by ASC 815, the Company records all derivatives at fair value. Accounting for changes in fair value of derivatives differs depending on whether the derivative has been designated and qualifies as part of a hedge relationship, and further, on the type of relationship.

Derivatives Designated as Hedging Relationships

The Company has entered into forward interest rate swap contracts to minimize the variability of future cash flows that is caused by changes in interest rates or other economic factors. These derivative instruments were designated as cash flow hedges under ASC Topic 815, Derivatives and Hedging. For cash flow hedges, the effective portion of the gain or loss related to the derivative instrument is initially reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings or when the hedge is terminated. The ineffective portion of the gain or loss is reported in earnings immediately.

Derivatives Not Designated as Hedging Relationships

The Company offers certain derivative instruments directly to qualified commercial lending clients seeking to manage their interest rate risk. These derivative instruments, including interest rate swap agreements, are not designated for hedge accounting and changes in fair value are recognized in earnings immediately. Interest rate swaps are contracts in which a series of interest rate cash flows are exchanged over a prescribed period. The notional balance of interest rate swap agreements held by the Company at December 31, 2016 and 2015 was minimal and not material to the consolidated balance sheets.

Repurchase Agreements—Securities sold under agreements to repurchase are secured borrowings treated as financing activities and are carried at the amounts at which the securities will be subsequently reacquired as specified in the respective agreements.

Deferred Compensation—We record the expense of deferred compensation agreements over the service periods of the persons covered under these agreements.

Income Taxes—Deferred tax assets and liabilities are recorded for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Future tax benefits, such as net operating loss carry forwards, are recognized to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the assets and liabilities are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date.

In the event the future tax consequences of differences between the financial reporting bases and the tax bases of our assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such assets is required. A valuation allowance is provided when it is more likely than not that a portion or the full amount of the deferred tax asset will not be realized. In assessing the ability to realize the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies. A deferred tax liability is not recognized for portions of the allowance for loan losses for income tax purposes in excess of the financial statement balance. Such a deferred tax liability will only be recognized when it becomes apparent that those temporary differences will reverse in the foreseeable future.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent more likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Stock-Based Compensation—We expense stock-based compensation based upon the grant date fair value of the related equity award over the requisite service period of the employee.

Basic and Diluted Earnings Per Common Share—Basic earnings per common share (“EPS”) excludes dilution and is computed by dividing net earnings by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted EPS is computed by dividing net earnings by the total of the weighted-average number of shares outstanding plus the dilutive effect of outstanding options. The amounts of common stock and additional paid-in capital are adjusted to give retroactive effect to large stock dividends. Small stock dividends, or dividends less than 25% of issued shares at the declaration date, are reflected as an increase in common stock and additional paid-in capital and a decrease in retained earnings for the market value of the shares on the date the dividend is declared.

Comprehensive Income—Generally all recognized revenues, expenses, gains and losses are included in net earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net earnings, are components of comprehensive income. We present comprehensive income in a separate consolidated statement of comprehensive income.

Statements of Cash Flows—For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold, and interest-bearing deposits in other banks with original maturities of less than 90 days. Generally, federal funds are sold for one-day periods.

Recent Accounting Pronouncements — ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities is the first ASU issued under the FASB's financial instruments project. ASU 2016-01 primarily affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. The guidance in this ASU requires all equity securities with readily determinable fair values to be measured at fair value on the balance sheet, with changes in fair value recorded through earnings. For financial liabilities that are measured at fair value in accordance with the fair value option, the guidance requires changes in the fair value of a financial liabilities attributable to a change in instrument-specific credit risk to be recorded separately in other comprehensive income. This ASU eliminates the requirement to disclose the methods and significant assumptions used to estimate fair value. It does require public entities to use the exit price when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. In addition, the new guidance requires financial assets and financial liabilities to be presented separately in the notes to the financial statements, grouped by measurement category and form of financial asset. The effective date of this Update is for fiscal years beginning on or after December 15, 2017. The Company is evaluating the impact, if any, that ASU 2016-01 will have on its financial position, results of operations, and its financial statement disclosures.

ASU 2016-02, Leases (Topic 842) was issued with the intention of improving financial reporting about leasing transactions. Under the new guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP - which requires only capital leases to be recognized on the balance sheet - the guidance in the ASU will require both types of leases to be recognized on the balance sheet. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The effective date of this Update is for fiscal years beginning on or after December 15, 2018. The Company is evaluating the impact that ASU 2016-02 will have on its financial position, results of operations, and its financial statement disclosures.

ASU 2016-09, Compensation - Stock Compensation (Topic 718) was issued as part of the FASB's simplification initiative. Under the new guidance, several aspects of the accounting for share-based payment award transactions are simplified, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The effective date of this Update is for fiscal years beginning on or after December 15, 2016. The Company is evaluating the impact that ASU 2016-09 will have on its financial position, results of operations, and its financial statement disclosures.

ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments was issued with the intention of improving financial reporting by requiring timely recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets not recorded at fair value based on historical experience, current conditions, and reasonable and supportable forecasts. This ASU will be required to be implemented through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the amendments are effective. The effective date of this Update is for fiscal years beginning on or after December 15, 2019. The Company is evaluating the impact that ASU 2016-13 will have on its financial position, results of operations, and its financial statement disclosures. We expect the new accounting guidance to increase the allowance for loan losses with a resulting negative adjustment to retained earnings, and we will be implementing a new software program during 2017 to enable us to determine the extent of the impact, which could be material.

ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments was issued to address diversity in practice of how certain cash receipts and cash payments are currently presented and classified in the statement of cash flows. The amendments in the ASU provide guidance on the following issues: debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investees and beneficial interests in securitization transactions. Further, the ASU addresses the topic of separately identifiable cash flows and application of the predominance principle. The effective date of this Update is for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The Company is evaluating the impact that ASU 2016-15 will have, if any, on its financial statement disclosures.

Reclassifications—Certain reclassifications have been made to the prior years' financial statements in order to conform to the classifications adopted for reporting in 2016. The reclassifications had no impact on net income or stockholders' equity.

2. INVESTMENT SECURITIES

The portfolio of securities consisted of the following (in thousands):

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Obligations of state and political subdivisions	$29,935	$ 226	$ 1,020	$29,141
GSE mortgage-backed securities	72,144	1,736	302	73,578
Collateralized mortgage obligations: residential	223,602	206	3,606	220,202
Collateralized mortgage obligations: commercial	3,135	—	53	3,082
Mutual funds	2,100	—	41	2,059
Corporate debt securities	13,500	311	—	13,811
	$344,416	$ 2,479	$ 5,022	$341,873

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Obligations of state and political subdivisions	$30,750	$ 770	$ 27	$31,493
GSE mortgage-backed securities	84,946	2,321	229	87,038
Collateralized mortgage obligations: residential	194,067	297	2,276	192,088
Collateralized mortgage obligations: commercial	5,512	1	65	5,448
Mutual funds	2,100	—	8	2,092
	$317,375	$ 3,389	$ 2,605	$318,159

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of state and political subdivisions	$40,515	$ 309	$ 39	$40,785
GSE mortgage-backed securities	44,375	426	311	44,490
Collateralized mortgage obligations: residential	8,969	—	323	8,646
Collateralized mortgage obligations: commercial	4,352	—	12	4,340
	$98,211	$ 735	$ 685	$98,261

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of state and political subdivisions	$43,737	$ 697	$ 6	$44,428
GSE mortgage-backed securities	55,696	705	131	56,270
Collateralized mortgage obligations: residential	10,803	—	361	10,442
Collateralized mortgage obligations: commercial	6,556	2	—	6,558
	$116,792	$ 1,404	$ 498	$117,698

With the exception of two private-label collateralized mortgage obligations ("CMOs") with a combined balance remaining of $18,000 and $27,000 at December 31, 2016 and 2015, respectively, all of the Company’s CMOs are government-sponsored enterprise securities.

The amortized cost and fair value of debt securities at December 31, 2016 by contractual maturity are shown below (in thousands). Actual maturities may differ from contractual maturities because of rights to call or repay obligations with or without penalties and scheduled and unscheduled principal payments on mortgage-backed securities and collateralized mortgage obligations.

	Amortized Cost	Fair Value
Available-for-sale:		
Due in one year or less	$2,166	$2,179
Due after one year through five years	11,341	11,540
Due after five years through ten years	49,661	51,053
Due after ten years	279,148	275,042
	$342,316	$339,814

	Amortized Cost	Fair Value
Held-to-maturity:		
Due in one year or less	$ 347	$347
Due after one year through five years	6,427	6,445
Due after five years through ten years	32,837	33,310
Due after ten years	58,600	58,159
	$ 98,211	$98,261

Details concerning investment securities with unrealized losses are as follows (in thousands):

	December 31, 2016					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Available-for-sale:						
Obligations of state and political subdivisions	$13,402	$ 1,020	$—	$ —	$13,402	$ 1,020
GSE mortgage-backed securities	29,119	302	—	—	29,119	302
Collateralized mortgage obligations: residential	187,235	3,099	14,194	507	201,429	3,606
Collateralized mortgage obligations: commercial	961	4	2,121	49	3,082	53
Mutual funds	2,059	41	—	—	2,059	41
	$232,776	$ 4,466	$16,315	$ 556	$249,091	$ 5,022

	December 31, 2015					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Available-for-sale:						
Obligations of state and political subdivisions	$1,192	$ 27	$—	$ —	$1,192	$ 27
GSE mortgage-backed securities	21,607	229	—	—	21,607	229
Collateralized mortgage obligations: residential	140,999	1,207	30,029	1,069	171,028	2,276
Collateralized mortgage obligations: commercial	—	—	2,946	65	2,946	65
Mutual funds	2,092	8	—	—	2,092	8
	$165,890	$ 1,471	$32,975	$ 1,134	$198,865	$ 2,605

	December 31, 2016					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Held-to-maturity:						
Obligations of state and political subdivisions	$8,054	$ 39	$—	$ —	$8,054	$ 39
GSE mortgage-backed securities	19,408	311	—	—	19,408	311
Collateralized mortgage obligations: residential	—	—	8,645	323	8,645	323
Collateralized mortgage obligations: commercial	$4,340	$ 12	—	—	4,340	12
	$31,802	$ 362	$8,645	$ 323	$40,447	$ 685

	December 31, 2015					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Held-to-maturity:						
Obligations of state and political subdivisions	$541	$ 1	$505	$ 5	$1,046	$ 6
GSE mortgage-backed securities	—	—	7,021	131	7,021	131
Collateralized mortgage obligations: residential	—	—	10,442	361	10,442	361