CULLEN/FROST BANKERS, INC.
Form 10-Q
July 27, 2017
Table of Contents

United States
Securities and Exchange Commission
Washington, D.C. 20549
Form 10-Q
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended: June 30, 2017
Or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission file number: 001-13221
Cullen/Frost Bankers, Inc.
(Exact name of registrant as specified in its charter)

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

(210) 220-4011
(Registrant’s telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No ý
As of July 20, 2017 there were 64,229,805 shares of the registrant’s Common Stock, $.01 par value, outstanding.

Table of Contents

Cullen/Frost Bankers, Inc.
Quarterly Report on Form 10-Q
June 30, 2017
Table of Contents

Table of Contents

Part I. Financial Information
Item 1. Financial Statements (Unaudited)
Cullen/Frost Bankers, Inc.
Consolidated Balance Sheets
(Dollars in thousands, except per share amounts)

	June 30, 2017	December 31, 2016
Assets:		
Cash and due from banks	$542,475	$561,838
Interest-bearing deposits	3,040,148	3,560,865
Federal funds sold and resell agreements	123,692	18,742
Total cash and cash equivalents	3,706,315	4,141,445
Securities held to maturity, at amortized cost	1,596,262	2,250,460
Securities available for sale, at estimated fair value	10,783,737	10,203,277
Trading account securities	27,600	16,703
Loans, net of unearned discounts	12,512,338	11,975,392
Less: Allowance for loan losses	(149,558)	(153,045)
Net loans	12,362,780	11,822,347
Premises and equipment, net	520,253	525,821
Goodwill	654,952	654,952
Other intangible assets, net	5,880	6,776
Cash surrender value of life insurance policies	178,987	177,884
Accrued interest receivable and other assets	369,548	396,654
Total assets	$30,206,314	$30,196,319
Liabilities:		
Deposits:		
Non-interest-bearing demand deposits	$10,707,365	$10,513,369
Interest-bearing deposits	14,906,208	15,298,206
Total deposits	25,613,573	25,811,575
Federal funds purchased and repurchase agreements	924,867	976,992
Junior subordinated deferrable interest debentures, net of unamortized issuance costs	136,155	136,127
Subordinated notes, net of unamortized issuance costs	98,473	99,990
Accrued interest payable and other liabilities	209,317	169,107
Total liabilities	26,982,385	27,193,791
Shareholders' Equity:		
Preferred stock, par value $0.01 per share; 10,000,000 shares authorized; 6,000,000 Series A shares ($25 liquidation preference) issued at June 30, 2017 and December 31, 2016	144,486	144,486
Common stock, par value $0.01 per share; 210,000,000 shares authorized; 64,225,827 shares issued at June 30, 2017 and 63,632,464 shares issued at December 31, 2016	642	637
Additional paid-in capital	948,593	906,732
Retained earnings	2,078,898	1,985,569
Accumulated other comprehensive income, net of tax	51,310	(24,623)
Treasury stock, at cost; none at June 30, 2017 and 158,243 shares at December 31, 2016	—	(10,273)
Total shareholders' equity	3,223,929	3,002,528
Total liabilities and shareholders' equity	$30,206,314	$30,196,319

See Notes to Consolidated Financial Statements.

3

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Interest income:				
Loans, including fees	$131,073	$113,349	$253,673	$225,935
Securities:				
Taxable	23,527	25,531	48,829	51,505
Tax-exempt	55,435	50,910	112,382	101,243
Interest-bearing deposits	9,076	3,602	15,912	7,255
Federal funds sold and resell agreements	163	59	270	117
Total interest income	219,274	193,451	431,066	386,055
Interest expense:				
Deposits	2,173	1,773	4,041	3,560
Federal funds purchased and repurchase agreements	187	52	326	108
Junior subordinated deferrable interest debentures	962	803	1,870	1,553
Other long-term borrowings	1,164	321	1,532	608
Total interest expense	4,486	2,949	7,769	5,829
Net interest income	214,788	190,502	423,297	380,226
Provision for loan losses	8,426	9,189	16,378	37,689
Net interest income after provision for loan losses	206,362	181,313	406,919	342,537
Non-interest income:				
Trust and investment management fees	27,727	26,021	54,197	51,355
Service charges on deposit accounts	21,198	19,865	41,967	40,229
Insurance commissions and fees	9,728	9,360	23,549	24,783
Interchange and debit card transaction fees	5,692	5,381	11,266	10,403
Other charges, commissions and fees	9,898	10,069	19,490	19,122
Net gain (loss) on securities transactions	(50)	—	(50)	14,903
Other	6,887	7,321	14,361	13,365
Total non-interest income	81,080	78,017	164,780	174,160
Non-interest expense:				
Salaries and wages	80,995	78,106	163,507	157,403
Employee benefits	18,198	17,712	39,823	38,017
Net occupancy	19,153	18,242	38,390	35,429
Furniture and equipment	18,250	17,978	36,240	35,495
Deposit insurance	5,570	4,197	10,485	7,854
Intangible amortization	438	619	896	1,283
Other	45,447	42,591	86,625	83,123
Total non-interest expense	188,051	179,445	375,966	358,604
Income before income taxes	99,391	79,885	195,733	158,093
Income taxes	13,838	8,378	25,239	17,770
Net income	85,553	71,507	170,494	140,323
Preferred stock dividends	2,015	2,015	4,031	4,031
Net income available to common shareholders	$83,538	$69,492	$166,463	$136,292

Earnings per common share:

Basic	$1.30	$1.12	$2.59	$2.19
Diluted	1.29	1.11	2.57	2.19

See Notes to Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$85,553	$71,507	$170,494	$140,323
Other comprehensive income (loss), before tax:				
Securities available for sale and transferred securities:				
Change in net unrealized gain/loss during the period	90,390	165,288	124,201	287,506
Change in net unrealized gain on securities transferred to held to maturity	(3,860)	(9,185)	(10,146)	(17,351)
Reclassification adjustment for net (gains) losses included in net income	50	—	50	(14,903)
Total securities available for sale and transferred securities	86,580	156,103	114,105	255,252
Defined-benefit post-retirement benefit plans:				
Change in the net actuarial gain/loss	—	(862)	—	(862)
Reclassification adjustment for net amortization of actuarial gain/loss included in net income as a component of net periodic cost (benefit)	1,358	1,740	2,715	3,293
Total defined-benefit post-retirement benefit plans	1,358	878	2,715	2,431
Other comprehensive income (loss), before tax	87,938	156,981	116,820	257,683
Deferred tax expense (benefit) related to other comprehensive income	30,778	54,943	40,887	90,189
Other comprehensive income (loss), net of tax	57,160	102,038	75,933	167,494
Comprehensive income (loss)	$142,713	$173,545	$246,427	$307,817

See Notes to Consolidated Financial Statements.

Table of Contents

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

	Six Months Ended June 30,	
	2017	2016
Total shareholders' equity at beginning of period	$3,002,528	$2,890,343
Net income	170,494	140,323
Other comprehensive income (loss)	75,933	167,494
Stock option exercises/stock unit conversions (752,075 shares in 2017 and 67,075 shares in 2016)	44,149	3,586
Stock compensation expense recognized in earnings	6,291	5,477
Purchase of treasury stock (469 shares in 2017)	(42)	—
Cash dividends – preferred stock (approximately $0.67 per share in both 2017 and in 2016)	(4,031)	(4,031)
Cash dividends – common stock ($1.11 per share in 2017 and $1.07 per share in 2016)	(71,393)	(66,524)
Total shareholders' equity at end of period	$3,223,929	$3,136,668

See Notes to Consolidated Financial Statements.

Table of Contents

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

	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Operating Activities:		
Net income	$170,494	$140,323
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	16,378	37,689
Deferred tax expense (benefit)	(4,173)	(9,633)
Accretion of loan discounts	(7,403)	(8,185)
Securities premium amortization (discount accretion), net	43,652	38,806
Net (gain) loss on securities transactions	50	(14,903)
Depreciation and amortization	24,055	23,823
Net (gain) loss on sale/write-down of assets/foreclosed assets	(1,383)	(596)
Stock-based compensation	6,291	5,477
Net tax benefit from stock-based compensation	5,579	65
Earnings on life insurance policies	(1,565)	(1,745)
Net change in:		
Trading account securities	(7,120)	177
Accrued interest receivable and other assets	(20,116)	(26,795)
Accrued interest payable and other liabilities	(36,277)	(4,664)
Net cash from operating activities	188,462	179,839
Investing Activities:		
Securities held to maturity:		
Purchases	—	—
Sales	—	135,610
Maturities, calls and principal repayments	634,874	164,687
Securities available for sale:		
Purchases	(8,825,545)	(1,514,263)
Sales	8,247,439	1,060,196
Maturities, calls and principal repayments	164,182	165,883
Proceeds from sale of loans	—	30,470
Net change in loans	(549,408)	(144,192)
Benefits received on life insurance policies	462	591
Proceeds from sales of premises and equipment	1,550	1,516
Purchases of premises and equipment	(14,481)	(23,459)
Proceeds from sales of repossessed properties	345	297
Net cash from investing activities	(340,582)	(122,664)
Financing Activities:		
Net change in deposits	(198,002)	(56,144)
Net change in short-term borrowings	(52,125)	(160,362)
Proceeds from issuance of subordinated notes	98,434	—
Principal payments on subordinated notes	(100,000)	—
Proceeds from stock option exercises	44,149	3,586
Purchase of treasury stock	(42)	—

Cash dividends paid on preferred stock	(4,031)	(4,031)
Cash dividends paid on common stock	(71,393)	(66,524)
Net cash from financing activities	(283,010)	(283,475)
Net change in cash and cash equivalents	(435,130)	(226,300)
Cash and equivalents at beginning of period	4,141,445	3,591,523
Cash and equivalents at end of period	$3,706,315	$3,365,223

See Notes to Consolidated Financial Statements.

Table of Contents

Notes to Consolidated Financial Statements
(Table amounts in thousands, except for share and per share amounts)
Note 1 - Significant Accounting Policies
Nature of Operations. Cullen/Frost Bankers, Inc. ("Cullen/Frost") is a financial holding company and a bank holding company headquartered in San Antonio, Texas that provides, through its subsidiaries, a broad array of products and services throughout numerous Texas markets. The terms "Cullen/Frost," "the Corporation," "we," "us" and "our" mean Cullen/Frost Bankers, Inc. and its subsidiaries, when appropriate. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, insurance, brokerage, mutual funds, leasing, treasury management, capital markets advisory and item processing.
Basis of Presentation. The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of Cullen/Frost and all other entities in which Cullen/Frost has a controlling financial interest. All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies we follow conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry.
The consolidated financial statements in this Quarterly Report on Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of our financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with our consolidated financial statements, and notes thereto, for the year ended December 31, 2016, included in our Annual Report on Form 10-K filed with the SEC on February 3, 2017 (the "2016 Form 10-K"). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.
Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses and the fair values of financial instruments and the status of contingencies are particularly subject to change.
Cash Flow Reporting. Additional cash flow information was as follows:

	Six Months Ended June 30,	
	2017	2016
Cash paid for interest	$6,666	$ 5,770
Cash paid for income taxes	22,801	25,979
Significant non-cash transactions:		
Unsettled purchases of securities	80,586	306,564
Loans foreclosed and transferred to other real estate owned and foreclosed assets	—	422

Accounting Changes, Reclassifications and Restatements. Certain items in prior financial statements have been reclassified to conform to the current presentation. As more fully described in our 2016 Form 10-K, during the third quarter of 2016, we elected to adopt the provisions of ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," in advance of the required application date of January 1, 2017. Our financial statements for the three and six months ended June 30, 2016 have been restated to reflect the adoption of ASU 2016-09 as of January 1, 2016. As a result, compared to previously reported amounts, our consolidated income statement reflects decreases in income tax expense of $28 thousand and $65 thousand for the three and six months ended June 30, 2016, respectively, and corresponding increases in net income of $28 thousand and $65 thousand for the three and six months ended June 30, 2016, respectively. The increase in net income during the six months ended June 30, 2016 resulted in a $0.01 increase in previously reported diluted earnings per share.

Table of Contents

Note 2 - Securities

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

	June 30, 2017				December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held to Maturity								
U.S. Treasury	$—	$—	$—	$—	$249,889	$1,762	$—	$251,651
Residential mortgage-backed securities	3,992	32	24	4,000	4,511	39	—	4,550
States and political subdivisions	1,590,920	37,288	2,891	1,625,317	1,994,710	16,821	6,335	2,005,196
Other	1,350	—	2	1,348	1,350	—	—	1,350
Total	$1,596,262	$37,320	$2,917	$1,630,665	$2,250,460	$18,622	$6,335	$2,262,747
Available for Sale								
U.S. Treasury	$4,203,901	$27,541	$7,188	$4,224,254	$4,003,692	$24,984	$8,945	$4,019,731
Residential mortgage-backed securities	681,364	25,693	1,436	705,621	756,072	30,388	1,293	785,167
States and political subdivisions	5,734,600	122,028	45,286	5,811,342	5,403,918	50,101	98,134	5,355,885
Other	42,520	—	—	42,520	42,494	—	—	42,494
Total	$10,662,385	$175,262	$53,910	$10,783,737	$10,206,176	$105,473	$108,372	$10,203,277

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. At June 30, 2017, approximately 98.1% of the securities in our municipal bond portfolio were issued by political subdivisions or agencies within the State of Texas, of which approximately 67.3% are either guaranteed by the Texas Permanent School Fund, which has a “triple A” insurer financial strength rating, or are secured by U.S. Treasury securities via defeasance of the debt by the issuers. Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost and are reported as other available for sale securities in the table above. The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law was $3.3 billion at June 30, 2017 and $3.9 billion at December 31, 2016.

During the fourth quarter of 2012, we reclassified certain securities from available for sale to held to maturity. The securities had an aggregate fair value of $2.3 billion with an aggregate net unrealized gain of $165.7 million ($107.7 million, net of tax) on the date of the transfer. The net unamortized, unrealized gain on the remaining transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of June 30, 2017 totaled $17.6 million ($11.4 million, net of tax). This amount will be amortized out of accumulated other comprehensive income over the remaining life of the underlying securities as an adjustment of the yield on those securities.

Unrealized Losses. As of June 30, 2017, securities with unrealized losses, segregated by length of impairment, were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held to Maturity						
Residential mortgage-backed securities	$2,191	$ 24	$—	$ —	$2,191	$ 24
States and political subdivisions	20,127	83	118,937	2,808	139,064	2,891

Other	1,348	2	—	—	1,348	2
Total	$23,666	$ 109	$118,937	$ 2,808	$142,603	$ 2,917
Available for Sale						
U.S. Treasury	$1,587,812	$ 7,188	$—	$ —	$1,587,812	$ 7,188
Residential mortgage-backed securities	67,596	1,204	5,866	232	73,462	1,436
States and political subdivisions	1,450,982	38,138	142,507	7,148	1,593,489	45,286
Total	$3,106,390	$ 46,530	$148,373	$ 7,380	$3,254,763	$ 53,910

Table of Contents

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

Management has the ability and intent to hold the securities classified as held to maturity in the table above until they mature, at which time we expect to receive full value for the securities. Furthermore, as of June 30, 2017, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that we will not have to sell any such securities before a recovery of cost. Any unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of June 30, 2017, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in our consolidated income statement.

Contractual Maturities. The amortized cost and estimated fair value of securities, excluding trading securities, at June 30, 2017 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Residential mortgage-backed securities and equity securities are shown separately since they are not due at a single maturity date.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$329,237	$334,156	$57,171	$57,528
Due after one year through five years	170,170	177,977	4,818,303	4,845,635
Due after five years through ten years	349,324	357,485	362,030	375,143
Due after ten years	743,539	757,047	4,700,997	4,757,290
Residential mortgage-backed securities	3,992	4,000	681,364	705,621
Equity securities	—	—	42,520	42,520
Total	$1,596,262	$1,630,665	$10,662,385	$10,783,737

Sales of Securities. As more fully discussed in our 2016 Form 10-K, during 2016, we sold certain securities issued by municipalities that, based upon our internal credit analysis, had experienced significant deterioration in creditworthiness. Some of the securities we sold were classified as held to maturity prior to their sale. Despite their classification as held to maturity, we believe the sale of these securities was merited and permissible under the applicable accounting guidelines because of the significant deterioration in the creditworthiness of the issuers.

Sales of securities held to maturity were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Proceeds from sales	$ —	$ —	$ —	$135,610
Amortized cost	—	—	—	131,840
Gross realized gains	—	—	—	3,770
Gross realized losses	—	—	—	—
Tax (expense) benefit of securities gains/losses	—	—	—	(1,319)

Sales of securities available for sale were as follows:

	Three Months Ended	Six Months Ended June 30,

	June 30,			
	2017	2016	2017	2016
Proceeds from sales	$8,247,439	$ —	$8,247,439	$1,060,196
Gross realized gains	—	—	—	11,133
Gross realized losses	(50)	—	(50)	—
Tax (expense) benefit of securities gains/losses	18	—	18	(3,897)

10

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Premium amortization	$(24,119)	$(22,219)	$(48,147)	$(44,559)
Discount accretion	2,105	3,138	4,495	5,753
Net (premium amortization) discount accretion	$(22,014)	$(19,081)	$(43,652)	$(38,806)

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

	June 30, 2017	December 31, 2016
U.S. Treasury	$17,726	$ 16,594
States and political subdivisions	9,874	109
Total	$27,600	$ 16,703

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net gain on sales transactions	$293	$351	$604	$653
Net mark-to-market gains (losses)	(56)	(2)	(43)	(1)
Net gain (loss) on trading account securities	$237	$349	$561	$652

Note 3 - Loans

Loans were as follows:

	June 30, 2017	Percentage of Total	December 31, 2016	Percentage of Total
Commercial and industrial	$4,604,269	36.8 %	$4,344,000	36.3 %
Energy:				
Production	1,040,506	8.3	971,767	8.1
Service	183,543	1.5	221,213	1.8
Other	185,563	1.5	193,081	1.7
Total energy	1,409,612	11.3	1,386,061	11.6
Commercial real estate:				
Commercial mortgages	3,620,885	28.9	3,481,157	29.1
Construction	1,050,837	8.4	1,043,261	8.7
Land	322,130	2.6	311,030	2.6
Total commercial real estate	4,993,852	39.9	4,835,448	40.4
Consumer real estate:				
Home equity loans	355,744	2.8	345,130	2.9
Home equity lines of credit	283,344	2.3	264,862	2.2
Other	351,985	2.8	326,793	2.7
Total consumer real estate	991,073	7.9	936,785	7.8
Total real estate	5,984,925	47.8	5,772,233	48.2
Consumer and other	513,532	4.1	473,098	3.9
Total loans	$12,512,338	100.0 %	$11,975,392	100.0 %

Concentrations of Credit. Most of our lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio, as well as other markets. The majority of our loan portfolio consists of commercial and industrial and commercial real estate loans. As of June 30, 2017, there were no concentrations of loans related to any single industry in excess of 10% of total loans other than energy loans, which totaled 11.3% of total loans. Unfunded commitments to extend credit and standby letters of credit issued to customers in the energy industry totaled $1.1 billion and $42.9 million, respectively, as of June 30, 2017.

Table of Contents

Foreign Loans. We have U.S. dollar denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant at June 30, 2017 or December 31, 2016.

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

	June 30, 2017	December 31, 2016
Commercial and industrial	$21,226	$ 31,475
Energy	55,464	57,571
Commercial real estate:		
Buildings, land and other	6,916	8,550
Construction	—	—
Consumer real estate	2,543	2,130
Consumer and other	264	425
Total	$86,413	$ 100,151

As of June 30, 2017, non-accrual loans reported in the table above included $11.4 million related to loans that were restructured as “troubled debt restructurings” during 2017. See the section captioned “Troubled Debt Restructurings” elsewhere in this note. Had non-accrual loans performed in accordance with their original contract terms, we would have recognized additional interest income, net of tax, of approximately $798 thousand and $1.6 million for the three and six months ended June 30, 2017, compared to $936 thousand and $1.8 million for three and six months ended June 30, 2016.

An age analysis of past due loans (including both accruing and non-accruing loans), segregated by class of loans, as of June 30, 2017 was as follows:

	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and industrial	$ 24,320	$ 26,149	$50,469	$4,553,800	$4,604,269	$ 10,768
Energy	5,991	6,430	12,421	1,397,191	1,409,612	2,902
Commercial real estate:						
Buildings, land and other	21,157	4,166	25,323	3,917,692	3,943,015	944
Construction	—	—	—	1,050,837	1,050,837	—
Consumer real estate	4,693	2,022	6,715	984,358	991,073	739
Consumer and other	3,508	740	4,248	509,284	513,532	650
Total	$ 59,669	$ 39,507	$99,176	$12,413,162	$12,512,338	$ 16,003

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

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
June 30, 2017					
Commercial and industrial	$ 27,709	$ 14,777	$ 4,040	$ 18,817	$ 1,780
Energy	59,771	36,162	19,215	55,377	350
Commercial real estate:					
Buildings, land and other	9,729	5,478	—	5,478	—
Construction	—	—	—	—	—
Consumer real estate	1,203	1,203	—	1,203	—
Consumer and other	—	—	—	—	—
Total	$ 98,412	$ 57,620	$ 23,255	$ 80,875	$ 2,130

12

Table of Contents

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
December 31, 2016					
Commercial and industrial	$ 40,288	$ 19,862	$ 9,047	$ 28,909	$ 5,436
Energy	60,522	27,759	29,804	57,563	3,750
Commercial real estate:					
Buildings, land and other	11,369	6,866	—	6,866	—
Construction	—	—	—	—	—
Consumer real estate	977	655	—	655	—
Consumer and other	32	30	—	30	—
Total	$ 113,188	$ 55,172	$ 38,851	$ 94,023	$ 9,186

The average recorded investment in impaired loans was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Commercial and industrial	$21,347	$24,866	$23,867	$24,197
Energy	67,008	78,359	63,860	59,286
Commercial real estate:				
Buildings, land and other	5,966	20,533	6,266	24,497
Construction	—	648	—	622
Consumer real estate	1,376	443	1,135	457
Consumer and other	12	27	18	18
Total	$95,709	$124,876	$95,146	$109,077

Troubled Debt Restructurings. Troubled debt restructurings during the six months ended June 30, 2017 and June 30, 2016 are set forth in the following table.

	Six Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	Balance at Restructure	Balance at Period-End	Balance at Restructure	Balance at Period-End
Commercial and industrial	$784	$ 643	$510	$ 505
Energy	12,959	12,458	62,546	20,795
Commercial real estate:				
Buildings, land and other	—	—	1,456	1,456
Construction	—	—	243	224
	$13,743	$ 13,101	$64,755	$ 22,980

Loan modifications are typically related to extending amortization periods, converting loans to interest only for a limited period of time, deferral of interest payments, waiver of certain covenants, consolidating notes and/or reducing collateral or interest rates. The modifications during the reported periods did not significantly impact our determination of the allowance for loan losses. As of June 30, 2017, there were no loans restructured during the last year that were in excess of 90 days past due. During the six months ended June 30, 2017, we recognized charge-offs totaling $10.0 million related to loans restructured during the third and fourth quarters of 2016. During the six months ended June 30, 2016, we recognized a charge-off of $9.5 million related to a loan restructured during the first quarter of 2016. The loan was subsequently sold with proceeds from the sale totaling $30.5 million.

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

We utilize a risk grading matrix to assign a risk grade to each of our commercial loans. Loans are graded on a scale of 1 to 14. A description of the general characteristics of the 14 risk grades is set forth in our 2016 Form 10-K. In monitoring credit quality trends in the context of assessing the appropriate level of the allowance for loan losses, we monitor portfolio credit quality by the weighted-average risk grade of each class of commercial loan. Individual relationship managers review updated financial

Table of Contents

information for all pass grade loans to reassess the risk grade on at least an annual basis. When a loan has a risk grade of 9, it is still considered a pass grade loan; however, it is considered to be on management's "watch list," where a significant risk-modifying action is anticipated in the near term. When a loan has a risk grade of 10 or higher, a special assets officer monitors the loan on an on-going basis. The following tables present weighted-average risk grades for all commercial loans by class.

	June 30, 2017		December 31, 2016	
	Weighted Average Risk Grade	Loans	Weighted Average Risk Grade	Loans
Commercial and industrial:				
Risk grades 1-8	6.00	$4,146,261	6.01	$3,989,722
Risk grade 9	9.00	222,108	9.00	106,988
Risk grade 10	10.00	78,696	10.00	115,420
Risk grade 11	11.00	135,978	11.00	100,245
Risk grade 12	12.00	19,446	12.00	25,939
Risk grade 13	13.00	1,780	13.00	5,686
Total	6.39	$4,604,269	6.35	$4,344,000
Energy				
Risk grades 1-8	6.32	$1,024,927	6.34	$854,688
Risk grade 9	9.00	43,415	9.00	78,524
Risk grade 10	10.00	115,913	10.00	150,872
Risk grade 11	11.00	169,893	11.00	244,406
Risk grade 12	12.00	55,114	12.00	53,821
Risk grade 13	13.00	350	13.00	3,750
Total	7.49	$1,409,612	7.95	$1,386,061
Commercial real estate:				
Buildings, land and other				
Risk grades 1-8	6.69	$3,590,525	6.67	$3,463,064
Risk grade 9	9.00	123,492	9.00	109,110
Risk grade 10	10.00	148,718	10.00	145,067
Risk grade 11	11.00	73,364	11.00	66,396
Risk grade 12	12.00	6,916	12.00	8,550
Risk grade 13	13.00	—	13.00	—
Total	6.97	$3,943,015	6.95	$3,792,187
Construction				
Risk grades 1-8	7.03	$1,019,355	6.97	$1,023,194
Risk grade 9	9.00	22,632	9.00	15,829
Risk grade 10	10.00	5,116	10.00	2,889
Risk grade 11	11.00	3,734	11.00	1,349
Risk grade 12	12.00	—	12.00	—
Risk grade 13	13.00	—	13.00	—
Total	7.10	$1,050,837	7.01	$1,043,261

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Commercial and industrial	$(4,861)	$(3,966)	$(7,590)	$(5,098)
Energy	(6,236)	(16,747)	(10,461)	(17,758)

Commercial real estate:				
Buildings, land and other	460	481	502	542
Construction	3	2	6	9
Consumer real estate	111	74	207	173
Consumer and other	(1,401)	(1,199)	(2,529)	(1,702)
Total	$(11,924)	$(21,355)	$(19,865)	$(23,834)

Table of Contents

In assessing the general economic conditions in the State of Texas, management monitors and tracks the Texas Leading Index ("TLI"), which is produced by the Federal Reserve Bank of Dallas. The TLI, the components of which are more fully described in our 2016 Form 10-K, totaled 124.7 at May 31, 2017 (most recent date available) and 123.1 at December 31, 2016. A higher TLI value implies more favorable economic conditions.

Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of inherent losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. Our allowance for loan loss methodology, which is more fully described in our 2016 Form 10-K, follows the accounting guidance set forth in U.S. generally accepted accounting principles and the Interagency Policy Statement on the Allowance for Loan and Lease Losses, which was jointly issued by U.S. bank regulatory agencies. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss and recovery experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off.

The following table presents details of the allowance for loan losses allocated to each portfolio segment as of June 30, 2017 and December 31, 2016 and detailed on the basis of the impairment evaluation methodology we used:

	Commercial and Industrial	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
June 30, 2017						
Historical valuation allowances	$ 28,504	$32,452	$ 17,975	$ 2,416	$ 5,455	$86,802
Specific valuation allowances	1,780	350	—	—	—	2,130
General valuation allowances	8,418	5,934	4,724	2,032	137	21,245
Macroeconomic valuation allowances	10,204	15,541	10,303	1,087	2,246	39,381
Total	$ 48,906	$54,277	$ 33,002	$ 5,535	$ 7,838	$149,558
Allocated to loans:						
Individually evaluated	$ 1,780	$350	$ —	$ —	$ —	$2,130
Collectively evaluated	47,126	53,927	33,002	5,535	7,838	147,428
Total	$ 48,906	$54,277	$ 33,002	$ 5,535	$ 7,838	$149,558
December 31, 2016						
Historical valuation allowances	$ 33,251	$34,626	$ 16,976	$ 2,225	$ 4,585	$91,663
Specific valuation allowances	5,436	3,750	—	—	—	9,186
General valuation allowances	6,708	3,769	5,004	1,506	(144)	16,843
Macroeconomic valuation allowances	7,520	18,508	8,233	507	585	35,353
Total	$ 52,915	$60,653	$ 30,213	$ 4,238	$ 5,026	$153,045
Allocated to loans:						
Individually evaluated	$ 5,436	$3,750	$ —	$ —	$ —	$9,186
Collectively evaluated	47,479	56,903	30,213	4,238	5,026	143,859
Total	$ 52,915	$60,653	$ 30,213	$ 4,238	$ 5,026	$153,045

Table of Contents

Our recorded investment in loans as of June 30, 2017 and December 31, 2016 related to each balance in the allowance for loan losses by portfolio segment and detailed on the basis of the impairment methodology we used was as follows:

	Commercial and Industrial	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
June 30, 2017						
Individually evaluated	$ 18,817	$ 55,377	$ 5,478	$ 1,203	$ —	$ 80,875
Collectively evaluated	4,585,452	1,354,235	4,988,374	989,870	513,532	12,431,463
Total	$ 4,604,269	$ 1,409,612	$ 4,993,852	$ 991,073	$ 513,532	$ 12,512,338
December 31, 2016						
Individually evaluated	$ 28,909	$ 57,563	$ 6,866	$ 655	$ 30	$ 94,023
Collectively evaluated	4,315,091	1,328,498	4,828,582	936,130	473,068	11,881,369
Total	$ 4,344,000	$ 1,386,061	$ 4,835,448	$ 936,785	$ 473,098	$ 11,975,392

The following table details activity in the allowance for loan losses by portfolio segment for the three and six months ended June 30, 2017 and 2016. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Commercial and Industrial	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
Three months ended:						
June 30, 2017						
Beginning balance	$ 45,583	$ 61,793	$ 34,009	$ 4,823	$ 6,848	$ 153,056
Provision for loan losses	8,184	(1,280)	(1,470)	601	2,391	8,426
Charge-offs	(5,579)	(6,317)	(14)	(2)	(3,623)	(15,535)
Recoveries	718	81	477	113	2,222	3,611
Net charge-offs	(4,861)	(6,236)	463	111	(1,401)	(11,924)
Ending balance	$ 48,906	$ 54,277	$ 33,002	$ 5,535	$ 7,838	$ 149,558
June 30, 2016						
Beginning balance	$ 45,084	$ 84,973	$ 23,587	$ 3,786	$ 4,450	$ 161,880
Provision for loan losses	6,460	(1,887)	2,993	75	1,548	9,189
Charge-offs	(4,857)	(16,749)	(19)	(23)	(3,252)	(24,900)
Recoveries	891	2	502	97	2,053	3,545
Net charge-offs	(3,966)	(16,747)	483	74	(1,199)	(21,355)
Ending balance	$ 47,578	$ 66,339	$ 27,063	$ 3,935	$ 4,799	$ 149,714
Six months ended:						
June 30, 2017						
Beginning balance	$ 52,915	$ 60,653	$ 30,213	$ 4,238	$ 5,026	$ 153,045
Provision for loan losses	3,581	4,085	2,281	1,090	5,341	16,378
Charge-offs	(9,106)	(10,595)	(14)	(13)	(7,171)	(26,899)
Recoveries	1,516	134	522	220	4,642	7,034
Net charge-offs	(7,590)	(10,461)	508	207	(2,529)	(19,865)
Ending balance	$ 48,906	$ 54,277	$ 33,002	$ 5,535	$ 7,838	$ 149,558
June 30, 2016						
Beginning balance	$ 42,993	$ 54,696	$ 24,313	$ 4,659	$ 9,198	$ 135,859
Provision for loan losses	9,683	29,401	2,199	(897)	(2,697)	37,689
Charge-offs	(6,718)	(17,760)	(47)	(177)	(5,976)	(30,678)
Recoveries	1,620	2	598	350	4,274	6,844
Net charge-offs	(5,098)	(17,758)	551	173	(1,702)	(23,834)

Ending balance	$ 47,578	$66,339	$ 27,063	$ 3,935	$ 4,799	$149,714

Table of Contents

Note 4 - Goodwill and Other Intangible Assets

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

	June 30, 2017	December 31, 2016
Goodwill	$654,952	$ 654,952
Other intangible assets:		
Core deposits	$4,636	$ 5,298
Customer relationships	1,188	1,410
Non-compete agreements	56	68
	$5,880	$ 6,776

The estimated aggregate future amortization expense for intangible assets remaining as of June 30, 2017 is as follows:

Remainder of 2017	$807
2018	1,424
2019	1,167
2020	918
2021	697
Thereafter	867
	$5,880

Note 5 - Deposits

Deposits were as follows:

	June 30, 2017	Percentage of Total		December 31, 2016	Percentage of Total	
Non-interest-bearing demand deposits:						
Commercial and individual	$10,076,475	39.3	%	$9,670,989	37.5	%
Correspondent banks	259,686	1.0		280,751	1.1	
Public funds	371,204	1.5		561,629	2.2	
Total non-interest-bearing demand deposits	10,707,365	41.8		10,513,369	40.8	
Interest-bearing deposits:						
Private accounts:						
Savings and interest checking	6,349,462	24.8		6,436,065	24.9	
Money market accounts	7,403,054	28.9		7,486,431	29.0	
Time accounts of $100,000 or more	432,406	1.7		460,028	1.8	
Time accounts under $100,000	327,228	1.3		338,714	1.3	
Total private accounts	14,512,150	56.7		14,721,238	57.0	
Public funds:						
Savings and interest checking	299,505	1.2		446,872	1.7	
Money market accounts	77,361	0.3		113,669	0.4	
Time accounts of $100,000 or more	16,426	—		15,748	0.1	
Time accounts under $100,000	766	—		679	—	
Total public funds	394,058	1.5		576,968	2.2	
Total interest-bearing deposits	14,906,208	58.2		15,298,206	59.2	
Total deposits	$25,613,573	100.0	%	$25,811,575	100.0	%

The following table presents additional information about our deposits:

	June 30, 2017	December 31, 2016
Deposits from foreign sources (primarily Mexico)	$ 728,350	$ 776,003
Deposits not covered by deposit insurance	12,708,257	12,889,047

Table of Contents

Note 6 - Borrowed Funds

Subordinated Notes Payable. In March 2017, we issued $100 million of 4.50% subordinated notes that mature on March 17, 2027. The notes, which qualify as Tier 2 capital for Cullen/Frost, bear interest at the rate of 4.50% per annum, payable semi-annually on each March 17 and September 17. The notes are unsecured and subordinated in right of payment to the payment of our existing and future senior indebtedness and structurally subordinated to all existing and future indebtedness of our subsidiaries. Unamortized debt issuance costs related to these notes, totaled approximately $1.5 million at June 30, 2017. Proceeds from sale of the notes were used for general corporate purposes.

Our $100 million of 5.75% fixed-to-floating rate subordinated notes matured and were redeemed on February 15, 2017. See Note 8 - Borrowed Funds in our 2016 Form 10-K for additional information about these notes.

Note 7 - Commitments and Contingencies

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, we enter into various transactions, which, in accordance with generally accepted accounting principles are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. As more fully discussed in our 2016 Form 10-K, these transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

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

	June 30, 2017	December 31, 2016
Commitments to extend credit	$7,616,002	$ 7,476,420
Standby letters of credit	240,612	239,482
Deferred standby letter of credit fees	2,010	2,054

Lease Commitments. We lease certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled $7.5 million and $15.3 million during the three and six months ended June 30, 2017 and $7.3 million and $14.5 million during the three and six months ended June 30, 2016. There has been no significant change in our expected future minimum lease payments since December 31, 2016. See the 2016 Form 10-K for information regarding these commitments.

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

Note 8 - Capital and Regulatory Matters

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

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

Tier 1 capital includes Common Equity Tier 1 capital and additional Tier 1 capital. For Cullen/Frost, additional Tier 1 capital at June 30, 2017 and December 31, 2016 includes $144.5 million of 5.375% non-cumulative perpetual preferred stock. Frost Bank did not have any additional Tier 1 capital beyond Common Equity Tier 1 at June 30, 2017 or December 31, 2016.

Total capital includes Tier 1 capital and Tier 2 capital. Tier 2 capital for both Cullen/Frost and Frost Bank includes a permissible portion of the allowance for loan losses. Tier 2 capital for Cullen/Frost also includes $100.0 million of qualified subordinated debt at June 30, 2017 and $133.0 million of trust preferred securities at both June 30, 2017 and December 31, 2016.

Table of Contents

The following table presents actual and required capital ratios for Cullen/Frost and Frost Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of June 30, 2017 and December 31, 2016 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules. See the 2016 Form 10-K for a more detailed discussion of the Basel III Capital Rules.

Actual	Minimum Capital Required - Basel III Phase-In Schedule	Minimum Capital Required - Basel III Fully Phased-In