SOUTHSIDE BANCSHARES INC
Form 10-Q
May 07, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013

OR
o 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 0-12247
SOUTHSIDE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

TEXAS	75-1848732
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1201 S. Beckham, Tyler, Texas	75701
(Address of principal executive offices)	(Zip Code)

903-531-7111
(Registrant's telephone number, including area code)

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 x No o

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The number of shares of the issuer's common stock, par value $1.25, outstanding as of April 30, 2013 was 17,842,463 shares.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except share amounts)

	March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$42,992	$47,312
Interest earning deposits	12,126	103,318
Total cash and cash equivalents	55,118	150,630
Investment securities:		
Available for sale, at estimated fair value	685,794	617,707
Held to maturity, at amortized cost	1,008	1,009
Mortgage-backed and related securities:		
Available for sale, at estimated fair value	905,107	806,360
Held to maturity, at amortized cost	234,245	245,538
FHLB stock, at cost	25,415	27,889
Other investments, at cost	2,064	2,064
Loans held for sale	3,138	3,601
Loans:		
Loans	1,281,647	1,262,977
Less: Allowance for loan losses	(18,542)	(20,585)
Net Loans	1,263,105	1,242,392
Premises and equipment, net	49,985	50,075
Goodwill	22,034	22,034
Other intangible assets, net	283	324
Interest receivable	13,610	18,936
Deferred tax asset	6,148	4,120
Unsettled trades to sell securities	1,857	—
Other assets	43,186	44,724
TOTAL ASSETS	$3,312,097	$3,237,403
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$546,143	$595,093
Interest bearing	1,791,094	1,756,804
Total deposits	2,337,237	2,351,897
Short-term obligations:		
Federal funds purchased and repurchase agreements	857	984
FHLB advances	163,159	150,985
Other obligations	219	219
Total short-term obligations	164,235	152,188
Long-term obligations:		
FHLB advances	389,804	369,097
Long-term debt	60,311	60,311
Total long-term obligations	450,115	429,408
Unsettled trades to purchase securities	71,757	10,047

Other liabilities	33,041	36,100
TOTAL LIABILITIES	3,056,385	2,979,640
Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 10)		
Shareholders' equity:		
Common stock ($1.25 par, 40,000,000 shares authorized, 20,312,101 shares issued in 2013 (including 851,404 shares declared on March 28, 2013 as a stock dividend) and 19,446,187 shares issued in 2012)	25,390	24,308
Paid-in capital	212,151	195,602
Retained earnings	58,720	70,708
Treasury stock (2,469,638 and 2,379,338 shares at cost)	(37,692)	(35,793)
Accumulated other comprehensive (loss) income	(2,857)	2,938
TOTAL SHAREHOLDERS' EQUITY	255,712	257,763
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$3,312,097	$3,237,403

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(in thousands, except per share data)

	Three Months Ended March 31,	
	2013	2012
Interest income		
Loans	$17,665	$16,770
Investment securities – taxable	364	31
Investment securities – tax-exempt	3,958	2,667
Mortgage-backed and related securities	3,936	12,163
FHLB stock and other investments	65	79
Other interest earning assets	43	6
Total interest income	26,031	31,716
Interest expense		
Deposits	2,070	3,395
Short-term obligations	1,250	1,592
Long-term obligations	1,781	2,733
Total interest expense	5,101	7,720
Net interest income	20,930	23,996
Provision for loan losses	492	3,052
Net interest income after provision for loan losses	20,438	20,944
Noninterest income		
Deposit services	3,753	3,748
Gain on sale of securities available for sale	4,365	5,972
Loss on sale of securities carried at fair value through income	—	(485)
Total other-than-temporary impairment losses	(52)	—
Portion of loss recognized in other comprehensive income (before taxes)	10	(141)
Net impairment losses recognized in earnings	(42)	(141)
FHLB advance option impairment charges	—	(472)
Gain on sale of loans	319	131
Trust income	720	677
Bank owned life insurance income	254	266
Other	891	1,111
Total noninterest income	10,260	10,807
Noninterest expense		
Salaries and employee benefits	13,209	11,833
Occupancy expense	1,871	1,758
Advertising, travel & entertainment	641	604
ATM and debit card expense	381	279
Director fees	264	268
Supplies	250	159
Professional fees	640	691
Telephone and communications	451	406
FDIC insurance	421	470

Other	2,191	2,054
Total noninterest expense	20,319	18,522
Income before income tax expense	10,379	13,229
Provision for income tax expense	1,854	3,090
Net income	$8,525	$10,139
Earnings per common share – basic	$0.48	$0.56
Earnings per common share – diluted	$0.48	$0.56
Dividends paid per common share	$0.20	$0.18

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(in thousands)

	Three Months Ended March 31,	
	2013	2012
Net income	$8,525	$10,139
Other comprehensive income (loss):		
Unrealized holding losses on available for sale securities during the period	(5,215)	(4,886)
Noncredit portion of other-than-temporary impairment losses on the AFS securities	(10)	141
Reclassification adjustment for gain on sale of available for sale securities included in net income	(4,365)	(5,972)
Reclassification of other-than-temporary impairment charges on available for sale securities included in net income	42	141
Amortization of net actuarial loss, included in net periodic benefit cost	643	499
Amortization of prior service credit, included in net periodic benefit cost	(11)	(10)
Other comprehensive loss, before tax	(8,916)	(10,087)
Income tax benefit related to other items of comprehensive income	3,121	3,531
Other comprehensive loss, net of tax	(5,795)	(6,556)
Comprehensive income	$2,730	$3,583

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(UNAUDITED)
(in thousands, except share and per share data)

	Common Stock	Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance at December 31, 2011	$23,146	$176,791	$72,646	$(28,377)	$14,721	$258,927
Net Income			10,139			10,139
Other comprehensive loss					(6,556)	(6,556)
Issuance of common stock (14,496 shares)	18	282				300
Stock compensation expense		39				39
Cash dividends paid on common stock ($0.18 per share)			(2,970)			(2,970)
Stock dividend declared	1,035	16,441	(17,476)			—
Balance at March 31, 2012	$24,199	$193,553	$62,339	$(28,377)	$8,165	$259,879
Balance at December 31, 2012	$24,308	$195,602	$70,708	$(35,793)	$2,938	$257,763
Net Income			8,525			8,525
Other comprehensive loss					(5,795)	(5,795)
Issuance of common stock (14,361 shares)	18	288				306
Purchase of common stock (90,300 shares)				(1,899)		(1,899)
Stock compensation expense		207				207
Net issuance of common stock under employee stock plans		62	(62)			—
Cash dividends paid on common stock ($0.20 per share)			(3,395)			(3,395)
Stock dividend declared	1,064	15,992	(17,056)			—
Balance at March 31, 2013	$25,390	$212,151	$58,720	$(37,692)	$(2,857)	$255,712

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW
(UNAUDITED)
(in thousands)

	Three Months Ended March 31,	
	2013	2012
OPERATING ACTIVITIES:		
Net income	$8,525	$10,139
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	895	870
Amortization of premium	9,073	10,366
Accretion of discount and loan fees	(1,363)	(1,129)
Provision for loan losses	492	3,052
Stock compensation expense	207	39
Deferred tax expense (benefit)	1,093	(2,880)
Loss on sale of securities carried at fair value through income	—	485
Gain on sale of securities available for sale	(4,365)	(5,972)
Net other-than-temporary impairment losses	42	141
FHLB advance option impairment charges	—	472
Gain on sale of other real estate owned	(21)	—
Net change in:		
Interest receivable	5,326	5,491
Other assets	840	991
Interest payable	(244)	(289)
Other liabilities	(2,183)	3,227
Loans held for sale	463	1,650
Net cash provided by operating activities	18,780	26,653
INVESTING ACTIVITIES:		
Securities held to maturity:		
Purchases	(42,898)	—
Maturities, calls and principal repayments	57,275	15,365
Securities available for sale:		
Purchases	(448,973)	(618,587)
Sales	237,318	127,298
Maturities, calls and principal repayments	87,694	58,500
Securities carried at fair value through income:		
Purchases	—	(57,606)
Sales	—	664,224
Maturities, calls and principal repayments	—	24,872
Proceeds from redemption of FHLB stock	5,242	8,533
Purchases of FHLB stock and other investments	(2,768)	(7,071)
Net increase in loans	(21,524)	(55,281)
Purchases of premises and equipment	(805)	(656)
Proceeds from sales of other real estate owned	266	—
Proceeds from sales of repossessed assets	1,778	1,002
Net cash (used in) provided by investing activities	(127,395)	160,593

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW
(UNAUDITED) (continued)
(in thousands)

	Three Months Ended March 31, 2013	2012
FINANCING ACTIVITIES:		
Net increase in demand and savings accounts	30,071	71,978
Net decrease in certificates of deposit	(44,734)	(83,512)
Net decrease in federal funds purchased and repurchase agreements	(127)	(1,019)
Proceeds from FHLB advances	942,466	2,964,409
Repayment of FHLB advances	(909,585)	(3,133,462)
Purchase of common stock	(1,899)	—
Proceeds from the issuance of common stock	306	300
Cash dividends paid	(3,395)	(2,970)
Net cash provided by (used in) financing activities	13,103	(184,276)
Net (decrease) increase in cash and cash equivalents	(95,512)	2,970
Cash and cash equivalents at beginning of period	150,630	43,238
Cash and cash equivalents at end of period	$55,118	$46,208

SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:

	2013	2012
Interest paid	$5,345	$8,009
Income taxes paid	$—	$2,000

SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:

	2013	2012
Loans transferred to other repossessed assets and real estate through foreclosure	$1,410	$872
Adjustment to pension liability	$(632)	$(489)
Declaration of 5% stock dividend	$17,056	$17,476
Unsettled trades to purchase securities	$(71,757)	$(96,171)
Unsettled trades to sell securities	$1,857	$104,065

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

In this report, the words "the Company," "we," "us," and "our" refer to the combined entities of Southside Bancshares, Inc. and its subsidiaries. The words "Southside" and "Southside Bancshares" refer to Southside Bancshares, Inc. The words "Southside Bank" and "the Bank" refer to Southside Bank (which, subsequent to the internal merger of Fort Worth National Bank ("FWNB") with and into Southside Bank, includes FWNB). "FWBS" refers to Fort Worth Bancshares, Inc., a bank holding company acquired by Southside of which FWNB was a wholly-owned subsidiary. "SFG" refers to SFG Finance, LLC (formerly Southside Financial Group, LLC) which is a wholly-owned subsidiary of the Bank as of July 15, 2011. "SSI" refers to Southside Securities, Inc., which is a wholly-owned subsidiary of Southside Bancshares, Inc.

Subsequent to December 31, 2012, we made a decision to close Southside Securities, Inc. It is our expectation that we will complete the closing in the first half of 2013.

The consolidated balance sheet as of March 31, 2013, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows and notes to the financial statements for the three-month periods ended March 31, 2013 and 2012 are unaudited; in the opinion of management, all adjustments necessary for a fair statement of such financial statements have been included. Such adjustments consisted only of normal recurring items. All significant intercompany accounts and transactions are eliminated in consolidation. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires the use of management's estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2012. For a description of our significant accounting and reporting policies, refer to Note 1 of the Notes to Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2012.

On March 28, 2013 our board of directors declared a 5% stock dividend to common stock shareholders of record as of April 18, 2013, payable on May 9, 2013. All share data has been adjusted to give retroactive recognition to stock dividends.

Accounting Pronouncements

ASU 2011-11, "Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities." ASU 2011-11 amends Topic 210, "Balance Sheet," to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. We adopted ASU 2011-11 on January 1, 2013, and it did not have a significant impact on our consolidated financial statements.

ASU 2013-02, "Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU 2013-02 requires entities to provide information about the significant amounts reclassified out of accumulated other comprehensive income by component. This update also requires companies to disclose the income statement line items impacted by any significant reclassifications. We adopted ASU 2013-02 on

January 1, 2013, and it did not have a significant impact on our consolidated financial statements.

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2. Earnings Per Share

Earnings per share on a basic and diluted basis have been adjusted to give retroactive recognition to stock dividends and is calculated as follows (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2013	2012
Basic and Diluted Earnings:		
Net income	$8,525	$10,139
Basic weighted-average shares outstanding	17,857	18,191
Add: Stock options	20	13
Diluted weighted-average shares outstanding	17,877	18,204
Basic Earnings Per Share:	$0.48	$0.56
Diluted Earnings Per Share:	$0.48	$0.56

For the three month periods ended March 31, 2013 and 2012, there were approximately 25,000 and 8,000 anti-dilutive shares, respectively.

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3. Accumulated Other Comprehensive (Loss) Income

The changes in accumulated other comprehensive income by component are as follows (in thousands):

	Three Months Ended March 31, 2013				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Balance, January 1, 2013, net of tax	$30,500	$(1,140)	$248	$(26,670)	$2,938
Other comprehensive loss (income):					
Other comprehensive (loss) gain before reclassifications	(4,827)	(398)	—	—	(5,225)
Reclassified from accumulated other comprehensive income	(4,365)	42	(11)	643	(3,691)
Income tax benefit	3,217	125	4	(225)	3,121
Net current-period other comprehensive loss, net of tax	(5,975)	(231)	(7)	418	(5,795)
Balance, March 31, 2013, net of tax	$24,525	$(1,371)	$241	$(26,252)	$(2,857)

	Three Months Ended March 31, 2012				
	Unrealized Gains (Losses) on Securities		Pension Plans		
	Other	OTTI	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Balance, January 1, 2012, net of tax	$37,271	$(1,577)	$276	$(21,249)	$14,721
Other comprehensive loss (income):					
Other comprehensive (loss) gain before reclassifications	(4,904)	159	—	—	(4,745)
Reclassified from accumulated other comprehensive income	(5,972)	141	(10)	499	(5,342)
Income tax benefit	3,807	(105)	4	(175)	3,531
Net current-period other comprehensive loss, net of tax	(7,069)	195	(6)	324	(6,556)
Balance, March 31, 2012, net of tax	$30,202	$(1,382)	$270	$(20,925)	$8,165

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The reclassifications out of accumulated other comprehensive income into net income are presented below (in thousands):

	Three Months Ended March 31,			
	2013		2012	
Unrealized holding gains arising during period:				
Realized gain on sale of securities (1)	$4,365		$5,972	
Impairment losses (2)	(42	)	(141	)
Total before tax	4,323		5,831	
Tax expense	(1,513	)	(2,041	)
Net of tax	$2,810		$3,790	
Amortization of defined benefit pension items:				
Net loss (3)	$(643	)	$(499	)
Prior service credit (3)	11		10	
Total before tax	(632	)	(489	)
Tax expense	221		171	
Net of tax	$(411	)	$(318	)
Total reclassifications for the period, net of tax	$2,399		$3,472	

(1) Listed as Gain on sale of securities available for sale on the Statements of Income.
(2) Listed as Net impairment losses recognized in earnings on the Statements of Income.
(3) These accumulated other comprehensive income components are included in the computation of net periodic pension cost presented in “Note 7 - Employee Benefit Plans.”

4. Securities

The amortized cost and estimated fair value of investment and mortgage-backed securities as of March 31, 2013 and December 31, 2012, are reflected in the tables below (in thousands):

	March 31, 2013				
			Gross Unrealized Losses		
AVAILABLE FOR SALE:	Amortized Cost	Gross Unrealized Gains	OTTI	Other	Estimated Fair Value
Investment Securities:					
U.S. Government Agency Debentures	$39,215	$—	$—	$499	$38,716
State and Political Subdivisions	612,367	22,317	—	1,451	633,233
Other Stocks and Bonds	15,767	188	2,110	—	13,845
Mortgage-backed Securities: (1)					
Residential	654,539	17,730	—	568	671,701
Commercial	233,254	673	—	521	233,406
Total	$1,555,142	$40,908	$2,110	$3,039	$1,590,901

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	March 31, 2013				
			Gross Unrealized Losses		
HELD TO MATURITY:	Amortized Cost	Gross Unrealized Gains	OTTI	Other	Estimated Fair Value
Investment Securities:					
State and Political Subdivisions	$1,008	$149	$—	$—	$1,157
Mortgage-backed Securities: (1)					
Residential	186,966	7,074	—	18	194,022
Commercial	47,279	58	—	152	47,185
Total	$235,253	$7,281	$—	$170	$242,364

	December 31, 2012				
			Gross Unrealized Losses		
AVAILABLE FOR SALE:	Amortized Cost	Gross Unrealized Gains	OTTI	Other	Estimated Fair Value
Investment Securities:					
U.S. Government Agency Debentures	$61,461	$—	$—	$598	$60,863
State and Political Subdivisions	515,116	30,888	—	316	545,688
Other Stocks and Bonds	12,807	104	1,754	1	11,156
Mortgage-backed Securities: (1)					
Residential	789,356	18,003	—	999	806,360
Total	$1,378,740	$48,995	$1,754	$1,914	$1,424,067

	December 31, 2012				
			Gross Unrealized Losses		
HELD TO MATURITY:	Amortized Cost	Gross Unrealized Gains	OTTI	Other	Estimated Fair Value
Investment Securities:					
State and Political Subdivisions	$1,009	$128	$—	$—	$1,137
Mortgage-backed Securities: (1)					
Residential	245,538	8,770	—	47	254,261
Total	$246,547	$8,898	$—	$47	$255,398

(1) All mortgage-backed securities issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.

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Securities carried at fair value through income were as follows (in thousands):

	At March 31, 2013	At December 31, 2012	At December 31, 2011
Mortgage-backed Securities:			
U.S. Government Agencies	$—	$—	$30,413
Government-Sponsored Enterprises	—	—	617,346
Total	$—	$—	$647,759

Net gains and losses on securities carried at fair value through income were as follows (in thousands):

	Three Months Ended March 31,	
	2013	2012
Net (loss) gain on sales transactions	$—	$(485)
Net mark-to-market gains	—	—
Net (loss) gain on securities carried at fair value through income	$—	$(485)

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The following table represents the unrealized loss on securities for the three months ended March 31, 2013 and year ended December 31, 2012 (in thousands):

	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
As of March 31, 2013:						
Available for Sale						
U.S. Government Agency Debentures	$38,716	$499	$—	$—	$38,716	$499
State and Political Subdivisions	178,946	1,426	571	25	179,517	1,451
Other Stocks and Bonds	—	—	592	2,110	592	2,110
Mortgage-backed Securities	258,567	1,071	2,323	18	260,890	1,089
Total	$476,229	$2,996	$3,486	$2,153	$479,715	$5,149
Held to Maturity						
Mortgage-backed Securities	$38,276	$170	$—	$—	$38,276	$170
Total	$38,276	$170	$—	$—	$38,276	$170
As of December 31, 2012:						
Available for Sale						
U.S. Government Agency Debentures	$60,863	$598	$—	$—	$60,863	$598
State and Political Subdivisions	49,548	316	—	—	49,548	316
Other Stocks and Bonds	4,856	1	990	1,754	5,846	1,755
Mortgage-backed Securities	260,909	967	3,122	32	264,031	999
Total	$376,176	$1,882	$4,112	$1,786	$380,288	$3,668
Held to Maturity						
Mortgage-backed Securities	$3,251	$47	$—	$—	$3,251	$47
Total	$3,251	$47	$—	$—	$3,251	$47

When it is determined that a decline in fair value of Held to Maturity ("HTM") and Available for Sale ("AFS") securities is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and to other comprehensive income for the noncredit portion . In estimating other-than-temporary impairment losses, management considers, among other things, the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. Additionally, we do not currently intend to sell the securities and it is not more likely than not that we will be required to sell the securities before the anticipated recovery of their amortized cost basis.

The turmoil in the capital markets had a significant impact on our estimate of fair value for certain of our securities. We believe the fair values are reflective of illiquidity and credit impairment. At March 31, 2013, we have in AFS Other Stocks and Bonds, $2.7 million amortized cost basis in pooled trust preferred securities ("TRUPs"). Those securities are structured products with cash flows dependent upon securities issued by U.S. financial institutions, including banks and insurance companies. Our estimate of fair value at March 31, 2013 for the TRUPs is approximately $592,000 and reflects the market illiquidity. With the exception of the TRUPs, to the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment and mortgage-backed securities portfolio at March 31, 2013 with an other-than-temporary impairment.

Given the facts and circumstances associated with the TRUPs we performed detailed cash flow modeling for each TRUP using an industry-accepted cash flow model. Prior to loading the required assumptions into the model we reviewed the financial condition of each of the underlying issuing banks within the TRUP collateral pool that had not deferred or defaulted as of March 31, 2013. Management’s best estimate of a deferral assumption was assigned to each issuing bank based on the category in which it fell. Our analysis of the underlying cash flows contemplated various default, deferral and recovery scenarios to arrive at our best estimate of cash flows. Based on that detailed analysis, we have concluded that the other-than-temporary impairment, which captures the credit component, was estimated at $3.3 million at March 31, 2013 and December 31, 2012. The noncredit charge to

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other comprehensive income was estimated at $2.1 million and $1.8 million at March 31, 2013 and December 31, 2012, respectively. The carrying amount of the TRUPs was written down with $75,000 and $3.0 million recognized in earnings for the years ended December 31, 2010 and 2009, respectively. There was no write-down recognized in earnings during 2011 but there was an additional write-down of the TRUPs recognized in earnings in the amount of approximately $181,000 during 2012. For the three months ended March 31, 2013 and 2012, the additional write-down recognized in earnings was approximately $42,000 and $141,000, respectively. The cash flow model assumptions represent management's best estimate and consider a variety of qualitative factors, which include, among others, the credit rating downgrades, the severity and duration of the mark-to-market loss, and the structural nuances of each TRUP. Management believes that the detailed review of the collateral and cash flow modeling support the conclusion that the TRUPs had an other-than-temporary impairment at March 31, 2013. We will continue to update our assumptions and the resulting analysis each reporting period to reflect changing market conditions. Additionally, we do not currently intend to sell the TRUPs and it is not more likely than not that we will be required to sell the TRUPs before the anticipated recovery of their amortized cost basis.

The table below provides more detail on the TRUPs at March 31, 2013 (in thousands):

TRUP	Par	Credit Loss	Amortized Cost	Fair Value	Tranche	Credit Rating
1	$2,000	$1,298	$702	$65	C1	Ca
2	2,000	550	1,450	309	B1	C
3	2,000	1,450	550	218	B2	C
	$6,000	$3,298	$2,702	$592		

The following tables present a roll forward of the credit losses recognized in earnings, on AFS debt securities (in thousands):

	Three Months Ended March 31,	
	2013	2012
Balance, beginning of period	$3,256	$3,075
Additions for credit losses recognized on debt securities that had previously incurred impairment losses	42	141
Balance, end of period	$3,298	$3,216

Interest income recognized on securities for the periods presented (in thousands):

	Three Months Ended March 31,	
	2013	2012
U.S. Treasury	$17	$—
U.S. Government Agency Debentures	212	—
State and Political Subdivisions	4,048	2,674
Other Stocks and Bonds	45	24
Mortgage-backed Securities	3,936	12,163
Total interest income on securities	$8,258	$14,861

There were no securities transferred from AFS to HTM during the three months ended March 31, 2013 or 2012. There were no sales from the HTM portfolio during the three months ended March 31, 2013 or 2012. There were $235.3 million and $246.5 million of securities classified as HTM at March 31, 2013 and December 31, 2012, respectively.

Of the $4.4 million in net securities gains from the AFS portfolio for the three months ended March 31, 2013, there were $5.5 million in realized gains and approximately $1.1 million in realized losses. Of the $6.0 million in net securities gains from the AFS portfolio for the three months ended March 31, 2012, there were $6.0 million in realized gains and approximately $3,000 in realized losses.

The amortized cost and fair value of securities at March 31, 2013, are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are presented in total by category due to the fact that mortgage-backed securities typically are issued with stated principal amounts,

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and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the security holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

	March 31, 2013	
	Amortized Cost	Fair Value
Available for sale securities:	(in thousands)	
Investment Securities		
Due in one year or less	$3,161	$3,174
Due after one year through five years	29,694	30,248
Due after five years through ten years	142,304	145,638
Due after ten years	492,190	506,734
	667,349	685,794
Mortgage-backed securities	887,793	905,107
Total	$1,555,142	$1,590,901

	March 31, 2013	
	Amortized Cost	Fair Value
Held to maturity securities:	(in thousands)	
Investment Securities		
Due in one year or less	$—	$—
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	1,008	1,157
	1,008	1,157
Mortgage-backed securities	234,245	241,207
Total	$235,253	$242,364

Investment and mortgage-backed securities with book values of $934.5 million and $945.7 million were pledged as of March 31, 2013 and December 31, 2012, respectively, to collateralize Federal Home Loan Bank (“FHLB”) advances, repurchase agreements, and public funds or for other purposes as required by law.

Securities with limited marketability, such as FHLB stock and other investments, are carried at cost, which approximates its fair value and assessed for other-than-temporary impairment. These securities have no maturity date.

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5. Loans and Allowance for Probable Loan Losses

Loans in the accompanying consolidated balance sheets are classified as follows (in thousands):

	March 31, 2013	December 31, 2012
Real Estate Loans:		
Construction	$119,326	$113,744
1-4 Family residential	376,421	368,845
Other	242,571	236,760
Commercial loans	160,831	160,058
Municipal loans	215,869	220,947
Loans to individuals	166,629	162,623
Total loans	1,281,647	1,262,977
Less: Allowance for loan losses	18,542	20,585
Net loans	$1,263,105	$1,242,392

Allowance for Loan Losses

The allowance for loan losses is based on the most current review of the loan portfolio and is validated by multiple processes. First, the bank utilizes historical data to establish general reserve amounts for each class of loans. Previously, a review of data for one year was used to establish a general reserve. Beginning in the fourth quarter of 2012, an average three-year history of annualized net charge-offs against the average portfolio balance for that time period is utilized. The historical charge-off figure is further adjusted through qualitative factors that include general trends in past dues, nonaccruals and classified loans to more effectively and promptly react to both positive and negative movements. Management feels this change in methodology is appropriate to accurately estimate the bank's inherent losses in the current fragile economic climate. Second, our lenders have the primary responsibility for identifying problem loans and estimating necessary reserves based on customer financial stress and underlying collateral. These recommendations are reviewed by the senior lender, the Special Assets department, and the Loan Review department. Third, the Loan Review department does independent reviews of the portfolio on an annual basis. The Loan Review department follows a board-approved annual loan review scope. The loan review scope encompasses a number of metrics that takes into consideration the size of the loan, the type of credit extended, the seasoning of the loan along with the performance of the loan. The loan review scope as it relates to size, focuses more on larger dollar loan relationships, typically, for example, aggregate debt of $500,000 or greater. The loan review officer also tracks specific reserves for loans by type compared to general reserves to determine trends in comparative reserves as well as losses not reserved for prior to charge-off to determine the effectiveness of the specific reserve process.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $50,000 or more is updated on a quarterly basis in order to properly determine necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

For loans to individuals, the methodology associated with determining the appropriate allowance for losses on loans primarily consists of an evaluation of individual payment histories, remaining term to maturity and underlying collateral support.

Industry and our own experience indicates that a portion of our loans will become delinquent and a portion of the loans will require partial or full charge-off. Regardless of the underwriting criteria utilized, losses may be experienced as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit of the borrower and the ability of the borrower to make payments on the loan. Our determination of the appropriateness of the allowance for loan losses is based on various considerations, including an analysis of

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the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which would have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, the views of the bank regulators (who have the authority to require additional allowances in accordance with GAAP), and geographic and industry loan concentration.

Consumer loans at SFG are reserved for based on general estimates of loss at the time of purchase for current loans. SFG loans experiencing past due status or extension of maturity characteristics are reserved for at significantly higher levels based on the circumstances associated with each specific loan. In general the reserves for SFG are calculated based on the past due status of the loan. For reserve purposes, the portfolio has been segregated by past due status and by the remaining term variance from the original contract. During repayment, loans that pay late will take longer to pay out than the original contract. Additionally, some loans may be granted extensions for extenuating payment circumstances and evaluated for troubled debt classification. The remaining term extensions increase the risk of collateral deterioration and, accordingly, reserves are increased to recognize this risk.

New pools purchased are reserved following the expiration of their respective recourse period at their estimated annual loss. Additionally, we use data mining measures to track migration within risk tranches. Reserves are adjusted quarterly to match the migration metrics.

Credit Quality Indicators

We categorize loans into risk categories on an ongoing basis, based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We use the following definitions for risk ratings:

- Satisfactory (Rating 1 – 4) – This rating is assigned to all satisfactory loans. This category, by definition, should consist of acceptable credit. Credit and collateral exceptions should not be present, although their presence would not necessarily prohibit a loan from being rated Satisfactory, if deficiencies are in process of correction. These loans will not be included in the Watch List.

- Satisfactory (Rating 5) – Special Treatment Required – (Pass Watch) – These loans require some degree of special treatment, but not due to credit quality. This category does not include loans specially mentioned or adversely classified by the Loan Review Officer or regulatory authorities; however, particular attention must be accorded such credits due to characteristics such as:

- A lack of, or abnormally extended payment program;
- A heavy degree of concentration of collateral without sufficient margin;
- A vulnerability to competition through lesser or extensive financial leverage; and
- A dependence on a single, or few customers, or sources of supply and materials without suitable substitutes or alternatives.

- Special Mention (Rating 6) – A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

- Substandard (Rating 7) – Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

- Doubtful (Rating 8) – Loans classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation, in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

- Loss (Rating 9) – Loans classified as Loss are currently in the process of being charged off and are fully reserved. They are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

Loans that are accruing and not considered troubled debt restructurings ("TDR") are reserved for as a group of similar type credits and included in the general portion of the allowance for loan losses.

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The general portion of the loan loss allowance is reflective of historical charge-off levels for similar loans adjusted for changes in current conditions and other relevant factors. These factors are likely to cause estimated losses to differ from historical loss experience and include:

- Changes in lending policies or procedures, including underwriting, collection, charge-off, and recovery procedures;
- Changes in local, regional and national economic and business conditions including entry into new markets;
- Changes in the volume or type of credit extended;
- Changes in the experience, ability, and depth of lending management;
- Changes in the volume and severity of past due, nonaccrual, restructured, or classified loans;
- Changes in loan review or Board oversight;
- Changes in the level of concentrations of credit; and
- Changes in external factors, such as competition and legal and regulatory requirements.

The following tables detail activity in the Allowance for Loan Losses by portfolio segment for the periods presented (in thousands):

	Three Months Ended March 31, 2013							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Balance at beginning of period	$2,355	$3,545	$2,290	$3,158	$633	$7,373	$1,231	$20,585
Provision (reversal) for loan losses	(125)	167	(247)	(290)	(12)	1,344	(345)	492
Loans charged off	—	(228)	(46)	(71)	—	(2,807)	—	(3,152)
Recoveries of loans charged off	17	4	5	50	—	541	—	617
Balance at end of period	$2,247	$3,488	$2,002	$2,847	$621	$6,451	$886	$18,542

	Three Months Ended March 31, 2012							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Balance at beginning of period	$2,620	$1,957	$3,051	$2,877	$619	$6,244	$1,172	$18,540
Provision (reversal) for loan losses	49	339	12	355	(11)	2,311	(3)	3,052
Loans charged off	(8)	(11)	—	(88)	—	(2,123)	—	(2,230)
Recoveries of loans charged off	21	5	2	198	—	486	—	712
Balance at end of period	$2,682	$2,290	$3,065	$3,342	$608	$6,918	$1,169	$20,074

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment based on impairment method as described in the allowance for loan losses methodology discussion (in thousands):

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	As of March 31, 2013							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Ending balance – individually evaluated for impairment	$81	$216	$147	$492	$—	$131	$—	$1,067
Ending balance – collectively evaluated for impairment	2,166	3,272	1,855	2,355	621	6,320	886	17,475
Balance at end of period	$2,247	$3,488	$2,002	$2,847	$621	$6,451	$886	$18,542

	As of December 31, 2012							
	Real Estate							
	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Unallocated	Total
Ending balance – individually evaluated for impairment	$200	$222	$243	$631	$—	$175	$—	$1,471
Ending balance – collectively evaluated for impairment	2,155	3,323	2,047	2,527	633	7,198	1,231	19,114
Balance at end of period	$2,355	$3,545	$2,290	$3,158	$633	$7,373	$1,231	$20,585

The following table details activity of the Reserve for Unfunded Loan Commitments for the periods presented (in thousands):

	Three Months Ended March 31,	
	2013	2012
Reserve For Unfunded Loan Commitments:		
Balance at beginning of period	$5	$26
Provision (reversal) for losses on unfunded loan commitments	—	—
Balance at end of period	$5	$26

The following table sets forth the balance in the recorded investment in loans by portfolio segment based on impairment method as described in the allowance for loan losses methodology discussion for the periods presented (in thousands):

	Real Estate						
March 31, 2013	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total

Loans individually evaluated for impairment	$1,547	$3,236	$2,005	$2,001	$—	$464	$9,253
Loans collectively evaluated for impairment	117,779	373,185	240,566	158,830	215,869	166,165	1,272,394
Total ending loan balance	$119,326	$376,421	$242,571	$160,831	$215,869	$166,629	$1,281,647

	Real Estate						
December 31, 2012	Construction	1-4 Family Residential	Other	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$2,465	$2,799	$2,613	$2,043	$—	$594	$10,514
Loans collectively evaluated for impairment	111,279	366,046	234,147	158,015	220,947	162,029	1,252,463
Total ending loan balance	$113,744	$368,845	$236,760	$160,058	$220,947	$162,623	$1,262,977

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The following table sets forth loans by credit quality indicator for the periods presented (in thousands):

March 31, 2013	Pass	Pass Watch	Special Mention	Substandard	Doubtful	Loss	Total
Real Estate Loans:							
Construction	$112,100	$—	$3,654	$3,502	$70	$—	$119,326
1-4 Family residential	366,677	1,776	1,491	5,380	1,097	—	376,421
Other	231,700	2,663	5,024	3,076	108	—	242,571
Commercial loans	154,549	894	12	4,561	815	—	160,831
Municipal loans	215,514	—	—	355	—	—	215,869
Loans to individuals	165,629	69	4	617	304	6	166,629
Total	$1,246,169	$5,402	$10,185	$17,491	$2,394	$6	$1,281,647

December 31, 2012	Pass	Pass Watch	Special Mention	Substandard	Doubtful	Loss	Total
Real Estate Loans:							
Construction	$106,091	$—	$3,637	$3,941	$75	$—	$113,744
1-4 Family residential	360,282	1,805	170	5,711	877	—	368,845
Other	226,394	2,721	4,073	3,319	253	—	236,760
Commercial loans	153,774	731	—	4,690	863	—	160,058
Municipal loans	220,388	204	—	355	—	—	220,947
Loans to individuals	161,458	27	4	723	393	18	162,623
Total	$1,228,387	$5,488	$7,884	$18,739	$2,461	$18	$1,262,977

The following table sets forth nonperforming assets for the periods presented (in thousands):

	At March 31, 2013	At December 31, 2012
Nonaccrual loans	$8,570	$10,314
Accruing loans past due more than 90 days	2	15
Restructured loans	3,317	2,998
Other real estate owned	584	686
Repossessed assets	108	704
Total Nonperforming Assets	$12,581	$14,717

Nonaccrual and Past Due Loans

Nonaccrual loans are those loans which are 90 days or more delinquent and collection in full of both the principal and interest is in doubt. Additionally, some loans that are not delinquent may be placed on nonaccrual status due to doubts about full collection of principal or interest. When a loan is categorized as nonaccrual, the accrual of interest is discontinued and any accrued balance is reversed for financial statement purposes. Payments of contractual interest are recognized as income only to the extent that full recovery of the principal balance of the loan is reasonably certain. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Other factors, such as the value of collateral securing the loan and the financial condition of the borrower must be considered in judgments as to potential loan loss.

Loans are considered impaired if, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is generally based on the present value of the expected future cash flows discounted at the historical effective

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interest rate stipulated in the loan agreement, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral. In measuring the fair value of the collateral, in addition to relying on third party appraisals, we use assumptions such as discount rates, and methodologies, such as comparison to the recent selling price of similar assets, consistent with those that would be utilized by unrelated third parties performing a valuation. Loans that are evaluated and determined not to meet the definition of an impaired loan are reserved for at the general reserve rate for its appropriate class.

Nonaccrual loans and accruing loans past due more than 90 days include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table sets forth the recorded investment in nonaccrual and accruing loans past due more than 90 days by class of loans for the periods presented (in thousands):

	March 31, 2013		December 31, 2012	
	Nonaccrual	Accruing Loans Past Due More Than 90 Days	Nonaccrual	Accruing Loans Past Due More Than 90 Days
Real Estate Loans:				
Construction	$1,505	$—	$2,416	$—
1-4 Family residential	2,155	—	2,001	—
Other	776	—	1,357	—
Commercial loans	1,738	—	1,812	—
Loans to individuals	2,396	2	2,728	15
Total	$8,570	$2	$10,314	$15

The following tables present the aging of the recorded investment in past due loans by class of loans (in thousands):

	March 31, 2013					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Real Estate Loans:						
Construction	$352	$—	$1,505	$1,857	$117,469	$119,326
1-4 Family residential	4,913	127	2,155	7,195	369,226	376,421
Other	634	11	776	1,421	241,150	242,571
Commercial loans	785	34	1,738	2,557	158,274	160,831
Municipal loans	355	—	—	355	215,514	215,869
Loans to individuals	4,122	578	2,398	7,098	159,531	166,629
Total	$11,161	$750	$8,572	$20,483	$1,261,164	$1,281,647

	December 31, 2012					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Real Estate Loans:						
Construction	$1,589	$—	$2,416	$4,005	$109,739	$113,744
1-4 Family residential	4,450	977	2,001	7,428	361,417	368,845
Other	1,639	273	1,357	3,269	233,491	236,760
Commercial loans	769	175	1,812	2,756	157,302	160,058
Municipal loans	709	—	—	709	220,238	220,947

Loans to individuals	5,908	1,191	2,743	9,842	152,781	162,623
Total	$15,064	$2,616	$10,329	$28,009	$1,234,968	$1,262,977

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The following table sets forth interest income recognized on nonaccrual and restructured loans by class of loans for the periods presented. Average recorded investment is reported on a year-to-date basis (in thousands):

	Three Months Ended					
	March 31, 2013			March 31, 2012		
	Average Recorded Investment	Interest Income Recognized	Accruing Interest at Original Contracted Rate	Average Recorded Investment	Interest Income Recognized	Accruing Interest at Original Contracted Rate
Real Estate Loans:						
Construction	$2,194	$—	$40	$3,793	$3	$68
1-4 Family residential	3,034	8	35	2,799	28	43
Other	2,379	11	36	1,534	7	31
Commercial loans	2,050	2	30	1,922	1	27
Loans to individuals	3,379	64	179	3,105	31	88
Total	$13,036	$85	$320	$13,153	$70	$257

The following table sets forth impaired loans by class of loans for the periods presented (in thousands):

March 31, 2013	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance for Loan Losses
Real Estate Loans:					
Construction	$2,602	$—	$1,547	$1,547	$81
1-4 Family residential	3,392	—			