Independent Bankers Financial Corporation and Subsidiaries

Auditor's Report and Consolidated Financial Statements
December 31, 2019 and 2018

C O N T E N T S

BKD
CPAs & Advisors

14241 Dallas Parkway, Suite 1100 | Dallas, TX 75254-2961
972.702.8262 | Fax 972.702.0673 | bkd.com

Independent Auditor's Report

Board of Directors
Independent Bankers Financial Corporation
and Subsidiaries
Farmers Branch, Texas

We have audited the accompanying consolidated financial statements of Independent Bankers Financial Corporation and Subsidiaries (Corporation), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements. We also have audited the Corporation's internal control over financial reporting as of December 31, 2019, based on criteria established in the *Internal Control - Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Management's Responsibility for the Consolidated Financial Statements and Internal Control over Financial Reporting

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying Management's Report – FDICIA Requirements.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Corporation's internal control over financial reporting based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of consolidated financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of consolidated financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also involves obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audits were conducted to meet the reporting requirements of Section 112 of the *Federal Deposit Insurance Corporation Improvement Act* (FDICIA), our audit of the Corporation's internal control over financial reporting included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and with the instructions to the Parent Company Only Financial Statements for Small Holding Companies – (Form FR Y-9SP). An entity's internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Opinions

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Independent Bankers Financial Corporation and Subsidiaries as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in the *Internal Control - Integrated Framework* (2013), issued by the COSO.

BKD, LLP

Dallas, Texas
March 25, 2020

MANAGEMENT'S REPORT – FDICIA REQUIREMENTS

Statement of Management's Responsibilities
The management of Independent Bankers Financial Corporation (Corporation) is responsible for preparing the Corporation's annual financial statements in accordance with accounting principles generally accepted in the United States of America; for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions to the Parent Company Only Financial Statements for Small Holding Companies (Form FR Y-9SP); and for complying with the federal laws and regulations pertaining to insider loans and the federal and, if applicable, state laws and regulations pertaining to dividend restrictions.

Management's Assessment of Compliance with Designated Laws and Regulations
Management has assessed the Corporation's compliance with the federal laws and regulations pertaining to insider loans and the federal and state laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2019. Based upon its assessment, management has concluded that the Corporation complied with the federal laws and regulations pertaining to insider loans and the federal and state laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2019.

Management's Assessment of Internal Control Over Financial Reporting
The Corporation's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America and financial statements for regulatory reporting purposes, *i.e*., Form FR Y-9SP. The Corporation's internal control over financial reporting includes those policies and procedures that *(a)* pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation; *(b)* provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and financial statements for regulatory reporting purposes, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and *(c)* provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the Corporation's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Corporation's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the Call Report Instructions, as of December 31, 2019, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework* (2013). Based upon its assessment, management has concluded that, as of December 31, 2019, the Corporation's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the Call Report Instructions, is effective based on the criteria established in *Internal Control – Integrated Framework* (2013).

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the Call Report Instructions, as of December 31, 2019, has been audited by BKD LLP, an independent public accounting firm, as stated in their report dated March 25, 2020.

Mr. Michael O'Rourke
President, Independent Bankers Financial Corporation
President and Chief Executive Officer, TIB The Independent BankersBank, National Association

Mr. Charles M. Phelan
Vice President, Independent Bankers Financial Corporation
Executive Vice President and Chief Financial Officer, TIB The Independent BankersBank, National Association

Mrs. Terri Blanton
Senior Vice President and Director of Financial Reporting, TIB The Independent BankersBank, National Association

Mr. Kyle R. Garner
First Vice President and Director of Internal Audit, TIB The Independent BankersBank, National Association

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Balance Sheets
December 31, 2019 and 2018
(Dollar amounts in thousands, except per share amounts)

	2019	2018
Assets		
Cash and due from banks	$ 39,016	$ 26,752
Interest-bearing deposits in banks	987,623	845,678
Federal funds sold and securities purchased under agreements to resell	24,815	60,583
Cash and cash equivalents	1,051,454	933,013
Available-for-sale securities	337,521	390,435
Loans held for sale	9,516	2,765
Loans, net of allowance for loan losses of $14,091 and $13,091 at 2019 and 2018, respectively	1,195,320	1,048,548
Premises and equipment, net of accumulated depreciation of $12,220 and $10,507 at 2019 and 2018, respectively	23,508	24,367
Federal Reserve and Federal Home Loan Bank stock	3,501	14,962
Interest receivable	8,333	8,512
Deferred income taxes	5,320	6,109
Mortgage servicing rights	1,795	2,715
Cash surrender value of life insurance	56,379	55,059
Goodwill	2,000	2,000
Core deposits and other intangibles	721	1,568
Other	18,260	23,633
Total Assets	$ 2,713,628	$ 2,513,686

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Balance Sheets (Continued)
December 31, 2019 and 2018
(Dollar amounts in thousands, except per share amounts)

	2019	2018
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Demand	$ 402,756	$ 391,901
Interest-bearing	1,890,403	1,469,445
Total deposits	2,293,159	1,861,346
Short-term borrowings	97,080	78,251
Federal Home Loan Bank advances	-	280,000
Junior subordinated debentures	-	10,313
Derivatives	2,326	-
Interest payable and other liabilities	41,456	26,456
Total liabilities	2,434,021	2,256,366
Shareholders' Equity		
Common stock, $10 par value; 5,000,000 shares authorized, 1,118,827 and 1,118,828 shares issued and outstanding in 2019 and 2018, respectively	11,188	11,188
Additional paid-in capital	32,843	32,843
Retained earnings	231,597	215,738
Accumulated other comprehensive income (loss)	3,979	(2,449)
Total shareholders' equity	279,607	257,320
Total Liabilities and Shareholders' Equity	$ 2,713,628	$ 2,513,686

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statements of Income
Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands)

	2019	2018
Interest Income		
Loans, including fees, taxable	$ 46,208	$ 40,560
Loans, including fees, tax exempt	7,421	7,107
Securities	9,630	10,926
Federal funds sold and securities purchased under agreements to resell	1,837	2,264
Deposits with financial institutions	18,678	14,582
Other	205	270
Total interest income	83,979	75,709
Interest Expense		
Deposits	38,510	31,872
Short-term borrowings	1,534	1,535
Junior subordinated debentures and other borrowings	470	1,665
Total interest expense	40,514	35,072
Net Interest Income	43,465	40,637
Provision for Loan Losses	3,242	2,204
Net Interest Income After Provision for Loan Losses	40,223	38,433
Noninterest Income		
Credit card fees	42,845	41,890
Safekeeping fees	3,680	2,173
Mortgage servicing fees	1,004	3,090
Customer security transaction fees	4,872	3,536
Audit and loan review fees	2,625	2,813
Gain on sale of loans	3,369	2,496
Other	8,568	11,627
Total noninterest income	66,963	67,625

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statements of Income (Continued)
Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands)

	2019	2018
Noninterest Expense		
Credit card	$ 17,662	$ 18,515
Salaries and employee benefits	39,254	39,578
Premises, furniture and equipment	4,368	4,195
Telephone	1,607	1,613
Software	4,333	4,072
Mortgage operations	1,124	2,103
Decrease in fair value of mortgage servicing rights	920	-
Loss on non-hedging derivative transactions	-	1,352
Item processing	346	690
Intangible amortization	885	1,412
Professional fees	2,103	1,896
Other	9,328	8,435
Total noninterest expense	81,930	83,861
Income Before Income Taxes	25,256	22,197
Provision for Income Taxes	3,803	2,976
Net Income	$ 21,453	$ 19,221

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands)

	2019	2018
Net Income	$ 21,453	$ 19,221
Other Comprehensive Income (Loss)		
Change in fair value of interest rate swap contracts	(5,739)	2,372
Net tax effect	1,205	(498)
Change in fair value of interest rate swap contracts, net	(4,534)	1,874
Change in unrealized gains/(losses) on available-for-sale securities	13,876	(9,174)
Net tax effect	(2,914)	1,927
Unrealized gains/(losses) on available-for-sale securities, net	10,962	(7,247)
Total other comprehensive income (loss)	6,428	(5,373)
Comprehensive Income	$ 27,881	$ 13,848

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands, except per share amounts)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance as of January 1, 2018	$ 11,188	$ 32,845	$ 201,511	$ 2,406	$ 247,950
Net income	-	-	19,221	-	19,221
Other comprehensive loss	-	-	-	(5,373)	(5,373)
Reclassify stranded tax effects due to 2017 tax law changes	-	-	(518)	518	-
Purchase and retirement of common stock (10 shares)	-	(3)	-	-	(3)
Issuance of common stock (5 shares)	-	1	-	-	1
Common stock dividends declared ($4.00 per share)	-	-	(4,476)	-	(4,476)
Balance as of December 31, 2018	11,188	32,843	215,738	(2,449)	257,320
Net income	-	-	21,453	-	21,453
Other comprehensive income	-	-	-	6,428	6,428
Purchase and retirement of common stock (5 shares)	-	(1)	-	-	(1)
Issuance of common stock (4 shares)	-	1	-	-	1
Common stock dividends ($5.00 per share)	-	-	(5,594)	-	(5,594)
Balance as of December 31, 2019	$ 11,188	$ 32,843	$ 231,597	$ 3,979	$ 279,607

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statements of Cash Flows
Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands)

	2019	2018
Operating Activities		
Net income	$ 21,453	$ 19,221
Items not requiring (providing) cash:		
Depreciation and amortization	5,431	6,806
Provision for loan losses	3,242	2,204
Deferred income taxes	(919)	(3,923)
Deferred compensation and stock-based compensation expense	3,793	2,962
Change in fair value of mortgage servicing rights	920	(59)
Net gains on sale of loans	(3,369)	(2,496)
Net realized losses on available-for-sale securities	8	5
Net realized (gains) losses on non-hedging derivative financial instruments	-	1,352
Income from death benefit of bank-owned life insurance	-	(1,382)
Net realized other (gains) losses	(37)	564
Originations and purchases of loans held for sale	(232,018)	(264,693)
Proceeds from sale of loans held for sale	228,636	274,692
Change in:		
Interest receivable	179	(1,760)
Other assets	(43)	(2,661)
Interest payable and other liabilities	11,223	4,247
Net cash provided by operating activities	38,499	35,079
Investing Activities		
Purchases of available-for-sale securities	(999,650)	(1,016,876)
Proceeds from maturities, calls and pay downs of available-for-sale securities	64,375	69,395
Proceeds from the sale of available-for-sale securities	999,690	999,502
Purchases of mortgage servicing rights	-	(620)
Proceeds from (investment in) non-hedging derivative financial instruments	-	(1,902)
Purchase of Federal Home Loan Bank stock	(35,067)	(48,404)
Proceeds from Federal Home Loan Bank stock	46,528	43,155
Net change in loans	(150,014)	(57,972)
Proceeds of redemption of junior subordinated debentures	313	615
Redemption of cash surrender value of life insurance	-	4,667
Proceeds from the sale of fixed assets	37	38
Proceeds from the sale of mortgage servicing rights	-	16,703
Purchase of premises and equipment	(1,005)	(1,266)
Proceeds from the sale of foreclosed assets held for sale	-	147
Net cash (used in) provided by investing activities	(74,793)	7,182

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Continued)
Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands)

	2019	2018
Financing Activities		
Net change in deposits	$ 431,813	$ (95,040)
Net change in federal funds purchased and securities sold under agreements to repurchase	18,829	3,078
Repayments on Federal Home Loan Bank advances	(860,000)	(975,000)
Proceeds from Federal Home Loan Bank advances	580,000	1,105,000
Repurchase of junior subordinated debentures	(10,313)	(20,615)
Purchase and retirement of common stock	(1)	(3)
Proceeds from issuance of common stock	1	1
Dividends paid	(5,594)	(4,476)
Net cash provided by financing activities	154,735	12,945
Increase in Cash and Cash Equivalents	118,441	55,206
Cash and Cash Equivalents, Beginning of Year	933,013	877,807
Cash and Cash Equivalents, End of Year	$ 1,051,454	$ 933,013
Supplemental Cash Flows Information		
Interest paid	$ 40,772	$ 34,849
Income taxes paid	5,530	6,987

NOTE 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Independent Bankers Financial Corporation and Subsidiaries (the Corporation) is a bank holding company whose principal activity is the ownership and management of its wholly owned subsidiary, TIB The Independent BankersBank, National Association (the Bank). The Bank is defined by statute as a "bankers' bank." The Bank provides services to financial institutions in the United States, many of which are shareholders of the Corporation. The bank competes with other financial institutions and bank-service organizations. The statute requires shareholders to be depository institutions or holding companies for depository institutions. The Federal Reserve System and Office of the Comptroller of the Currency federally regulate the Corporation and Bank, respectively.

Principles of Consolidation

The consolidated financial statements include the accounts of Independent Bankers Financial Corporation (IBFC), the Bank and two nonbanking subsidiaries: ALX Consulting, Inc., (ALX) and TIB Service Company dba TIB Bequeaith Banking Solutions. The Corporation also owns IBFC Statutory Capital Trust II (Trust II). See Note 21 for more information on Trust II. The Corporation eliminated all significant intercompany accounts and transactions in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Estimates susceptible to significant change include the allowance for loan losses, valuation of real estate acquired in foreclosures, mortgage servicing rights, deferred tax assets, other-than-temporary impairments and fair values of financial instruments.

Cash and Cash Equivalents

Cash equivalents consist primarily of cash items, amounts due from banks, interest-bearing deposits, federal funds sold and securities purchased under agreements to resell all with original maturities within three months. Counterparties comply with credit risk parameters established by management.

At December 31, 2019, the Corporation had bank accounts exceeding FDIC insured limits by approximately $278,496.

Overnight federal funds sold are uncollateralized loans to other financial institutions.

Interest-bearing Deposits in Banks

Interest-bearing deposits in banks mature within one year and are carried at cost.

Securities

Management determines the classification of securities as available-for-sale, held-to-maturity, or trading when purchased based on the intent and objective of the investment and the ability to hold to maturity. Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities. The Corporation had only available-for-sale securities at the report date.

Securities available-for-sale are reported at fair value, with unrealized gains and losses reported as a separate component of shareholders' equity and other comprehensive income (loss), net of taxes. These securities can be sold in response to interest rate changes, changes in prepayment risk, and other similar reasons. Securities are designated as available-for-sale for earnings and liquidity purposes.

Interest on investment securities is recorded as income from securities as earned. Purchased premiums and discounts are amortized and accreted, respectively, to interest income from securities using a prospective method. Realized gains and losses are recorded as net security gain (losses). Gains and losses on the sale of securities are determined using the specific identification method.

For debt securities with fair values below amortized cost when the Corporation does not intend to sell a debt security, and it is more likely than not the Corporation will not have to sell the security before recovery of its cost basis, the credit component of an other-than-temporary impairment of a debt security is recognized in earnings and the remaining portion in other comprehensive income (loss).

Loans Held for Sale

Mortgage loans are purchased from respondent banks and resold in the secondary market in the normal course of the Corporation's business. The loans are classified as held-for-sale and carried at the lower of cost or fair value in the aggregate. Write-downs to fair value are recognized through a valuation allowance as a charge to noninterest expense at the time the decline in value occurs. Gains and losses arising from individual loan buying and selling activity are determined using the specific identification method and are recorded in noninterest income.

Loans

Loans the Corporation has the intent and ability to hold for the foreseeable future, or until maturity, or payoff are reported at their outstanding principal balances adjusted for charge-offs and the allowance for loan losses.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Interest accrual is discontinued when the loan is 90 days past due unless the credit is well-secured and in process of collection. When collection of principal or interest is doubtful, loans are put on nonaccrual or charged-off.

Interest accrued but not collected for these loans is reversed against interest income. The interest is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Accrual status is restored when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses

The allowance for loan losses is established through provisions for loan losses charged against income. Provisions to the allowance for loan losses are based on management’s analysis and evaluation of the loan portfolio. Management considers identification of problem credits, internal and external factors affecting collectability, relevant credit exposure, inherent risks in sector lending and collateral values. In management’s estimation, the allowance is adequate to absorb probable credit losses on existing loans that may become uncollectible and probable credit losses inherent in the remainder of the loan portfolio. This estimate is highly subjective and subjected to several internal and external reviews.

The allowance consists of allocated and general components. The allocated component relates to loans classified as impaired. For those loans classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical charge-off experience and expected loss given the default rate derived from the Corporation's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality not fully reflected in the historical loss or risk rating data.

A loan is impaired when, principal or interest probably cannot be collected according to the contractual terms of the loan agreement or through its collateral. Loans that experience insignificant payment delays and payment shortfalls are not classified as impaired. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans.

Loan losses are charged against the allowance when management believes a loan balance is partially or wholly uncollectable. Subsequent recoveries are credited to the allowance.

Premises and Equipment

Depreciable assets are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are capitalized and depreciated using the straight-line method over the respective lease term or the estimated useful lives of the improvements, whichever is shorter. Expected terms include lease option periods if exercising such options is reasonably assured.

The estimated useful lives for each major depreciable classification of premises and equipment are:

Buildings	- 30 years
Building improvements	10 - 20 years
Leasehold improvements	5 10 years
Furniture and equipment	3 10 years

Long-lived Asset Impairment

Management evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended December 31, 2019 and 2018.

Federal Reserve Bank of Dallas and Federal Home Loan Bank of Dallas Stock

Federal Reserve Bank of Dallas and Federal Home Loan Bank of Dallas (FHLB) stock are required investments for membership. The required investment in the common stock is based on a predetermined formula. The stock is carried at cost and periodically evaluated for impairment.

Foreclosed Assets Held for Sale

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure, establishing a new cost basis. After foreclosure, the Corporation periodically receives valuations on the assets and makes any adjustments to carry at the lower of carrying amount or fair value, less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net income or expense from foreclosed assets.

Equity Method Investments

The Corporation uses the equity method of accounting for investments in entities in which it has an ownership interest but does not exercise a controlling interest in the operating and financial policies of an investee and for VIEs for which it is not considered the primary beneficiary. Under this method, an investment is carried at the acquisition cost, plus the Corporation's equity in undistributed earnings or losses since acquisition. Losses due to impairment are recorded when it is determined that the investment no longer has the ability to recover its carrying amount.

Goodwill

Goodwill is evaluated annually for impairment or more frequently if impairment indicators are present. A qualitative assessment is performed to determine whether the existence of events or circumstances leads to a determination that it is more likely than not the fair value is less than the carrying amount, including goodwill. If, based on the evaluation, it is determined to be more likely than not that the fair value is less than the carrying value, then goodwill is tested further for impairment. When the implied fair value of goodwill is less than the carrying amount, goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recorded.

Intangible Assets

Intangible assets with finite lives are amortized using the straight-line basis over periods ranging from three to ten years. Such assets are periodically evaluated for recoverability of their carrying values.

Revenue Recognition

The Company's credit card business generates significant fees from its activities. The business is organized into two segments: Merchant Acquirer and Issuer. The Merchant Acquirer unit provides card network access, payment processing, and related services to merchants. The Issuer unit serves financial institutions, and their referrals, with an assortment of credit card products and services commonly used in the marketplace.

(Dollar amounts in thousands)

Under ASC 606 Revenue from Contracts with Customers, the Company reports net revenues when appropriate. Net revenue is gross revenue less network processing fees, association fees, and others charged by the agent networks in fulfilling their electronic payment processing responsibilities. Other revenues and expenses are incurred as principal and those transactions are recorded gross. The adoption of ASC 606 did not impact the Company's net income but materially impacts the Company's noninterest interest income line item.

	December 31, 2019	December 31, 2018
Merchant and Issuer Units		
Gross revenues	74,901	72,790
Network and other expenses	(32,056)	(30,900)
Net revenues	42,845	41,890

Derivatives

The Corporation's hedging policies permit the use of various derivative financial instruments to manage interest rate risk or to hedge specified assets and liabilities. Derivatives are recognized as assets and liabilities on the consolidated balance sheets and measured at fair value. For exchange-traded contracts, fair value is based on quoted market prices. For nonexchange-traded contracts, fair value is based on dealer quotes, pricing models, discounted cash flow methodologies or similar techniques for which the determination of fair value may require significant management judgment or estimation. To qualify for hedge accounting, derivatives must be highly effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the derivative contract. A hedge is considered to be highly effective when the change in fair value of the derivative hedging instrument is within 80 percent to 120 percent of the opposite change in the fair value of the hedged item. If derivative instruments are designated as hedges of fair values, both the change in the fair value of the hedges and the hedged items are included in current earnings. Fair value adjustments related to cash flow hedges are recorded in other comprehensive income (loss). Ineffective portions of hedges are reflected in earnings as they occur. During the life of the hedge, the Corporation formally assesses whether derivatives designated as hedging instruments continue to be highly effective in offsetting changes in the fair value or cash flows of hedged items. If it is determined that a hedge has ceased to be highly effective, the Corporation will discontinue hedge accounting prospectively and the derivative instrument is reclassified to a trading position recorded at fair value.

Mortgage Servicing Assets

Mortgage servicing assets are recognized separately when rights are acquired through the purchase or sale of financial assets. Under the servicing assets and liabilities accounting guidance (Accounting Standards Codification [ASC] 860-50), servicing rights resulting from the sale of loans purchased by the Corporation are initially measured at fair value at the date of transfer. Subsequently, the Corporation measures each class of servicing asset using the fair value method. Under the fair value method, the servicing rights are carried in the consolidated balance sheets at fair value and the changes in fair value are reported in earnings in the period in which the changes occur.

Fair value is based on market prices for comparable mortgage servicing contracts, when available, or on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses. These variables change from quarter to quarter as market conditions and projected interest rates change, and may adversely impact the value of the mortgage servicing rights and may cause an increase in noninterest expense.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned.

Transactions as Agent

The Corporation acts as an agent in facilitating overnight investment transactions between participating respondent banks and the Federal Reserve System. Transactions with the Federal Reserve System are facilitated via the Excess Balance Account (EBA) pursuant to Regulation D for correspondent banks and similarly purposed institutions. The Corporation acts as intermediary for these transactions but is not otherwise obligated by the transaction. The Corporation's consolidated financial statements do not reflect these transactions except for the fees earned. At December 31, 2019 and 2018, the Corporation was agent for participating respondent banks on EBA funds totaling $2,880,827 and $2,308,583, respectively.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed surrendered when (1) the assets have been isolated from the Corporation and put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership; and (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Income Taxes

Income taxes are accounted for in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period.

The Corporation determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax basis of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Tax positions are recognized if it is more likely than not, based on the technical merits, the tax position will be realized or sustained upon examination. The term "more likely than not" means a likelihood of over 50 percent; the terms examined and upon examination, also include resolution of the related appeals or litigation processes, if any. A tax position meeting the more-likely-than-not recognition threshold is initially and subsequently measured as the largest tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority with full knowledge of all relevant information. Determining whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment. With a few exceptions, the Corporation is no longer subject to U.S. Federal, state and local tax examinations by tax authorities for years before 2017.

The Corporation recognizes interest and penalties on income taxes as a component of income tax expense.

The Corporation files consolidated income tax returns with its subsidiaries.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss), net of applicable income taxes. Other comprehensive income (loss) includes unrealized gains and losses on available-for-sale securities and unrealized and realized gains and losses in derivative financial instruments that qualify for hedge accounting.

Transfers Between Fair Value Hierarchy Levels

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs), and Level 3 (significant unobservable inputs) are recognized on the period ending date. No such transfers were made in 2019 or 2018.

Reclassifications

Certain reclassifications have been made to the 2018 consolidated financial statements to conform to the 2019 consolidated financial statement presentation. These reclassifications had no effect on net income.

Accounting Standards Updates

ASU 2016-02, "Leases (Topic 842)". ASU 2016-02 requires lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and *ASC Topic 606, "Revenue from Contracts with Customers*." The Corporation adopted ASU 2016-02 effective January 1, 2019. The Corporation elected the package of practical expedients which relieves the requirement to reassess classifications, contracts and indirect costs for existing and expired arrangements as well as the exemption for not recording leases with a term of less than 12 months. Other practical expedients were elected as well. The Corporation's leases historically have been low in volume and amount because of its business model. The Corporation does not have significant real estate holdings (property and plant) outside its wholly-owned headquarters and disaster recovery sites. Additionally, most equipment, furniture, and fixtures are purchased outright. The majority of the company's contracts are "service agreements" for software related to processing loans, deposits, securities, electronic banking and correspondent banking services. Service contracts are not covered under ASC 842. Consequently, the Corporation elected to adopt a reasonable capitalization threshold when evaluating the requirement to recognize leases on the balance sheet as permitted under ASU 2016-02. As of January 1, 2019, the present value of operating leases was below the Corporation's established capitalization threshold. Management will review the threshold and the present value of operating leases annually to determine materiality and until such time the aggregate of all leases exceeds the Corporation's capitalization threshold, leases will be expensed as incurred.

ASU 2017-08, "Receivables – Nonrefundable Fees and Other Costs (Topic 310-20): Premium Amortization on Purchased Callable Debt Securities". ASU 2017-08 amends the amortization period for purchased callable debt securities held at a premium. Specifically, the amendments shorten the amortization period by requiring that the premium be amortized to the earliest call date. Under previous US GAAP, entities generally amortized the premium as an adjustment of yield over the contractual life of the instrument. The amendments require no accounting change for securities held at a discount; the discount continues to be amortized to maturity. The Corporation adopted ASU 2017-08 effective on January 1, 2019 and its adoption had no material effect on our results of operations, financial position or financial statement disclosures.

ASU 2017-12, "Derivatives and Hedging (Topic 815) – Targeted Improvements to Accounting for Hedging". ASU 2017-12 changes both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results to better align a company's risk management activities and financial reporting for hedging relationships. In summary, this amendment 1) expands transactions eligible for hedge accounting; 2) eliminates the separate measurement and presentation of hedge ineffectiveness; 3) simplifies the requirements around the assessment of hedge effectiveness; 4) provides companies more time to finalize hedge documentation; and 5) enhances presentation and disclosure requirements. The Corporation adopted the guidance on January 1, 2019 and its adoption did not have a material effect on our results of operations, financial position or disclosures.

ASU 2017-04, "*Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment".* ASU 2017-04 eliminates Step 2 from the goodwill impairment test that required entities to compare the implied fair value of goodwill to its carrying amount. Under the amendments, the goodwill impairment will be measured as the excess of the reporting unit's carrying amount over its fair value. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total goodwill allocated to that reporting unit. ASU 2017-04 will be effective for the Corporation on January 1, 2020. We do not expect this ASU to have a material effect on our results of operations, financial position or disclosures.

ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326)": Measurement of Credit Losses on Financial Instruments." ASU 2016-13 requires earlier measurement of credit losses, expands the range of information considered in determining expected credit losses and enhances disclosures. The main objective of ASU 2016-13 is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendments replace the incurred loss impairment methodology in current US GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU 2019-10 extended the effective date for ASU 2016-13 for non SEC filers and small reporting companies. ASU 2016-13 will be effective for the Corporation on January 1, 2023. The Corporation has formed a cross functional implementation team that has initiated data gathering and begun assessment to support forecasting of asset quality, loan balances and net charge-offs. The Corporation expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but has not yet determined the extent of any such one-time adjustment or the overall impact on its results of operations, financial position or disclosures.

ASU 2018-13, "Fair Value Measurement (Topic 820) - Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement." ASU 2018-13 modifies the disclosure requirements on fair value measurements in Topic 820. The amendments in this update remove disclosures that no longer are cost beneficial, modify/clarify the specific requirements of certain disclosures, and add disclosure requirements identified as relevant. ASU 2018-13 will be effective for the Corporation on January 1, 2020, with early adoption permitted, and is not expected to have a significant impact on our financial statements.

ASU 2018-15, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) - Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract." ASU 2018-15 clarifies certain aspects of ASU 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement," which was issued in April 2015.

(Dollar amounts in thousands)

Specifically, ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). ASU 2018-15 does not affect the accounting for the service element of a hosting arrangement that is a service contract. ASU 2018-15 will be effective for the Corporation on January 1, 2020, with early adoption permitted. We do not expect this ASU to have a material effect on our financial statements.

NOTE 2. RESTRICTION ON CASH AND DUE FROM BANKS

Required reserves on deposit with the Federal Reserve Bank of Dallas at December 31, 2019 and 2018 totaled $132,979 and $155,598, respectively. The balances include respondents' reserve requirements of $95,424 and $124,879 at December 31, 2019 and 2018, respectively.

NOTE 3. SECURITIES

The amortized cost and approximate fair values, with gross unrealized gains and losses, of available-for-sale securities are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2019				
Mortgage-backed U.S Government sponsored enterprises (GSEs) - residential	$ 330,175	$ 7,346	$ -	$ 337,521
December 31, 2018				
Mortgage-backed U.S. Government sponsored enterprises - residential	$ 396,964	$ 904	$ 7,433	$ 390,435

Mortgage-backed securities owned by the Corporation are backed by pools of residential mortgages insured or guaranteed by the Federal Home Loan Mortgage Corporation (FHLMC), the Government National Mortgage Corporation (GNMA) or the Federal National Mortgage Corporation (FNMA). Mortgage-backed securities are not due at a single due date.

At December 31, 2019, there were no holdings of securities of any one issuer, other than the U.S. Government and its government sponsored entities, in an amount greater than 10 percent of shareholders' equity.

(Dollar amounts in thousands)

Securities with estimated fair values of $318,457 and $366,927 at December 31, 2019 and 2018, respectively, were pledged to secure securities sold under agreements to repurchase or lines of credit as permitted by law.

Gross losses of $8 and $5 resulting from sales of available-for-sale securities were realized for 2019 and 2018, respectively.

The following table shows available-for-sale securities with unrealized losses not deemed other-than-temporarily impaired, segregated by investment class and time in a continuous unrealized loss position at December 31, 2018. There were no available-for-sale securities in a continuous unrealized loss position at December 31, 2019.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2018						
Mortgage-backed securities U.S. GSEs - residential	$ 74,393	$ 564	$ 264,413	$ 6,869	$ 338,806	$ 7,433

At December 31, 2018, securities with unrealized losses were considered temporary and caused by interest rate changes, not credit impairment. Management has the ability and intent to hold these securities until recovery of cost.

NOTE 4. SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL

Management enters into purchases of securities under agreements to resell substantially identical securities in the normal course of business.

The amounts advanced under these agreements are recorded as assets in the consolidated balance sheets. The securities used in the transaction are taken into possession in book entry form under a custodial agreement. These agreements specify management's right to request additional collateral, based on its monitoring of the fair value of the underlying securities. There were no resell agreements outstanding at December 31, 2019 or December 31, 2018. The maximum and minimum amounts of outstanding resell agreements during 2019 were $196,069 and $0, respectively. The interest rate on these agreements is based on the federal funds rate and ranged from 2% to 3% for agreements in 2019.

(Dollar amounts in thousands)

NOTE 5. LOANS AND ALLOWANCE FOR LOAN LOSSES

Classes of loans at December 31, 2019 and 2018 include:

	2019	2018
Correspondent loans		
Bank stock	$ 179,743	$ 189,032
Real estate	305,169	299,869
Mortgage warehouse	217,437	62,932
Commercial and industrial	40,486	40,039
Consumer	1,070	816
Other	1,773	5,770
	745,678	598,458
Municipal	290,036	288,472
Credit card	166,470	167,350
Mortgage	7,227	7,359
Gross loans	1,209,411	1,061,639
Less allowance for loan losses	(14,091)	(13,091)
Net loans	$ 1,195,320	$ 1,048,548

The tables on the following pages present the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of December 31, 2019 and 2018.

(Dollar amounts in thousands)

	2019						
	Bank Stock	Real Estate	Other Correspondent	Municipal	Mortgage	Credit Card	Total
Allowance for loan losses							
Balance, beginning of year	$ 3,932	$ 6,070	$ 762	$ 248	$ 88	$ 1,991	$ 13,091
Provision charged to expense	133	576	55	28	(4)	2,454	3,242
Losses charged off	-	-	-	-	-	(2,545)	(2,545)
Recoveries	-	-	-	-	-	303	303
Balance, end of year	$ 4,065	$ 6,646	$ 817	$ 276	$ 84	$ 2,203	$ 14,091
Ending balance individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance collectively evaluated for impairment	$ 4,065	$ 6,646	$ 817	$ 276	$ 84	$ 2,203	$ 14,091
Loans							
Ending balance	$ 179,743	$ 305,169	$ 260,766	$ 290,036	$ 7,227	$ 166,470	$ 1,209,411
Ending balance individually evaluated for impairment	$ -	$ 1,594	$ -	$ -	$ 161	$ -	$ 1,755
Ending balance collectively evaluated for impairment	$ 179,743	$ 303,575	$ 260,766	$ 290,036	$ 7,066	$ 166,470	$ 1,207,656

(Dollar amounts in thousands)

	2018						
	Bank Stock	Real Estate	Other Correspondent	Municipal	Mortgage	Credit Card	Total
Allowance for loan losses							
Balance, beginning of year	$ 4,548	$ 5,615	$ 936	$ 76	$ 126	$ 1,807	$ 13,108
Provision charged to expense	(616)	493	(156)	172	(38)	2,349	2,204
Losses charged off	-	(38)	(18)	-	-	(2,651)	(2,707)
Recoveries	-	-	-	-	-	486	486
Balance, end of year	$ 3,932	$ 6,070	$ 762	$ 248	$ 88	$ 1,991	$ 13,091
Ending balance individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance collectively evaluated for impairment	$ 3,932	$ 6,070	$ 762	$ 248	$ 88	$ 1,991	$ 13,091
Loans							
Ending balance	$ 189,032	$ 299,869	$ 109,557	$ 288,472	$ 7,359	$ 167,350	$ 1,061,639
Ending balance individually evaluated for impairment	$ -	$ 1,666	$ -	$ -	$ 203	$ -	$ 1,869
Ending balance collectively evaluated for impairment	$ 189,032	$ 298,203	$ 109,557	$ 288,472	$ 7,156	$ 167,350	$ 1,059,770

Internal Risk Categories

Loan grades are numbered 1 through 10. Grades 1 through 6 are satisfactory grades. The grade of 7, or Special Mention, represents loans of lower quality and is criticized. The grades of 8, or Substandard, and 9, or Doubtful, refer to classified assets. The grade of 10, or Loss, refers to loans considered uncollectible. The use and application of these grades by the Bank will be uniform and shall conform to the Bank's policy.

- **Grade 1** – A SUPERIOR graded asset is secured by highly liquid collateral. If a loan is secured by marketable securities, it should be adequately margined. This loan grade includes Municipal Loans with the guaranty of the Permanent School Fund. A Superior asset should have no documentation deficiencies and minimal servicing issues.

- **<u>Grade 2</u>** – A STRONG graded asset is a secured loan with some form of credit enhancement, other than liquid collateral, adequately margined. This grade will typically apply to loans made to municipalities backed by the local taxing authority where law requires taxes to be sufficient to cover the debt obligation (i.e. General Obligations or Certificates of Obligations). Loans could be secured by marketable securities, but have margins lower than those in the Superior category. Loans or revolving lines of credit made to finance mortgage warehouse banking activities secured by mortgage notes, further secured by deeds of trusts, having liquid collateral able to be sold in the secondary market may also be a Strong asset. A Strong asset should have no documentation deficiencies and minimal servicing issues.

- **<u>Grade 3</u>** – A GOOD graded asset is based on an individual's or a company's financial capacity and/or secured by collateral where there is no impairment to liquidation. A Good asset may have some vulnerability to changing economic or industry conditions but is a satisfactory risk. Loans to municipalities backed by project revenues could be in this loan grade. Leveraged loans may also fall into this category.

- **<u>Grade 4</u>** – A SATISFACTORY graded asset is based on an individual's or a company's financial capacity and/or secured by collateral where there is no impairment to liquidation. A Satisfactory asset may have some deficiency or vulnerability above the norm, based on adverse economic trends and/or industry conditions but is an acceptable risk with the vulnerability noted. Borrowers typically have acceptable, but minimum debt service coverage ratios.

- **<u>Grade 5</u> –** An ACCEPTABLE graded asset is similar in repayment capacity to the above with increased vulnerability to changing economic or industry conditions based on underwriting concessions; excessive levels of guideline non-compliance (for bank stock loans); acceptable, but marginal debt service coverage ratios (for real estate loans); or acceptable, erratic financial trends but, not to the point of potential weakness. This loan grade would include unsecured or marginally secured loans to borrowers with reasonable credit risk.

- **<u>Grade 6</u> –** A PASS/NEEDS ATTENTION graded asset is used to identify loans which may have one or more of these characteristics: collateral documentation deficiencies, marginal collateral support, weak or unsupported collateral valuations, lack current or complete financial data and/or analysis, need additional monitoring, recent changes in management or operations, terms beyond policy guidelines, variations in balance sheet or cash flow/operating components or trends from prior periods or forecasts, past credit problems, high leverage, or untested performance under repayment terms, among others. This loan grade may include loan participations with a financially weak selling bank or a selling bank lacking the knowledge or expertise to lead the credit.

- **Grade 7** – A SPECIAL MENTION graded asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may cause 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.

- **Grade 8** – A SUBSTANDARD graded asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses jeopardizing the liquidation of the debt. They are characterized by the possibility that some loss will occur, if the deficiencies are not corrected.

- **Grade 9** – A DOUBTFUL graded asset has all the weaknesses inherent in a substandard loan with the added factor that the weaknesses are pronounced to a point where on the basis of current information, and values, collection or liquidation in full is highly improbable. The length of time an asset may be classified Doubtful is a matter of judgment.

- **Grade 10** – Assets classified LOSS are uncollectible and of such little value their continuance as active assets is not warranted. This classification does not necessarily indicate the asset has absolutely no recovery or salvage value, but rather its recovery may be prolonged or not expected. Assets classified Loss are promptly charged off.

Loan Origination Risk Management

Lending policies are designed to maximize loan income within an acceptable level of risk. A reporting system supplements the review process by providing management with frequent reports on credit production, credit quality, credit concentrations, credit delinquencies, and nonperforming and potential problem credits. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Loans are generally in four primary categories: correspondent, credit cards, mortgage origination and municipal.

Correspondent. Correspondent lending includes bank stock, real estate, commercial and industrial, mortgage warehouse lines, and other credit types. Correspondent loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral. Underwriting procedures are designed to evaluate past, current and projected cash flows to determine the ability of the borrower to repay obligations as agreed and assess the borrower's ethics and business acumen. Most correspondent loans are secured by the assets being financed or other business assets. However, some short-term loans may be unsecured.

Bank stock loans are generally made to bank holding companies, control groups or individuals. Loans to holding companies and control groups are generally for the bank capitalization, bank/branch purchases or liquidity. These loans are generally secured by a majority of the outstanding stock of the bank unless, underwriting determines the borrower warrants unsecured debt. Loans are also made to individuals secured by minority interest bank stock. There is value in this underlying collateral, but emphasis is given to the overall creditworthiness of the borrower. Specific minimum guidelines are considered for both secured and unsecured obligations.

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate depends largely on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Corporation's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity can help reduce the Corporation's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. Within the category of commercial real estate, the volume of construction and development loans is insignificant. As a general rule, the Corporation avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The level of commercial real estate is monitored consistent with regulatory guidelines with levels substantially below those guidelines. Changes in real property values may affect the collectability of these loans, and the condition of the collateral if foreclosed.

Mortgage warehouse borrowers generally have higher leverage and lower liquidity in relation to monthly operating expenses. Management underwrites these loans on the borrower’s financial capacity to service debt requirements, quality of the collateral portfolio, and short-term nature of the participation interest in each of the residential mortgage loans secured by one-to-four family residences before they are sold into the secondary market. Fraud risk is mitigated by a fraud insurance policy. Management collaborates with experienced servicers in the mortgage warehouse lending industry to purchase participation interests in mortgages.

Credit Cards. The credit card portfolio comprises unsecured consumer and business receivables which are referrals from respondent banks. Management has marketing agreements with respondent banks to offer the Corporation’s card products for a fee. The employment status of borrowers is a key risk factor affecting the collectability of these consumer receivables.

Mortgage Origination. The majority of the residential one-to-four family real estate mortgage loans are underwritten utilizing agency guidelines and booked to sell into the secondary market. Risks on these loans are limited to early payment default and breaches of representations and warranties. A few loans are held to maturity and are accommodations for Bank officers and directors. Repayment of these loans depends primarily on the personal income and credit rating of the borrowers. Economic conditions within certain market areas could affect property values or personal income.

(Dollar amounts in thousands)

Municipal Loans. Loans are made to tax-exempt municipal entities. These entities will primarily be governmental entities such as cities, counties, school districts and economic development authorities, but may also include hospital districts, utility districts, universities, colleges and private schools. These loans are General Obligations, Revenue Bonds, or Permanent School Fund (PSF) guaranteed loans. The taxing authority of the municipalities primarily protects these loans, although declines in property values or usage affect collectability.

Loan Review

TIB Bequeaith Banking Solutions, a consulting company wholly owned by the Corporation, periodically assesses credit quality and the risk identification program established by management. Results are presented to management and the board of directors.

Concentrations of Credit

The Corporation lends nationwide and evaluates each credit on whether or not it meets the terms of the lending policy regardless of location.

The following tables present the credit risk profile of the loan portfolio using the Corporation's internal rating system as of December 31, 2019 and 2018.

	2019						
	Bank Stock	Real Estate	Other Correspondent	Municipal	Mortgage	Credit Card	Total
Grade:							
Pass (1-6)	$ 178,787	$ 297,834	$ 260,766	$ 290,036	$ 6,279	$ 166,130	$ 1,199,832
Special Mention	956	451	-	-	-	-	1,407
Substandard	-	6,884	-	-	948	340	8,172
Doubtful	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-
Total	$ 179,743	$ 305,169	$ 260,766	$ 290,036	$ 7,227	$ 166,470	$ 1,209,411

	2018						
	Bank Stock	Real Estate	Other Correspondent	Municipal	Mortgage	Credit Card	Total
Grade:							
Pass (1-6)	$ 189,032	$ 298,203	$ 108,175	$ 288,472	$ 7,070	$ 166,970	$ 1,057,922
Special Mention	-	-	-	-	-	-	-
Substandard	-	1,666	1,382	-	289	375	3,712
Doubtful	-	-	-	-	-	5	5
Loss	-	-	-	-	-	-	-
Total	$ 189,032	$ 299,869	$ 109,557	$ 288,472	$ 7,359	$ 167,350	$ 1,061,639

(Dollar amounts in thousands)

The Corporation evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis. No significant changes were made either during 2019 and 2018.

The following tables present the Corporation's loan portfolio aging analysis of the recorded investment in loans as of December 31, 2019 and 2018:

2019

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 89 Days	Total Past Due	Current	Total Loans	Total Loans > 90 Days and Accruing
Correspondent loans:							
Bank stock	$ 544	$ -	$ -	$ 544	$ 179,199	$ 179,743	$ -
Real estate	1,173	1,204	-	2,377	302,792	305,169	-
Mortgage warehouse	-	-	-	-	217,437	217,437	-
Commercial and industrial	-	-	-	-	40,486	40,486	-
Consumer	-	-	-	-	1,070	1,070	-
Other	-	-	-	-	1,773	1,773	-
Municipal	-	-	-	-	290,036	290,036	-
Credit card	495	294	46	835	165,635	166,470	46
Mortgage	119	134	414	667	6,560	7,227	414
Total	$ 2,331	$ 1,632	$ 460	$ 4,423	$ 1,204,988	$ 1,209,411	$ 460

2018

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 89 Days	Total Past Due	Current	Total Loans	Total Loans > 90 Days and Accruing
Correspondent loans:							
Bank stock	$ 3,394	$ -	$ -	$ 3,394	$ 185,638	$ 189,032	$ -
Real estate	2,617	683	-	3,300	296,569	299,869	-
Mortgage warehouse	-	-	-	-	62,932	62,932	-
Commercial and industrial	-	-	-	-	40,039	40,039	-
Agriculture	-	-	-	-	-	-	-
Consumer	-	-	-	-	816	816	-
Other	-	-	-	-	5,770	5,770	-
Municipal	-	-	-	-	288,472	288,472	-
Credit card	517	249	131	897	166,453	167,350	-
Mortgage	123	181	-	304	7,055	7,359	-
Total	$ 6,651	$ 1,113	$ 131	$ 7,895	$ 1,053,744	$ 1,061,639	$ -

(Dollar amounts in thousands)

A loan is impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, the Corporation will probably be unable to collect all amounts due from the borrower under the contractual terms of the loan. Impaired loans include nonperforming correspondent and mortgage loans, but also include loans modified in troubled debt restructurings (TDRs).

The following tables present impaired loans for the years ended December 31, 2019 and 2018:

	2019				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Investment in Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Real estate	$ 1,594	$ 1,594	$ -	$ 1,601	$ -
Mortgage	161	161	-	173	3
Total loans without a specific valuation allowance	1,755	1,755	-	1,774	3
Loans with a specific valuation allowance:	-	-	-	-	-
Total impaired loans	$ 1,755	$ 1,755	$ -	$ 1,774	$ 3

	2018				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Investment in Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Real estate	$ 1,666	$ 1,666	$ -	$ 2,133	$ -
Mortgage	203	203	-	210	8
Total loans without a specific valuation allowance	1,869	1,869	-	2,343	8
Loans with a specific valuation allowance:	-	-	-	-	-
Total impaired loans	$ 1,869	$ 1,869	$ -	$ 2,343	$ 8

(Dollar amounts in thousands)

The following table presents the Corporation's nonaccrual loans at December 31, 2019 and 2018. This table excludes performing troubled debt restructurings.

	2019	2018
Real estate	$ 1,594	$ 1,666
Mortgage	106	23
Total	$ 1,700	$ 1,689

At December 31, 2019 and 2018, the Corporation had loans modified in TDRs and impaired. The modification of terms of such loans included one or a combination of the following: an extension of maturity, a reduction of the stated interest rate or a permanent reduction of the recorded investment in the loan.

There were no new TDR’s for the years ended December 31, 2019 or 2018.

There were no TDRs during the previous 12 months that defaulted during the years ended December 31, 2019 and 2018.

NOTE 6. FORECLOSED ASSETS HELD FOR SALE

Activity applicable to foreclosed assets during 2019 and 2018 includes the following:

	2019	2018
Net gain (loss) on sale of foreclosed assets held for sale	$ -	$ 20
Net operating expense	-	(13)
	$ -	$ 7

NOTE 7. PREMISES AND EQUIPMENT

Major classifications of premises and equipment, stated at cost, are as follows:

	2019	2018
Land	$ 2,480	$ 2,480
Buildings and improvements	24,461	23,938
Furniture and equipment	8,492	8,161
Leasehold improvements	295	295
	35,728	34,874
Less accumulated depreciation	12,220	10,507
Net premises and equipment	$ 23,508	$ 24,367

(Dollar amounts in thousands)

NOTE 8. DERIVATIVE FINANCIAL INSTRUMENTS

In the normal course of business, the Corporation uses various derivative financial instruments to manage its interest rate and market risks. These instruments have varying degrees of credit, interest rate and market or liquidity risks. Derivative instruments are recognized as either assets or liabilities in the Corporation's accompanying consolidated financial statements and are measured at fair value.

Cash Flow Hedge

Interest rate swap contracts are used to mitigate interest rate risk in a rising rate environment. The “plain vanilla” interest rate swap contracts offset some variable funding cost during rising interest rate environments to stabilize the margin. The interest rate swap contracts are designated as highly effective cash flow hedges due to high correlation with their hedged item. There were no amounts reclassified to earnings due to ineffectiveness during 2019 or 2018. No new swap contracts were executed in 2019 or 2018.

The swap contracts at December 31, 2019 and 2018, are summarized as follows:

Effective Date	Termination Date	Fixed Rate	Variable Rate	Notional Amount	Fair Value 2019	Fair Value 2018
December 29, 2014	December 29, 2022	2.310%	L Month Libor Daily Rate	50,000	(734)	474
December 29, 2014	December 29, 2022	2.310%	L Month Libor Daily Rate	50,000	(734)	474
December 30, 2015	December 29, 2023	2.050%	L Month Libor Daily Rate	50,000	(648)	1,140
December 30, 2015	December 29, 2023	1.913%	L Month Libor Daily Rate	25,000	(210)	723
December 30, 2015	December 29, 2021	1.660%	L Month Libor Daily Rate	25,000	17	618
					$ (2,309)	$ 3,429

An asset of $17 and $3,429 is included in other assets at December 31, 2019 and 2018, respectively. A liability of $2,326 and $0 is included in derivative liabilities at December 31, 2019 and 2018, respectively. An unrealized loss of $4,534 and an unrealized gain of $1,874, net of deferred tax of $1,205 and $498, is included in other comprehensive income (loss) for the years ended December 31, 2019 and 2018, respectively.

Swap Collateral

There were no marketable government securities pledged as collateral related to swap contracts totaled at December 31, 2019 and 2018, respectively.

(Dollar amounts in thousands)

Non-hedging derivatives

Various U.S. treasury puts, calls and futures contracts are used to offset changes in the fair value of mortgage servicing rights. These positions mature or expire approximately every 90 days and are replaced with similar positions. Non-hedging derivatives were discontinued during 2018 to coincide with the sale of the majority of servicing rights; therefore, no positions were outstanding at December 31, 2018 or December 2019. The Corporation recorded a loss of $1,352 in noninterest expense in 2018 and a gain of $324 in noninterest income in 2018, for these derivatives.

The following table presents the fair value of derivative instruments as of December 31, 2019 and 2018.

	2019		2018	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate derivatives designated as cash flow hedges:				
Interest rate swaps on brokered deposits	$ 200,000	$ (2,309)	$ 200,000	$ 3,429
Total derivatives	$ 200,000	$ (2,309)	$ 200,000	$ 3,429
Derivative - assets (included in other assets)		$ 17		$ 3,429
Derivative - liabilities		(2,326)		-
		$ (2,309)		$ 3,429

(Dollar amounts in thousands)

NOTE 9. EQUITY METHOD INVESTMENTS

The Corporation's investments in entities accounted for under the equity method of accounting and recorded in other assets on the consolidated balance sheets at December 31 were as follows:

Entity	Percentage and Type of Interest	Amount of Investment 2019	Amount of Investment 2018
IBC Management, LLC	20% Member	$ 273	$ 200
Independent Bankers Capital Fund II, L.P.	21.85% Limited Partner	2,606	3,237
IBC II, LLC	28% Member	479	476
Independent Bankers Capital Fund III, L.P.	14.17% Limited Partner	4,065	3,596
IBC III, LLC	25% Member	220	192
IBFC Statuatory Trust II	100% of common securities	-	313
Total equity method investments		$ 7,643	$ 8,014

For the investments in the entities above other than the statutory trust, summarized financial information for the combined group includes total assets of $72,109 and total liabilities of $28,075 as of December 31, 2019 and net income of $5,547 for the year ended December 31, 2019.

(Dollar amounts in thousands)

NOTE 10. OTHER INTANGIBLE ASSETS

The carrying basis and accumulated amortization of recognized intangible assets at December 31, 2019 and 2018, were:

	2019		2018	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Merchant Contracts	$ 7,892	$ (7,892)	$ 7,892	$ (7,476)
Purchased Credit Card Portfolio Premiums	1,565	(978)	2,093	(1,199)
Other	865	(731)	865	(607)
	$ 10,322	$ (9,601)	$ 10,850	$ (9,282)

Amortization expense for the years ended December 31, 2019 and 2018, was $885 and $1,412, respectively. Estimated amortization expense for each of these five years is:

2020	$ 368
2021	187
2022	126
2023	37
2024	3

NOTE 11. LOAN SERVICING

Loans serviced for others are not included in the consolidated balance sheets. The risks inherent in mortgage servicing assets relate primarily to changes in prepayments that result from shifts in mortgage interest rates. The unpaid principal balances of mortgage and other loans serviced for others were $255,245 and $300,491 at December 31, 2019 and 2018, respectively.

(Dollar amounts in thousands)

The following table summarizes the activity in mortgage servicing rights measured using the fair value method for the years ended December 31, 2019 and 2018.

	2019	2018
Fair value as of the beginning of the period	$ 2,715	$ 19,450
Additions		
Purchases	-	620
Disposals		
Sale of mortage servicing rights	-	(17,325)
Changes in fair value due to changes in valuation inputs or assumptions used in the valuation model*	(920)	(30)
Fair value at the end of the period	$ 1,795	$ 2,715

*Reflects changes in discount rates and prepayment speed assumptions.

NOTE 12. TIME DEPOSITS

Time deposits in denominations of $250 or more were $630 on December 31, 2019 and 2018.

At December 31, 2019, net brokered deposit balances totaled $205,400 all with denominations less than $250. The scheduled maturities of time deposits are as follows:

2020	$ 206,161

NOTE 13. SHORT-TERM BORROWINGS

Short-term borrowings included the following at December 31, 2019 and 2018:

	2019	2018
Federal funds purchased and agreements to repurchase	$ 97,080	$ 78,251
FHLB advances	$ -	$ 280,000

(Dollar amounts in thousands)

The Corporation sells certain securities under agreements to repurchase. The agreements are treated as financings, and the obligations to repurchase securities sold are reflected as a liability in the consolidated balance sheets. The dollar amount of securities underlying the agreements remains in the asset accounts. There were no repurchase agreements outstanding at December 31, 2019 or 2018. There were also no repurchase agreements outstanding at any time during 2019.

At December 31, 2019 and 2018, the Bank had a primary credit line with the Federal Reserve Bank of Dallas for $449,020 and $320,950, respectively, secured by loans. There were no balances outstanding on this credit line at December 31, 2019 and 2018. There were no balances outstanding at any time in 2019 or 2018.

At December 31, 2019 and 2018, the Bank also had a credit line with the FHLB for $307,860 and $75,381, respectively. There were no balances outstanding on this credit line at December 31, 2019. The maximum and minimum amounts of FHLB advances outstanding during 2019 were $230,000 and $0, respectively. The interest rate on these advances ranged from 2.25% to 2.70%. At December 31, 2018, the Bank had outstanding balances of $200,000 and $80,000 at fixed rates of 2.40% and 2.65%, respectively, and maturity dates of January 3, 2019 and January 2, 2019, respectively, secured by marketable securities.

NOTE 14. INCOME TAXES

The Corporation or one of its subsidiaries files income tax returns in the U.S. Federal jurisdiction and various states' jurisdictions.

The provision for income taxes includes these components:

	2019	2018
Taxes currently payable	$ 4,722	$ 6,899
Deferred income taxes - current	(919)	(3,923)
Income tax expense	$ 3,803	$ 2,976

(Dollar amounts in thousands)

A reconciliation of income tax expense at the statutory rate to the Corporation's actual income tax expense is as follows:

	2019	2018
Computed at the statutory rate	$ 5,304	$ 4,661
Increase (decrease) resulting from		
Tax-exempt interest	(1,558)	(1,493)
Nondeductible expenses	334	377
Life insurance proceeds	-	(287)
Increase in cash value of life insurance	(277)	(282)
Actual tax expense	$ 3,803	$ 2,976

Deferred assets as of December 31, 2019 and 2018 are based on the newly enacted U.S. statutory federal income tax rate of 21%. The tax effects of temporary differences related to deferred taxes on the consolidated balance sheets are presented in the table below.

	2019	2018
Deferred tax assets		
Allowance for loan losses	$ 2,845	$ 2,635
Unrealized losses on available-for-sale securities	-	1,371
Interest rate swap derivatives	485	-
Credit card premiums and intangibles	-	37
Accrued expenses and other liabilities	3,952	3,429
Other	348	241
Total deferred tax assets	7,630	7,713
Deferred tax liabilities		
Credit card premiums and intangibles	99	-
Premises and equipment	291	314
Interest rate swap derivatives	-	720
Mortgage servicing rights	377	570
Unrealized gains on available-for-sale securities	1,543	-
Total deferred tax liabilities	2,310	1,604
Net deferred tax assets	$ 5,320	$ 6,109

(Dollar amounts in thousands)

NOTE 15. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The components of accumulated other comprehensive income (loss), included in shareholders' equity are as follows:

	2019	2018
Net unrealized gains (losses) on available-for-sale securities	$ 7,346	$ (6,529)
Cash flow hedges	(2,309)	3,429
	5,037	(3,100)
Tax effect	(1,058)	651
Net-of-tax amount	$ 3,979	$ (2,449)

NOTE 16. SHAREHOLDERS' EQUITY

The Corporation has 5,000,000 common, 2,000,000 convertible redeemable Class B common and 1,000,000 preferred shares authorized. Our capital stock is not quoted or traded on a recognized stock exchange and holders do not have preemptive rights. The Corporation has no convertible redeemable Class B common or preferred shares outstanding as of December 31, 2019 and 2018.

NOTE 17. REGULATORY MATTERS

As a result of the increase in the asset size threshold for determining applicability of the Federal Reserve's Small Bank Holding Company Policy Statement, the Corporation is no longer subject to capital requirements as of September 30, 2018; however, the Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve a quantitative measure 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. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. Banks (Basel III rules) became effective for the Corporation on January 1, 2015 with full compliance with all requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019.

The Bank is subject to the minimum capital ratios in the Basel III capital framework effective January 1, 2015. Basel III mandates minimum capital ratios plus a phased in Capital Conservation Buffer of 2.5% to be achieved by January 1, 2019. The buffer serves as additional capital protection to weather periods of economic stress. Banking organizations with a buffer greater than 2.5% are not subject to limits on distributions or payments; however, an organization with a buffer of less than 2.5% is subject to increasingly stringent limitations as the buffer approaches zero. At December 31, 2019 and 2018, the capital buffer was 2.50% and 1.875%, respectively, which is included in the 2019 minimum capital requirements relative to risk-weighted assets in the following table. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital.

(Dollar amounts in thousands)

Management believes as of December 31, 2019, the Bank meets all capital adequacy requirements to which it is subject. At year-end 2019 and 2018, the most recent regulatory notifications categorized the Bank as "well capitalized" pursuant to prompt corrective action framework. There are no conditions or events since last notification to suggest the Bank's category has changed.

The Bank's actual capital amounts and ratios are presented in the following tables:

	Actual		Minimum Capital Requirement Basel III Schedule		Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2019						
Tier I capital to average assets						
Bank only	268,543	9.64%	111,431	4.00%	139,289	5.00%
Common Equity Tier I capital to risk-weighted assets						
Bank only	268,543	16.03%	117,267	7.00%	108,890	6.50%
Tier I capital to risk-weighted assets						
Bank only	268,543	16.03%	142,395	8.50%	134,019	8.00%
Total capital to risk-weighted assets						
Bank only	282,659	16.87%	175,900	10.50%	167,524	10.00%

(Dollar amounts in thousands)

	Actual		Minimum Capital Requirement Basel III Schedule		Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018						
Tier I capital to average assets						
Bank only	259,131	10.83%	95,719	4.00%	$ 119,649	5.00%
Common Equity Tier I capital to risk-weighted assets						
Bank only	259,131	16.87%	98,002	6.38%	99,845	6.50%
Tier I capital to risk-weighted assets						
Bank only	259,131	16.87%	121,043	7.88%	122,886	8.00%
Total capital to risk-weighted assets						
Bank only	272,247	17.72%	151,765	9.88%	153,608	10.00%

NOTE 18. RELATED-PARTY TRANSACTIONS

At December 31, 2019 and 2018, the Corporation had loans outstanding to executive officers, directors, significant shareholders and their affiliates (related parties) for $9,618 and $13,225, respectively.

Annual activity consisted of the following:

	2019	2018
Beginning balance	$ 13,225	$ 10,093
New loans	29	12,678
Repayments	(3,636)	(9,546)
Ending balance	$ 9,618	$ 13,225

In management's opinion, such loans and other extensions of credit and deposits were made in the ordinary course of business and were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. Further, in management's opinion, these loans did not involve more than normal risk of collectability or present other unfavorable features.

(Dollar amounts in thousands)

Deposits from related parties held by the Bank at December 31, 2019 and 2018, totaled $118,799 and $77,176 respectively.

NOTE 19. EMPLOYEE BENEFITS

The Corporation maintains a 401K savings plan for employees. Employees are eligible to participate immediately upon hire subject to the next enrollment date. The Corporation may contribute a maximum of 5 percent of the employee's annual compensation. Both employer and employee contributions to the savings plan vest immediately. The Corporation's contributions were $1,036 and $1,051 in 2019 and 2018, respectively.

Nonqualified deferred compensation plans provide death and retirement benefits to certain officers. Deferred compensation expense of $1,357 and $1,665 was recorded in 2019 and 2018, respectively. Deferred compensation payable totaled $14,275 and $13,236 at December 31, 2019 and 2018, respectively. The Corporation purchased life insurance policies to fund future plan obligations. These policies had an aggregate cash surrender value of $56,379 and $55,059 at December 31, 2019 and 2018, respectively.

The Corporation maintains a Stock Appreciation Right Plan (SAR). Certain employees are awarded the right to receive an amount tied to the Corporation's performance on an established date, after the vesting period of generally five years. The value of the SAR awards is calculated using a fair value method to estimate the change in the book value of the Corporation's stock over the vesting period. Information regarding SAR awards is as follows:

	2019	2018
SAR awards outstanding, beginning of year	94,050	87,750
Redeemed	(13,080)	(11,650)
Forfeited	(620)	-
Granted	21,350	17,950
SAR awards outstanding, end of year	101,700	94,050

The number of shares of SAR awards granted in 2019 and 2018 was 21,350 and 17,950, respectively. The value of SAR awards vested totaled $1,225 and $1,070 in 2019 and 2018, respectively. The value of SAR awards redeemed totaled $1,094 and $918 in 2019 and 2018, respectively. The tax benefit recognized was $230 and $193, respectively, in 2019 and 2018.

(Dollar amounts in thousands)

Compensation expense for stock appreciation rights is accrued over the vesting period of the award. Accrued compensation payable under the plans totaled $4,014 and $2,673 at December 31, 2019 and 2018, respectively. Compensation expense recognized under the plans totaled $2,436 and $1,297 in 2019 and 2018, respectively.

NOTE 20. LEASES

The Corporation has non-cancelable operating leases for certain property with payment terms up to 40 months with some including extensions for an additional 36 months. The lease payments are charged to expense over the lease term as it becomes payable. Rental expense for these leases was $294 and $436 for the years ended December 31,2019 and 2018, respectively. At December 31, 2019, the lease payments for operating leases with initial terms of greater than 12 months are as follows:

	Operating Leases
2020	$ 225
2021	201
2022	107
2023	18
Total minimum lease payments	$ 551

NOTE 21. JUNIOR SUBORDINATED DEBENTURES

On January 25, 2006, the Corporation issued $30,928 of Floating Rate Junior Subordinated Debentures to a newly formed wholly owned subsidiary, Trust II. Trust II sold Capital Securities of $30,000. The Corporation also made an equity contribution of $928 to form Trust II. Interest on the debentures is payable quarterly at 3-month LIBOR plus 1.480 percent (4.26819 percent at December 31, 2018, respectively) and the debentures mature on March 15, 2036.

On September 15, 2018, the Corporation exercised its right to redeem $20,615 of the Debentures with a like amount of the Capital and Common Securities also being redeemed. On June 14, 2019, the Corporation exercised its right to redeem the remaining $10,313 of the Debentures with a like amount of the Capital and Common Securities also being redeemed. As of December 31, 2019, no debentures are outstanding and Trust II is dissolved.

NOTE 22. DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

Fair value is the price received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. A hierarchy of three levels of inputs may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities that the Corporation can access at the measurement date.

Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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

Recurring Measurements

The table on the following page presents the fair value measurements of assets and liabilities recognized in the Corporation's consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2019 and 2018.

(Dollar amounts in thousands)

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019:				
Available-for-sale securities				
U.S. GSEs - residential	$ 337,521	$ -	$ 337,521	$ -
Mortgage servicing rights	1,795	-	-	1,795
Derivative assets	17	-	17	-
Derivative liabilities	2,326	-	2,326	-
December 31, 2018:				
Available-for-sale securities				
U.S. GSEs - residential	$ 390,435	$ -	$ 390,435	$ -
Mortgage servicing rights	2,715	-	-	2,715
Derivative assets	3,429	-	3,429	-
Derivative liabilities	-	-	-	-

Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis and recognized in the consolidated balance sheets, and the general classification of such assets and liabilities under the valuation hierarchy. There have been no significant changes in the valuation techniques during the years ended December 31, 2019 and 2018. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation's creditworthiness and unobservable parameters. Any such valuation adjustments are applied consistently. The Corporation's valuation methodologies may produce a fair value calculation that may not indicate net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, using different methodologies or assumptions to determine the fair value of certain financial instruments could cause a different estimate of fair value at the reporting date. The reported fair value amounts have not been comprehensively revalued since the presentation dates and, therefore, estimates of fair value after the consolidated balance sheets date may differ significantly from the amounts presented.

Available-for-sale Securities

Securities classified as "available for sale" are reported at fair value utilizing Level 2 inputs. For these securities, the Corporation obtains fair value measurements from an independent pricing service. The fair value measurements observable data includes dealer quotes, market spreads, cash flows, the U.S. Treasury and other yield curves, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms.

Derivatives

Derivatives are reported at fair value utilizing Level 2 inputs. The Corporation performs an internal evaluation to estimate fair value of interest rate swap contracts through valuation models with observable market data inputs (Level 2).

Mortgage Servicing Rights

Mortgage servicing rights are reported at fair value utilizing Level 3 inputs. The Corporation uses an independent valuation firm to estimate the fair value of mortgage servicing rights through prevailing market participant assumptions and market participant valuation processes. This valuation and its techniques are periodically tested and validated against other third-party firm valuations. To determine the fair value of mortgage servicing rights, they are placed in homogeneous groups by investor, remittance requirements, loan type, interest rate and year of origination. At December 31, 2019 and 2018, prepayment speeds were determined using Andrew Davidson's MBS Enhanced Prepayment Model and resulted in weighted-average years to payoff of 5.74 years and 6.76 years, respectively. At December 31, 2019 and 2018, the primary discount rates averaged 10.24 percent and 10.43 percent, respectively. During the years ended December 31, 2019 and 2018, changes in fair value were attributable to changes in valuation inputs and assumptions.

Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the Corporation's accompanying consolidated balance sheets using significant unobservable (Level 3) inputs.

(Dollar amounts in thousands)

	Mortgage Servicing Rights
Balance, January 1, 2018	$ 19,450
Included in net income:	
Decrease in fair value	(30)
Purchases	620
Disposal	(17,325)
Balance, December 31, 2018	2,715
Included in net income:	
Decrease in fair value	(920)
Purchases	-
Disposals	-
Balance, December 31, 2019	$ 1,795

Changes in fair value reflected in the table above are included in noninterest expense for the years ended December 31, 2019 and 2018.

For the years ended December 31, 2019 and 2018, there were no significant transfers among Levels 1, 2 and 3.

Nonrecurring Measurements

Certain financial assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). There were no financial assets measured at fair value on a nonrecurring basis at December 31, 2019 or 2018.

(Dollar amounts in thousands)

Unobservable (Level 3) Inputs

The following tables presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements other than goodwill at December 31, 2019 and 2018.

	Fair Value at December 31, 2019		Valuation Technique	Unobservable Inputs	Range (Weighted Average)
				Discount rate	10.1% - 16.1% (10.24%)
Mortgage servicing rights	$	1,795	Discounted cash flow	Prepayments	5.7% - 11.7% (10.47%)
				Delinquencies	3.1% - 14.3% (6.11%)

	Fair Value at December 31, 2018		Valuation Technique	Unobservable Inputs	Range (Weighted Average)
				Discount rate	10.3% - 16.8% (10.43%)
Mortgage servicing rights	$	2,715	Discounted cash flow	Prepayments	4.0% - 10.8% (8.11%)
				Delinquencies	3.1% - 14.3% (5.67%)

(Dollar amounts in thousands)

The table below presents estimated fair values, and related carrying amounts, of the Corporation's financial instruments, not previously disclosed, at December 31, 2019 and 2018.

	December 31, 2019		
	Carrying Amount	Fair Value	Level
Financial assets:			
Cash and cash equivalents	$ 1,051,454	$ 1,051,454	1
Federal Reserve and FHLB stock	3,501	3,501	3
Interest receivable	8,333	8,333	1
Loans held for sale	9,516	9,516	3
Loans - net	1,195,320	1,190,989	3
Financial liabilities:			
Demand and non-interest bearing	402,756	402,756	1
Interest bearing transaction accounts	1,684,242	1,684,242	2
Time deposits	206,161	206,239	3
Interest payable	193	193	1
Short-term borrowings	97,080	97,080	1

	December 31, 2018		
	Carrying Amount	Fair Value	Level
Financial assets:			
Cash and cash equivalents	$ 933,013	$ 933,013	1
Federal Reserve and FHLB stock	14,962	14,962	3
Interest receivable	8,512	8,512	1
Loans held for sale	2,765	2,765	3
Loans - net	1,048,548	1,042,038	3
Financial liabilities:			
Demand and non-interest bearing	391,901	391,901	1
Interest bearing transaction accounts	1,263,144	1,305,176	2
Time deposits	206,301	206,282	3
Interest payable	451	451	1
FHLB advances	280,000	279,996	2
Junior subordinated debentures	10,313	10,313	2
Short-term borrowings	78,251	78,251	1

NOTE 23. SIGNIFICANT ESTIMATES, CONCENTRATIONS, COMMITMENTS AND CREDIT RISK

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and vulnerabilities due to certain concentrations. Estimates related to the allowance for loan losses are reflected in the note regarding loans.

General Litigation

The Corporation is subject to claims and lawsuits that arise primarily in the ordinary course of business. Management believes the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operations and cash flows of the Corporation.

Standby Letters of Credit

Standby letters of credit are irrevocable, conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Financial standby letters of credit are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. Performance standby letters of credit are issued to guarantee performance of certain customers under nonfinancial contractual obligations. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. Should the Corporation be obligated to perform under the standby letters of credit, the Corporation may seek recourse from the customer for reimbursement of amounts paid.

The Corporation had total outstanding standby letters of credit amounting to $7,471 and $2,006 December 31, 2019 and 2018, respectively, with terms ranging from 30 to 365 days.

Lines of Credit

Lines of credit are agreements to lend to customers if there is no violation of any condition established in the contract. Lines of credit have fixed expiration dates. Since a portion of the line of credit may expire without being drawn upon, the total unused lines do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. Collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate. Management uses the same credit policies in granting lines of credit as it does for on-balance-sheet instruments.

At December 31, 2019, the Corporation had unused lines of credit to borrowers aggregating approximately $1,009,000 and $394,000 for commercial lines and open-end consumer lines, respectively. At December 31, 2018, unused lines of credit to borrowers aggregated approximately $922,000 and $414,000 for commercial lines and open-end consumer lines, respectively.

Securities

The Corporation invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the consolidated balance sheets.

NOTE 24. SUBSEQUENT EVENTS

The Corporation has evaluated subsequent events for recognition and disclosure through March 25, 2020, which is the date the consolidated financial statements were issued.

Effective January 1, 2020, the Bank established a wholly-owned subsidiary, TIB Holdings, LLC, a Texas limited liability company, to (a) hold and manage municipal loans originated or acquired by the Bank, and (b) originate municipal loans.

As a result of the spread of the COVID-19 coronavirus, economic uncertainties have arisen which may negatively affect the financial position, results of operations and cash flows of the Corporation. The duration of these uncertainties and the ultimate financial effects cannot be reasonably estimated at this time.

Independent Bankers Financial Corporation and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2019 and 2018
(Dollar amounts in thousands)

NOTE 25. CONDENSED FINANCIAL INFORMATION (PARENT CORPORATION ONLY)

Presented below is condensed financial information on financial position, results of operations and cash flows of the Corporation:

	Years Ended December 31, 2019	2018
Condensed Balance Sheets		
Assets		
Cash and cash equivalents	$ 4,101	$ 6,084
Investment in common stock of subsidiaries	275,243	260,250
Other assets	4,278	4,072
Total assets	$ 283,622	$ 270,406
Liabilities		
Junior subordinated debentures	$ -	$ 10,313
Other liabilities	4,015	2,773
Total liabilities	4,015	13,086
Shareholders' Equity	279,607	257,320
Total liabilities and shareholders' equity	$ 283,622	$ 270,406

Independent Bankers Financial Corporation and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2019 and 2018
(Dollar amounts in thousands)

	Years Ended December 31, 2019	2018
Condensed Statements of Income and Comprehensive Income		
Income		
Dividends from subsidiaries	$ 15,000	$ 12,000
Interest income	7	28
Total income	15,007	12,028
Expenses		
Interest expense	201	905
Other expenses	2,479	1,417
Total expenses	2,680	2,322
Income before income tax and equity in undistributed net income of subsidiaries	12,327	9,706
Income tax benefit	561	482
Income before equity in undistributed net income of subsidiaries	12,888	10,188
Equity in undistributed net income of subsidiaries	8,565	9,033
Net income	$ 21,453	$ 19,221
Total other comprehensive income (loss)	6,428	(5,373)
Comprehensive income	$ 27,881	$ 13,848

Independent Bankers Financial Corporation and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2019 and 2018
(Dollar amounts in thousands)

	Years Ended December 31,	
	2019	**2018**
Condensed Statements of Cash Flows		
Operating activities		
Net income	$ 21,453	$ 19,221
Items not providing cash	(7,842)	(9,055)
Net cash provided by operating activities	13,611	10,166
Investing activities		
Proceeds of redemption of junior subordinated debentures	313	615
Net cash provided by investing activities	313	615
Financing activities		
Sale of common stock	1	1
Purchase and retirement of common stock	(1)	(3)
Retirement of Trust Preferred Debt	(10,313)	(20,615)
Cash dividends paid on common stock	(5,594)	(4,476)
Net cash used in financing activities	(15,907)	(25,093)
Net change in cash and cash equivalents	(1,983)	(14,312)
Cash and cash equivalents, beginning of year	6,084	20,396
Cash and cash equivalents, end of year	$ 4,101	$ 6,084