GERMAN AMERICAN BANCORP, INC.
Form S-4
June 15, 2018

As filed with the Securities and Exchange Commission on June 15, 2018

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-4

**REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

GERMAN AMERICAN BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Indiana	**6022**	**35-1547518**
(State or Other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(IRS Employer Identification Number)

**711 Main Street, Box 810
Jasper, Indiana 47547-0810
(812) 482-1314**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Mark A. Schroeder
Chairman and Chief Executive Officer
German American Bancorp, Inc.
711 Main Street, Box 810
Jasper, Indiana 47547-0810
(812) 482-1314**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

With copies to:

Jeremy E. Hill	**R. James Straus**
Bradley C. Arnett	**Alan K. MacDonald**
Bingham Greenebaum Doll LLP	**Frost Brown Todd LLC**

2700 Market Tower
10 W. Market Street
Indianapolis, Indiana 46204
(317) 635-8900

400 West Market Street
32nd Floor
Louisville, Kentucky 40202
(502) 589-5400

Approximate date of commencement of proposed sale of the securities to the public: As soon as practicable after the effective date of this registration statement and upon the effective time of the merger described in the accompanying proxy statement/prospectus.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Excha nge Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act. o

If applicable, place an X in the box to designate the appropriate rule provision relied upon in conducting this transaction:

Exchange Act Rule 13e-4(i) (Cross-Border Issuer Tender Offer) o

Exchange Act Rule 14d-1(d) (Cross-Border Third Party Tender Offer) o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price Per Unit	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee(3)
Common Shares, no par value	Up to 2,045,772 shares	N/A	$71,523,207	$8,905

(1) Represents the maximum number of shares of German American Bancorp, Inc. common stock estimated to be issuable upon completion of the merger described herein.

(2) Estimated solely for the purpose of calculating the registration fee required by Section 6(b) of the Securities Act of 1933 and computed pursuant to Rule 457(f)(1) thereunder on the basis of the market value of the common stock of First Security, Inc. to be exchanged in the transaction, which is calculated as the product of (i) $40.235 (the average of the bid and asked price, as quoted on the OTCQX market place, on June 13, 2018, a date within five business days prior to the date of filing this registration statement) and (ii) 2,562,981 (the aggregate number of shares of First Security, Inc. common stock that may be received by the Registrant and/or cancelled upon consummation of the merger), less $31,598,334, which is the estimated aggregate amount of cash expected to be paid by the Registrant in exchange for such shares of First Security, Inc. common stock.

(3) The registration fee of $8,905 for the securities registered hereby has been calculated pursuant to Rule 457(f) under the Securities Act, as $71,523,207 multiplied by .0001245.

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant files a further amendment which specifically states that this registration statement is to become effective in accordance with Section 8(a) of the Securities Act or until the registration statement becomes effective on the date the Commission, acting under Section 8(a), determines.

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THE INFORMATION IN THIS PROXY STATEMENT/PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. A REGISTRATION STATEMENT RELATING TO THESE SECURITIES HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. WE MAY NOT ISSUE THESE SECURITIES UNTIL THE REGISTRATION STATEMENT IS EFFECTIVE. THIS PROXY STATEMENT/PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IT IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

PRELIMINARY PROXY STATEMENT/PROSPECTUS
DATED JUNE 15, 2018 SUBJECT TO COMPLETION

PROSPECTUS OF GERMAN AMERICAN BANCORP, INC. FOR UP TO 2,045,772 SHARES OF COMMON STOCK AND PROXY STATEMENT OF FIRST SECURITY, INC.

First Security, Inc. (which we refer to as "First Security") proposes to merge with and into German American Bancorp, Inc. (which we refer to as "German American"). At the effective time of the proposed merger, each outstanding share of First Security's common stock would be converted into the right to receive:

- 0.7982 shares of German American common stock (or cash in lieu of fractional share interests), and

- a cash payment of $12.00 (subject to reduction to the extent that First Security's consolidated common shareholders' equity is not at least equal to a certain level at the time of closing. See "THE MERGER AGREEMENT Calculation of Possible Reduction in Cash Payment" on page [•])

Because the exchange ratio is fixed (except for customary anti-dilution adjustments), if you receive German American common stock as consideration for all or a portion of your shares of First Security common stock, the implied value of the stock consideration that you will receive will depend on the market price of German American common stock when you receive your shares of German American common stock. On May 21, 2018, the last business day prior to the public announcement of the merger, the closing price of a share of German American common stock was $35.57, which based on the of 0.7982 exchange ratio and $12.00 per share cash consideration, represented an implied value of $40.39 per share of First Security common stock. On [•], 2018, the most recent practicable trading day before this proxy statement/prospectus was finalized, the closing price of a share of German American common stock was $[•], which based on the of 0.7982 exchange ratio and $12.00 per share cash consideration, represented an implied value of $[•] per share of First Security common stock. You should obtain current market prices for shares of German American common stock which is listed on the NASDAQ Global Select Market under the symbol "GABC."

First Security will hold a special meeting of its shareholders to vote on the merger agreement proposal at its principal office located at 313 Frederica Street, Owensboro, Kentucky, on [•], 2018, at [•], local time. **Your vote is important, because your failure to vote will have the same effect as your voting against the merger agreement proposal.** Regardless of whether you plan to attend the special meeting, please take the time to vote your shares in accordance with the instructions contained in the attached proxy statement/prospectus.

First Security's board of directors unanimously recommends that you vote "FOR" the merger.

This proxy statement/prospectus describes the special meeting, the merger agreement proposal, the German American shares to be issued in the merger, the manner of calculation of the number of German American shares to be issued and the amount of cash to be paid for each First Security common share in the merger, and other related matters. Please carefully read this entire document, including "Risk Factors" beginning on page 25, for a discussion of the risks relating to the merger agreement proposal and the German American common shares. Information about German American is included in this document and in documents that German American has filed with the Securities and Exchange Commission. See "WHERE YOU CAN FIND MORE INFORMATION," on page [•].

Neither the Securities and Exchange Commission nor any state securities commission or regulatory body has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The securities are not savings accounts, deposits or obligations of any bank and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency.

The common shares of German American are traded on the NASDAQ Global Select Market under the symbol "GABC," and the common shares of First Security are quoted on the OTCQX Market under the symbol "FIIT."

All information in this proxy statement/prospectus concerning German American and its subsidiaries has been provided by German American, and all information in this proxy statement/prospectus concerning First Security has been provided by First Security.

You should rely only on the information contained in this proxy statement/prospectus to vote on the proposals to First Security's shareholders in connection with the merger. We have not authorized anyone to provide you with information that is different from what is contained in this proxy statement/prospectus.

You should not assume that the information contained in this proxy statement/prospectus is accurate as of any date other than the date below, and neither the mailing of this proxy statement/prospectus to shareholders nor the issuance of German American shares as contemplated by the merger agreement shall create any implication to the contrary.

This proxy statement/prospectus is dated [•], 2018, and it is first being mailed to First Security, Inc. shareholders on or about [•], 2018.

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AVAILABLE INFORMATION

As permitted by the rules of the Securities and Exchange Commission (the "SEC"), this proxy statement/prospectus incorporates important information about German American from other documents that are not included or delivered with this document. You may request, either orally or in writing, a copy of the documents incorporated by reference by German American in this proxy statement/prospectus without charge by requesting them in writing or by telephone from German American at the following addresses and telephone number:

German American Bancorp, Inc.
711 Main Street, Box 810
Jasper, Indiana 47547-0810
Attention: Terri Eckerle
Telephone: (812) 482-1314

If you would like to request documents, please do so by [•], [•], 2018, in order to receive them before First Security's special meeting.

You also can obtain documents incorporated by reference in this document through the SEC's website at www.sec.gov. See "WHERE YOU CAN FIND MORE INFORMATION," on page [•].

Notice of Special Meeting of Shareholders to be held [•], 2018

A special meeting of shareholders of First Security, Inc., a Kentucky corporation ("First Security"), will be held at [•], local time, on [•], 2018 at First Security's principal office located at 313 Frederica Street, Owensboro, Kentucky. Any adjournments or postponements of the special meeting will be held at the same location unless otherwise announced at the conclusion of the adjourned or postponed meeting session.

At the special meeting, you will be asked:

1. to consider and vote upon a proposal to approve the Agreement and Plan of Reorganization, dated as of May 22, 2018 (which we refer to as "the merger agreement"), which has been entered into by and among First Security, German American Bancorp, Inc., First Security Bank, Inc., and German American Bank (including the related plan of merger in the form that is attached to the merger agreement), and thereby to approve the transactions contemplated by the merger agreement, including the merger of First Security into German American Bancorp, Inc.;

2. to approve one or more adjournments of the special meeting (upon the motion of any shareholder of record entitled to vote on the merger proposal duly made and seconded) if necessary to permit further solicitation of proxies in favor of the merger agreement and the related plan of merger; and

3. to transact such other business as may be properly presented at the special meeting and any adjournments or postponements of the special meeting.

The accompanying proxy statement/prospectus describes the merger agreement and the proposed merger in detail, and includes a copy of the merger agreement (which includes the plan of merger) attached as Annex A. We urge you to read these materials carefully. The proxy statement/prospectus (and Annex A) forms a part of this notice.

Shareholders of First Security have dissenters' rights with respect to the merger under the Kentucky Business Corporation Act. Shareholders who assert their dissenters' rights and comply with the procedural requirements of Subtitle 13 of the Kentucky Business Corporation Act will be entitled to receive payment of the fair value of their shares in cash in accordance with Kentucky law. A copy of Subtitle 13 of the Kentucky Business Corporation Act is attached as Annex C to the accompanying proxy statement/prospectus.

The board of directors of First Security unanimously recommends that First Security shareholders vote "FOR" (1) the proposal to approve the merger agreement, and (2) the proposal to approve adjournments.

The board of directors of First Security has fixed the close of business on [•], 2018 as the record date for determining the shareholders entitled to notice of, and to vote at, the special meeting and any adjournments or postponements of the special meeting. Approval of the merger agreement proposal requires the affirmative vote of (i) at least a majority of the issued and outstanding shares of First Security *voting* common stock, and (ii) at least a majority of the outstanding shares of First Security *non-voting* common stock. Approval of the adjournment proposal requires that more shares of First Security voting common stock be voted in favor of the proposal than are voted against it.

To ensure your representation at the special meeting, please follow the voting procedures described in the accompanying proxy statement/prospectus. Submitting your proxy will not prevent you from voting in person. Your proxy may be revoked at any time before it is voted.

If you have any questions or need assistance voting your shares, please contact the undersigned at (270) 663-4668.

By Order of the Board of Directors

Michael F. Beckwith,
President and Chief Executive Officer
Owensboro, Kentucky
[•], 2018

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QUESTIONS AND ANSWERS

The following questions and answers are intended to address some commonly-asked questions regarding the proposed merger and the special meeting. These questions and answers may not address all the questions that may be important to you as one of First Security's shareholders. Please refer to the more detailed information contained elsewhere in this proxy statement/prospectus and the annexes to this proxy statement/prospectus.

Q:

What am I being asked to vote on? What is the proposed transaction?

A:

You are being asked to vote on a proposal to approve a merger agreement (including the related plan of merger) between First Security, Inc. (which we refer to as "First Security") and German American Bancorp, Inc. (which we refer to as "German American"), and the transactions contemplated by the merger agreement, including the merger of First Security with and into German American. We refer to this proposal as the "merger agreement proposal." As a result of the merger contemplated by the merger agreement proposal, First Security will cease to exist and First Security's bank subsidiary, First Security Bank, Inc. (which we refer to as "First Security Bank"), will merge into German American's bank subsidiary (which is named "German American Bank").

You are also being asked to vote:

- to approve one or more adjournments of the special meeting that will be convened to consider approving the merger agreement proposal (upon the motion of any shareholder of record entitled to vote thereon duly made and seconded) if necessary to permit further solicitation of proxies in favor of the merger agreement proposal, which we refer to as the "adjournment proposal;" and

- on such other matters that may be properly presented at the special meeting or any adjournment or postponement of the special meeting. First Security's Board is not aware of any such other matters.

Q:

What will I be entitled to receive in the merger?

A:

If the merger is completed, and you continue through the effective time of the merger to hold your shares of First Security common stock (other than Dissenting Shares as described below), you will be entitled to receive for (or in respect of) each of those shares of First Security common stock both:

- 0.7982 shares of German American common stock (and cash in lieu of any fractional share interests), and

- a cash payment of $12.00 (subject to reduction to the extent that First Security's consolidated common shareholder's equity is not at least equal to a certain level at the time of closing. See "THE MERGER AGREEMENT Calculation of Possible Reduction in Cash Payment" on page [•]).

It is currently expected that the former shareholders of First Security as a group will receive approximately [•]% of the outstanding shares of German American immediately after the merger.

Shares held in employee accounts by the First Security, Inc. 401k and Employee Stock Ownership Plan (the "KSOP") immediately prior to the effective time of the merger (other than Dissenting Shares), will be entitled to receive a cash payment equal to $40.00 for each share of First Security common stock.

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Q:

Am I entitled to "dissenters' rights" (sometimes also called "appraisal rights")?

A:

Yes. The shareholders of First Security have dissenters' rights with respect to the merger as described in the section entitled "THE MERGER AGREEMENT Dissenters' Rights of Appraisal" beginning on page [•] of this proxy statement/prospectus. Shares of First Security common stock that are issued and outstanding immediately prior to the effective time of the merger and which are held by persons who have properly exercised, and not withdrawn or waived, their dissenters' rights ("Dissenting Shares") in accordance with the Kentucky Business Corporation Act ("KBCA") will not be converted into the right to receive the merger consideration described in the preceding answer. Instead, those holders will be entitled to receive, in lieu of the merger consideration, payment of the fair value of their Dissenting Shares in accordance with the provisions of the KBCA unless and until those holders fail to perfect or effectively withdraw or lose their rights to appraisal and payment under the KBCA.

Q:

Why do First Security and German American want to merge?

A:

First Security's board of directors believes that the offer of 0.7982 shares of German American common stock plus $12.00 in cash for each share of First Security common stock is attractive from a financial perspective, and that the proposed merger will provide First Security shareholders with substantial benefits in light of German American's financial strength, the stock price performance and greater liquidity of its shares, and the prospects for the combined company. First Security's board of directors also believes that the merger presents a more certain opportunity to enhance shareholder value for First Security's shareholders than remaining independent.

German American believes that expanding its operations in the complementary geographic market areas where First Security operates offers financial and strategic benefits to German American and First Security as a combined company.

To review the reasons for the merger in more detail, see "THE MERGER German American's Reasons for the Merger" on page [•] and "THE MERGER First Security's Reasons for the Merger and Recommendation of the Board of Directors" on page [•].

Q:

What constitutes a quorum for the special meeting?

A:

The presence at the special meeting, in person or by proxy, of holders of a majority of the outstanding shares of First Security voting common stock entitled to vote at the special meeting will constitute a quorum for the transaction of business. Abstentions will be included in determining the number of shares present at the meeting for the purpose of determining the presence of a quorum.

Castle Creek Capital Partners V, L.P. ("Castle Creek"), the sole holder of First Security's non-voting common stock, has agreed to approve the merger and is expected to do so by written consent. Accordingly, quorum requirements relating to the First Security non-voting common stock at the special meeting will not apply.

Q:

What vote is required to adopt the proposals at the special meeting?

A:

Approval of the merger agreement proposal requires the affirmative vote of (i) at least a majority of the issued and outstanding shares of First Security *voting* common stock, and (ii) at least a majority of the outstanding shares of First Security *non-voting* common stock. We refer to First Security's *voting* common and *non-voting* common stock in this proxy/statement prospectus, collectively, as the "First Security common stock." **Abstentions (and broker non-votes, if any) will have the same effect as shares voted "AGAINST" the merger agreement proposal.**

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Approval of the adjournment proposal requires the holders of more shares of First Security voting common stock voting in favor of the proposal than voting against the proposal. Abstentions and broker non-votes will not be treated as "no" votes and, therefore, will have no effect on that proposal.

As stated above, Castle Creek, in its capacity as the sole holder of First Security's non-voting common stock, has agreed to approve the merger and is expected to do so by written consent.

As discussed under "THE SPECIAL MEETING Voting Agreement with First Security Directors" and "THE SPECIAL MEETING Voting and Support Agreements with Certain First Security Shareholders," the directors and certain principal shareholders of First Security are parties to voting agreements with German American pursuant to which such parties have agreed to vote all shares of First Security common stock beneficially owned by them in favor of the merger agreement proposal. As of the record date, these parties beneficially owned and were entitled to vote an aggregate of [•] shares of First Security voting common stock at the special meeting, or [•]% of the outstanding voting shares.

Q:

Who is entitled to vote at the First Security special meeting?

A:

Holders of shares of First Security voting common stock at the close of business on [•], 2018, which is the record date, are entitled to vote on the proposal to approve the merger agreement and the adjournment proposal at the First Security special meeting. As of the record date, [•] shares of First Security voting common stock were outstanding and entitled to vote.

Q:

How many shares do First Security's directors and executive officers control?

A:

As of the record date for the special meeting, First Security's directors and executive officers (in the aggregate) have the sole or shared right to vote approximately [•] of the outstanding shares of First Security voting common stock, or approximately [•]% of those shares then outstanding. See "THE SPECIAL MEETING Beneficial Ownership of First Security Common Stock by Certain Shareholders" on page [•].

Q:

When and where is the First Security special meeting?

A:

The special meeting of First Security shareholders is scheduled to take place at First Security's principal office, located at 313 Frederica Street, Owensboro, Kentucky, at [•], local time, on [•], 2018.

Q:

If I plan to attend the First Security special meeting in person, should I still grant my proxy?

A:

Yes. Whether or not you plan to attend the First Security special meeting, you should grant your proxy as described in this proxy statement/prospectus. **The failure of a First Security shareholder to vote in person or by proxy will have the same effect as a vote "AGAINST" approval of the merger agreement and related plan of merger**.

Q:

What is the recommendation of the First Security board of directors?

A:

The First Security board of directors has determined that the merger agreement (including the plan of merger attached as Appendix A to that agreement) and the merger contemplated by the merger agreement are advisable, fair to, and in the best interests of, First Security and its shareholders. The First Security board of directors unanimously recommends that you vote "FOR" (1) approval of the merger agreement proposal; and (2) approval of the adjournment proposal.

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Q:

What do I need to do now to vote my shares of First Security?

A:

After you have carefully read and considered the information contained in this proxy statement/prospectus, please vote by completing, signing, dating and returning the proxy card or voting form that accompanies this proxy statement/prospectus in the enclosed prepaid return envelope as soon as possible. This will enable your shares to be represented and voted at the special meeting.

Q:

If my shares are held in "street name" by my broker, will they automatically vote my shares for me?

A:

No. Your broker will not be able to vote your shares of First Security common stock on the proposal to adopt the merger agreement or the proposal for adjournment of the special meeting unless you provide instructions on how to vote. Please instruct your broker how to vote your shares, following the directions that your broker provides. If you do not provide instructions to your broker on the proposal to adopt the merger agreement or the proposal to adjourn the special meeting, your shares will not be voted. This will have the effect of voting "AGAINST" the adoption of the merger agreement, and will not be counted for purposes of the adjournment proposal. Please check the voting form used by your broker to see if it offers telephone or Internet voting.

Q:

How do I vote shares held in the KSOP (*i.e.*, First Security's 401k and Employee Stock Ownership Plan)?

A:

Under the terms of the KSOP, which is maintained by First Security for its employees and the employees of its subsidiaries, each KSOP participant instructs the KSOP trustee how to vote the shares of First Security common stock allocated to his or her account under the KSOP. If a participant properly executes the voting instruction card distributed by the trustee, the trustee will vote such participant's shares in accordance with the shareholder's instructions. If an instruction card is returned with no specific instructions as to how to vote at the special meeting, the trustee will vote the shares in favor of both the merger proposal and the adjournment proposal. With respect to the shares held in the KSOP but not allocated to any participant's account, and any shares allocated to an account for which the trustee receives no voting instructions, the trustee will vote those shares in the same proportion as KSOP participants have instructed the trustee to vote their shares on each of the merger proposal and the adjournment proposal, so long as such vote is in accordance with the provisions of the Employee Retirement Income Security Act.

Q:

May I change or revoke my vote after submitting a proxy?

A:

Yes. If you have not voted through your broker, you can change your vote by:

- providing written notice of revocation to the Secretary of First Security, which must be filed with the Secretary by the time the special meeting begins;

- submitting a new proxy card (any earlier proxies will be revoked automatically); or

- attending the special meeting and voting in person. Any earlier proxy will be revoked.

However, simply attending the special meeting without voting will not revoke your proxy.

If you have instructed a broker to vote your shares, you must follow your broker's directions to change your vote.

Q:

What are the material U.S. federal income tax consequences of the merger to me?

A:

German American and First Security expect the merger to qualify as a "reorganization" (within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended (the "Code"))

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for U.S. federal income tax purposes. If the merger qualifies as a reorganization, then, in general, for U.S. federal income tax purposes:

First Security shareholders generally will recognize gain (but not loss) in an amount not to exceed the cash received as part of the merger consideration and will recognize gain or loss with respect to any cash received in lieu of fractional shares of German American common stock; and

First Security shareholders will not recognize gain (or loss) as a result of receiving shares of German American common stock in the merger.

To review the tax consequences of the merger to First Security shareholders in greater detail, please see the section "MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES" beginning on page [•]. **Your individual tax consequences will depend on your personal situation. You should consult your tax advisor for a full understanding of the tax consequences of the merger to you.**

Q:

When is the merger expected to be completed?

A:

We will try to complete the merger as soon as possible. Before that happens, the merger agreement (including the plan of merger) must be approved by First Security's shareholders and we must obtain the necessary regulatory approvals. Assuming shareholders vote at least a majority of the issued and outstanding shares of First Security voting common stock in favor of the merger agreement proposal at the scheduled shareholders meeting (without the need for any adjournment) and we obtain the other necessary approvals in a timely fashion, we hope to close the merger effective October 1, 2018. Prior to that date, German American would file the necessary documents with the appropriate offices of the State of Indiana and the Commonwealth of Kentucky to cause the mergers to become effective. Those documents would specify an "effective time" of the merger of 12:01 a.m. (Eastern time) on October 1, 2018.

Q:

Is completion of the merger subject to any conditions besides shareholder approval?

A:

Yes. The transaction must receive the required regulatory approvals, dissenting shareholders must not represent twenty percent (20%) or more of the outstanding shares of First Security common stock, and other customary closing conditions must be satisfied (or waived, if applicable). To review the conditions of the merger in more detail, see "THE MERGER AGREEMENT Conditions to Completion of the Merger" on page [•].

Q:

Should I send in my stock certificates now?

A:

No. You **SHOULD NOT** send in any stock certificates now. If the merger is approved and completed, transmittal materials, with instructions for their completion, will be provided to all shareholders of First Security under separate cover. Only then should you send the stock certificates in accordance with those instructions.

Q:

Who can answer my other questions?

A:

If you have more questions about the merger, or how to submit your proxy, or if you need additional copies of this proxy statement/prospectus or the enclosed proxy form, you should contact Michael F. Beckwith, President and CEO, First Security, Inc., 313 Frederica Street, Owensboro, Kentucky 42301, telephone (270) 663-4668.

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SUMMARY

The following summary, together with the section of the proxy statement/prospectus entitled "Questions and Answers," highlight selected information contained in this proxy statement/prospectus. It may not contain all of the information that might be important in your consideration of the merger agreement and the proposed merger. We encourage you to carefully read this proxy statement/prospectus (including the documents that are annexed to this document and listed in the Table of Contents) in their entirety before voting. See "WHERE YOU CAN FIND MORE INFORMATION" on page [•].

In this proxy statement/prospectus, the term "First Security" refers to First Security, Inc., the term "German American" refers to German American Bancorp, Inc., the terms "we" or "us" or "our" refer to First Security and German American, the term "merger agreement" refers to that certain Agreement and Plan of Reorganization, dated as of May 22, 2018, as it may be amended from time to time, among German American, First Security, and their banking subsidiaries, a copy of which is attached as Annex A to this proxy statement/prospectus, the term "merger" refers to the merger of First Security with and into German American pursuant to the merger agreement, and the term "shares" refers to the shares of common stock of German American or First Security (as applicable in context). Where appropriate, we have set forth a section and page reference directing you to a more complete description of the topics described in this summary.

Information about the Companies

German American Bancorp, Inc. (page [•])
711 Main Street, Box 810
Jasper, Indiana 47547-0810
(812) 482-1314

German American, an Indiana corporation, is a bank holding company based in Jasper, Indiana. German American (through its bank subsidiary) operates 58 banking offices in 20 contiguous southern Indiana counties and one adjacent northern Kentucky county. German American also owns an investment brokerage subsidiary (German American Investment Services, Inc.) and a full line property and casualty insurance agency (German American Insurance, Inc.). As of March 31, 2018, German American had total assets of approximately $3.1 billion, total loans of approximately $2.2 billion, and total deposits of approximately $2.5 billion.

First Security, Inc. (page [•])
313 Frederica Street
Owensboro, Kentucky 42301
(270) 663-4668

First Security, a Kentucky corporation, is a financial services holding company based in Owensboro, Kentucky. First Security operates 11 retail banking offices through its wholly owned subsidiary, First Security Bank, Inc., in Owensboro, Bowling Green, Franklin and Lexington, Kentucky and in Evansville and Newburgh, Indiana. As of March 31, 2018, First Security had total assets of approximately $586 million, total loans of approximately $409 million, and total deposits of approximately $458 million.

The Merger and the Merger Agreement (pages [•] and [•])

First Security's merger into German American is governed by the merger agreement, and the related plan of merger that is an exhibit to the merger agreement. The merger agreement provides that, if all of the conditions are satisfied or waived, First Security will be merged with and into German American with German American surviving the merger and First Security ceasing to exist. We encourage you to read the merger agreement, which is included as Annex A to this proxy statement/prospectus.

What First Security Shareholders Will Receive as a Result of the Merger (page [•])

If the merger is completed, each share of First Security common stock that you own of record immediately before the effective time of the merger (other than Dissenting Shares and shares held by the KSOP) will be converted at the effective time into the right to receive 0.7982 shares of German American common stock and a cash payment of $12.00. Cash will be paid in lieu of any fractional German American share interests, and the cash payment per share is subject to reduction to the extent that First Security's consolidated common shareholders' equity is not at least equal to a certain level at the time of closing. See "THE MERGER AGREEMENT Calculation of Possible Reduction in Cash Payment" on page [•]).

Because the exchange ratio is fixed (except for customary anti-dilution adjustments), if you receive German American common stock as consideration for all or a portion of your shares of First Security common stock, the implied value of the stock consideration that you will receive will depend on the market price of German American common stock when you receive your shares. On [•], 2018, the most recent practicable trading day before this proxy statement/prospectus was finalized, the closing price of a share of German American common stock was $[•], which based on the of 0.7982 exchange ratio and $12.00 per share cash consideration, represented an implied value of $[•] per share of First Security common stock. It is currently expected that the former shareholders of First Security as a group will receive approximately [•]% of the outstanding shares of German American immediately after the merger.

Board of Directors of German American (and its Bank Subsidiary) Following Completion of the Merger (page [•])

After completion of the merger, German American will appoint one (1) person who is currently a member of the First Security board of directors (chosen by German American after consultation with First Security) to the German American board of directors. As of the date of this proxy statement/prospectus, it has not yet been determined which First Security director will be appointed to the German American board of directors. The board of directors of German American and of its banking subsidiary will otherwise be the same as the boards of directors of such companies immediately prior to the effective time of the merger. Information about the current German American directors and executive officers can be found in German American's Annual Report on Form 10-K for its year ended December 31, 2017, which is incorporated by reference into, and forms part of, this proxy statement/prospectus.

Recommendation of First Security Board of Directors (page [•])

The First Security board of directors has approved and adopted the merger agreement and the proposed merger. The First Security board believes that the merger agreement, including the merger and the other transactions contemplated by the merger agreement, is advisable and fair to, and in the best interests of, First Security and its shareholders, and therefore unanimously recommends that First Security shareholders vote "FOR" the: (1) approval of the merger agreement proposal; and (2) approval of the adjournment proposal. In reaching this decision, First Security's board of directors considered many factors, which are described in the section captioned "THE MERGER First Security's Reasons for the Merger and Recommendation of the Board of Directors" beginning on page [•]. Because of the wide variety of factors considered, First Security's board of directors did not believe it practicable, nor did it attempt, to quantify or otherwise assign relative weight to the specific factors it considered in reaching its decision.

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Opinion of First Security's Financial Advisor (page [•])

At the May 22, 2018 meeting of the board of directors of First Security, a representative of Raymond James & Associates, Inc. ("Raymond James") rendered Raymond James's oral opinion, which was subsequently confirmed by delivery of a written opinion to the First Security board dated May 22, 2018, as to the fairness, as of such date, from a financial point of view, to the holders of First Security's outstanding common stock, of the consideration to be received by such common shareholders pursuant to the merger agreement, based upon and subject to the qualifications, assumptions and other matters considered in connection with the preparation of its opinion.

The full text of the written opinion of Raymond James, dated May 22, 2018, which sets forth, among other things, the various qualifications, assumptions and limitations on the scope of the review undertaken, is attached as Annex B to this proxy statement/prospectus. Raymond James provided its opinion for the information and assistance of the board of directors of First Security (solely in its capacity as such) in connection with, and for purposes of, its consideration of the merger and its opinion only addresses whether the merger consideration was fair, from a financial point of view, to the holders of First Security's common stock as of the date of the opinion. The opinion of Raymond James did not address any other term or aspect of the merger agreement or the merger contemplated thereby. The Raymond James opinion does not constitute a recommendation to the First Security board or any holder of First Security's common stock as to how such board, such holders of First Security's common stock or any other person should vote or otherwise act with respect to the merger or any other matter.

Regulatory Approvals (page [•])

Under the terms of the merger agreement, the merger cannot be completed until German American and First Security and their bank subsidiaries have received the necessary regulatory approvals for the merger of First Security and German American and the merger of their bank subsidiaries. Filings have been made with all regulatory authorities that are believed by German American and First Security to have authority to grant such approvals, and such filings are under consideration by such authorities but have not yet been approved as of the date of this proxy statement/prospectus.

Conditions to the Merger (page [•])

The completion of the merger is subject to the fulfillment of a number of conditions, including:

- approval of the merger agreement by the holders of at least a majority of each of First Security's issued and outstanding voting and non-voting common shares;
- dissenting shares must not represent twenty percent (20%) or more of the outstanding shares of First Security common stock;
- approval of the transaction by the appropriate regulatory authorities; and
- the representations and warranties made by the parties in the merger agreement must be true in all material respects as of the closing date of the merger, except for such changes as have not had, and cannot reasonably be expected to have, a "material adverse effect" as defined in the merger agreement.

Termination (page [•])

The merger agreement may be terminated by mutual consent of German American and First Security at any time before articles of merger are filed with the Indiana Secretary of State and the Kentucky Secretary of State. Additionally, subject to conditions and circumstances described in the

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merger agreement, either German American or First Security may terminate the merger agreement prior to the filing of the articles of merger if, among other things, any of the following occur:

- the closing of the merger has not occurred by February 1, 2019;
- First Security's shareholders do not adopt the merger agreement at the special meeting by the requisite vote;
- there is a material breach by the other party of any representation or warranty contained in the merger agreement (other than those breaches that together with other breaches arising after the date of the merger agreement, do not have a "material adverse effect" on such other party as defined by the merger agreement, which breach cannot be cured, or has not been cured within 30 days after the giving of written notice to the other party of such breach);
- there is a breach by the other party in any material respect of any of its covenants or agreements contained in the merger agreement, which breach cannot be cured, or has not been cured within 30 days after the giving of written notice to the other party of such breach; or
- certain adverse regulatory determinations.

In addition, German American may terminate the merger agreement if First Security breaches its notice obligations related to an acquisition transaction, or does not terminate all discussions, negotiations and information exchanges related to such inquiry, proposal, indication of interest or offer related to an acquisition transaction within forty-five (45) days after the first communication between First Security or First Security Bank and the third party and does not provide German American with written notice of such termination.

Termination Fee (page [•])

If (i) First Security breaches its notice obligations related to an acquisition transaction, or does not terminate all discussions, negotiations and information exchanges related to such inquiry, proposal, indication of interest or offer related to an acquisition transaction within forty-five (45) days after the first communication between First Security or First Security Bank and the third party and does not provide German American with written notice of such termination or (ii) First Security's board of directors should fail to include its recommendation to shareholders of First Security that they vote in favor of the merger at the special meeting, or should withdraw its recommendation following First Security's receipt of a proposal from another party to engage in a business combination, and, in either case, the merger agreement is terminated as a result, then First Security would owe German American a termination fee of $3,000,000.

Interests of Officers and Directors in the Merger That are Different From Yours (page [•])

In considering the recommendation of the board of directors of First Security to adopt the merger agreement, you should be aware that executive officers and directors of First Security have (or had) employment and other compensation agreements or plans that give them (or gave them) interests in connection with the merger that may be different from, or in addition to, their interests as First Security shareholders. These current or former interests and agreements include:

- the accelerated vesting of all outstanding unvested stock options held by First Security directors and executive officers, and the agreement by German American to pay cash in cancellation of each unexercised option upon completion of the merger in an amount equal to $40.00 (subject to reduction in certain circumstances) less the applicable exercise price and tax withholding. If none of the outstanding options were to be exercised before closing, option cancellation payments to First Security directors and executive officers would total approximately $751,842;

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- the Bonus and Change in Control Termination Agreement with Mr. Beckwith that provides for payment to him upon a change in control of First Security, subject to certain limitations. Under this agreement, Mr. Beckwith would be entitled to receive a change in control benefit in the amount of $450,000, if the merger transaction closes. In addition, the agreement also provides that Mr. Beckwith is entitled to receive (whether or not the merger closes) a bonus payment in the amount of $500,000 on or before the earlier of (i) the closing of the merger, or (ii) March 15, 2019.

- the closing of the merger is conditioned upon German American entering into an employment agreement with Mr. Beckwith, which will become effective upon the effective time of the merger. To induce Mr. Beckwith to enter into this at-will employment relationship, German American will pay Mr. Beckwith a lump sum payment of $125,000 on each of the first and second anniversaries of the merger effective date, subject to Mr. Beckwith's continued employment;

- that one person who is currently a member of the First Security board of directors will be appointed to the German American board of directors, and that all independent directors currently serving on the First Security Bank board of directors, other than the director appointed to German American's board, will be appointed to a newly created Regional Advisory Board of German American, and each will be entitled to receive compensation from German American for their services on these boards. As of the date of this proxy statement/prospectus, it has not yet been determined which First Security director will be appointed to the German American board of directors; and

- rights of First Security officers and directors to indemnification and directors' and officers' liability insurance.

Certain Differences in Shareholder Rights (page [•])

When the merger is completed, First Security shareholders, whose rights are governed by Kentucky law and First Security's articles of incorporation and bylaws, will become German American shareholders and their rights will be governed by Indiana law, and by German American's articles of incorporation and bylaws. Certain differences in the rights of First Security shareholders in respect of their shares will result.

Dissenters' Rights of Appraisal (page [•])

If the merger agreement is approved and the merger is consummated, each shareholder of First Security who dissents from the merger will have the right to be paid the "fair value" of his or her shares of First Security common stock in cash, provided that the shareholder complies with Subtitle 13, Chapter 271B, Title XXIII of the Kentucky Revised Statutes. See "THE MERGER AGREEMENT Dissenters' Rights of Appraisal" and Annex C.

Prohibition on First Security's Solicitation of Other Offers and Having Discussions with Potential Acquirors (page [•])

The merger agreement prohibits First Security from soliciting offers from any other party that might also be interested in acquiring First Security, and from discussing a potential proposal with (including providing information to) any interested third party that might (despite the lack of any solicitation by First Security) reach out to it with regard to such an alternative proposal to the merger with German American, except to the extent such discussions may be required under fiduciary duties applicable to the First Security directors under Kentucky law.

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Dividends and Distributions (page [•])

Under the terms of the merger agreement, prior to the closing of the merger, First Security is prohibited from declaring or paying any cash dividend or other distribution to First Security shareholders, except First Security's quarterly cash dividend in an amount not to exceed $0.17 per share; provided, however, First Security and German American will coordinate First Security's dividend schedule for the quarter in which the merger closing occurs so that First Security's shareholders do not receive dividends for shares of both German American common stock and First Security common stock for the same calendar quarter.

Material U.S. Federal Income Tax Consequences of the Merger (page [•])

German American and First Security expect the merger to qualify as a "reorganization" (within the meaning of Section 368(a) of the Code) for U.S. federal income tax purposes. If the merger qualifies as a reorganization, then, in general, for U.S. federal income tax purposes, as a result of the merger:

- First Security shareholders will recognize gain (but not loss) in an amount not to exceed the cash received as part of the merger consideration and will recognize gain or loss with respect to any cash received in lieu of fractional shares of German American common stock; and

- First Security shareholders will not recognize gain (or loss) as a result of their receiving shares of German American common stock in the merger.

See "MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES" on page [•] for a summary of the material U.S. federal income tax consequences of the merger to U.S. holders of First Security common stock.

Because individual circumstances may differ, each shareholder should, at their own expense, consult such shareholder's tax advisor regarding the applicability of the rules discussed in this proxy statement/prospectus to the shareholder and the particular tax effects to the shareholder of the merger and the holding or disposing of German American shares in light of such shareholder's particular circumstances, the application of state, local and foreign tax laws, and, if applicable, the tax consequences of the transactions described in this proxy statement/prospectus relating to equity compensation and benefit plans.

Special Meeting

Date, Time and Place (page [•])

The special meeting of First Security shareholders is scheduled to be held at First Security's principal office located at 313 Frederica Street, Owensboro, Kentucky 42301, at [•], local time, on [•], 2018. At the First Security special meeting, you will be asked:

1. to consider and vote upon a proposal to approve the merger agreement and related plan of merger and thereby approve the transactions contemplated by the merger agreement, including the merger of First Security into German American;

2. to approve one or more adjournments of the special meeting if necessary to permit further solicitation of proxies in favor of the merger agreement and the related plan of merger; and

3. to vote upon such other business as may be properly presented at the special meeting and any adjournments or postponements of the special meeting.

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Record Date (page [•])

Only First Security shareholders of record as of the close of business on [•], 2018, are entitled to notice of, and to vote at, the First Security special meeting and any adjournments or postponements of the First Security special meeting. As of the close of business on the record date, there were [•] shares of First Security voting common stock outstanding and entitled to vote at the meeting, held by approximately [•] holders of record.

Castle Creek Capital Partners V, L.P. ("Castle Creek") beneficially owned all 571,147 shares of First Security's non-voting common stock outstanding as of the record date. Castle Creek has agreed to vote all the non-voting common stock in favor of the merger and is expected to do so by written consent.

Attending in Person (page [•])

All First Security shareholders of record as of the record date for the special meeting may attend the special meeting. WHETHER OR NOT YOU INTEND TO ATTEND THE SPECIAL MEETING, IT IS VERY IMPORTANT THAT YOUR SHARES BE REPRESENTED. Accordingly, please sign, date, and return the enclosed proxy card, which will indicate your vote upon the matters to be considered. If you do attend the special meeting and desire to vote in person, you may do so by withdrawing your proxy at that time prior to voting your shares.

How to Vote (page [•])

First Security shareholders may vote their shares at the special meeting:

In Person: by attending the special meeting and voting their shares in person; or

By Mail: by completing the enclosed proxy card, signing and dating it and mailing it in the enclosed post-prepaid envelope.

First Security's board of directors is asking for your proxy. Giving the First Security board of directors your proxy means you authorize it to vote your shares at the special meeting in the manner you direct. You may vote for or against the merger agreement proposal and the other proposals to be voted upon at the special meeting, or abstain from voting. All shares represented by a valid proxy received prior to the special meeting will be voted in accordance with the instructions provided by the shareholder. If you sign and return the enclosed proxy but provide no voting instructions, the shares represented by the proxy will be voted "FOR" the merger proposal, "FOR" the adjournment proposal, and as the named proxy holders may determine in their discretion with respect to any other matters that may properly come before the special meeting.

The form of proxy accompanying this proxy statement/prospectus confers discretionary authority upon the named proxy holders with respect to amendments or variations to the matters identified in the accompanying Notice of Special Meeting and with respect to any other matters that may properly come before the special meeting. As of the date of this proxy statement/prospectus, the First Security board of directors knows of no such amendment or variation or of any matters expected to come before the special meeting that are not referred to in the accompanying Notice of Special Meeting.

Shareholders who hold their shares in "street name," meaning the name of a broker, bank or trust company, or other nominee who is the record holder, must either direct the record holder of their shares to vote their shares or obtain a proxy or voting instruction from the record holder to vote their shares at the special meeting.

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Changing or Revoking a Proxy (page [•])

Any proxy may be revoked by the person giving it at any time before it is voted. A proxy may be revoked by (i) filing with First Security's Secretary, Mary L. Moorhouse (313 Frederica Street, Owensboro, Kentucky 42301), a written notice of revocation bearing a date later than the date of such proxy, (ii) submitting a subsequent proxy relating to the same shares, or (iii) attending the special meeting and voting in person. Simply attending the special meeting will not constitute revocation of your proxy. If your shares are held in the name of a broker, bank or trust company, or other nominee who is the record holder, you must follow the instruction of your broker, bank or trust company, or other nominee to revoke a previously given proxy.

Quorum (page [•])

The presence, in person or by proxy, of shareholders holding at least a majority of the issued and outstanding shares of First Security voting common stock entitled to vote on the record date will constitute a quorum for the special meeting. Abstentions will be included in determining the number of shares present at the meeting for the purpose of determining the presence of a quorum.

The sole holder of First Security's non-voting common stock, Castle Creek, has agreed to approve the merger and is expected to do so by written consent. Accordingly, quorum requirements relating to the non-voting common stock are not expected to apply at the special meeting.

Required Votes to Approve the Proposals (page [•])

To approve the merger agreement, holders of a majority of the issued and outstanding shares of both First Security's voting common stock and non-voting common stock, voting as separate voting groups, must vote in favor of the proposal.

As of [•], 2018, the record date for the meeting, there were [•] shares of First Security voting common stock outstanding and entitled to vote. Approval of the merger agreement requires the affirmative vote of holders of at least [•] of the shares of voting common stock.

Castle Creek, as the sole holder of First Security's non-voting common stock, has agreed to approve the merger and is expected to do so by written consent.

German American's shareholders are not required to approve the merger or merger agreement.

The adjournment proposal will be approved if more shares of First Security voting common stock are voted in favor of the proposal than are voted against it.

Treatment and Effect of Abstentions and "Broker Non-Votes" (page [•])

Shares of First Security as to which a shareholder abstains will be treated as being present at the special meeting for purposes of determining whether a quorum of shares is present at the special meeting. Because approval of the merger and the adoption of the merger agreement and plan of merger requires the affirmative vote of a majority of the shares of First Security issued and outstanding as of the record date, abstentions and broker non-votes (if any) will have the same effect as a vote "AGAINST" the adoption of the merger agreement and plan of merger and the approval of the merger.

If you are a beneficial owner of shares of First Security held by a broker or its nominee, you must instruct your nominee how to vote. Your nominee cannot vote your shares on your behalf without your instructions. If you do not provide instructions to your broker for the adjournment proposal, your shares will not be voted, and will not be counted for that proposal.

Voting Agreement with First Security Directors (page [•])

Each member of the board of directors of First Security has entered into a voting agreement with German American to cause all First Security common stock owned of record or beneficially by each of them to be voted in favor of the merger agreement proposal. See "THE SPECIAL MEETING Voting Agreement with First Security Directors" on page [•]. As of the record date, the First Security directors and their affiliates had the power to vote an aggregate of [•] shares of First Security voting common stock, representing [•]% of the outstanding voting shares.

Voting and Support Agreements with Certain First Security Shareholders (page [•])

German American entered into voting and support agreements with certain of First Security's principal shareholders pursuant to which those shareholders have agreed to vote all shares of First Security common stock beneficially owned by them in favor of the merger. See "THE SPECIAL MEETING Voting and Support Agreements with Certain First Security Shareholders" on page [•]. As of the record date, the shareholders subject to voting and support agreements beneficially owned and were entitled to vote an aggregate of [•] shares of First Security voting common stock at the special meeting, or [•]% of the outstanding voting shares.

The total number of shares of First Security voting common stock subject to voting agreements with directors and principal shareholders is [•], which represents [•]% of outstanding voting shares as of the record date.

Cost of Solicitation of Proxies (page [•])

The cost of soliciting proxies related to the special meeting will be borne by First Security. In addition to solicitation by mail, directors, officers, and employees of First Security may solicit proxies for the special meeting from First Security's shareholders personally or by telephone, the Internet, or other electronic means. However, First Security's directors, officers, and employees will not be paid any special or extra compensation for soliciting such proxies, although they may be reimbursed for out-of-pocket expenses incurred in connection with the solicitation. Upon request, First Security will reimburse brokers, dealers, banks, trustees, and other fiduciaries for the reasonable expenses they incur in forwarding proxy materials to beneficial owners of First Security's common stock.

Risk Factors (page [•])

In evaluating the merger, the merger agreement and the shares of German American to be received in connection with the merger, you should carefully read this proxy statement/prospectus and especially consider the factors discussed in the section entitled "RISK FACTORS."

Historical and Equivalent Per Share Stock Market Data

Shares of German American are listed on NASDAQ's Global Select Market under the symbol "GABC." Shares of First Security common stock are quoted on the OTCQX Market under the symbol "FIIT." The following table presents quotation information for German American common stock and for First Security common stock on May 21, 2018, the business day before the merger was publicly announced, which is the last day on which German American shares traded preceding the public

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announcement of the proposed merger, and on [•], 2018, the most recent practicable date prior to the mailing of this proxy statement/prospectus.

	German American Common Stock			First Security Common Stock		
	(Dollars Per Share)					
	High	Low	Close	High	Low	Close
May 21, 2018	$ 35.76	$ 35.29	$ 35.57	$ 27.10	$ 27.10	$ 27.10
[•], 2018	[•]	[•]	[•]	[•]	[•]	[•]

The following table sets forth the closing price of German American common stock and First Security common stock on May 21, 2018, and on [•], 2018, and the equivalent per share price of First Security common stock, which we determined by (a) multiplying the price of German American shares as of the indicated date by the exchange ratio (0.7982) and (b) adding to that result the $12.00 cash amount (assuming no reduction in accordance with the merger agreement) that is payable by German American in connection with the merger agreement proposal as merger consideration. The equivalent per share price of First Security common stock shows the implied value to be received in the merger by First Security shareholders who receive German American common stock in exchange for a share of First Security common stock on these dates.

	German American Common Stock Closing Price	First Security Common Stock Closing Price	First Security Equivalent Per Share Price
May 21, 2018	$ 35.57	$ 27.10	$ 40.39
[•], 2018	[•]	[•]	[•]

We suggest you obtain a current market quotation for German American common stock. We expect that the market price of German American common stock will fluctuate between the date of this document and the date on which the merger is completed and thereafter. Because the exchange ratio is fixed (except for customary anti-dilution adjustments) and the market price of German American common stock is subject to fluctuation, the value of the shares of German American common stock that First Security shareholders will receive in the merger may increase or decrease prior to and after the merger.

Comparative Per Share Data

The following table shows historical information about German American's and First Security's earnings per share, dividends per share and book value per share, and similar information reflecting the merger, which we refer to as "pro forma" information. In presenting the comparative pro forma information, we have assumed that the two companies had been combined throughout the periods shown in the table. The pro forma information reflects the "acquisition" method of accounting. The financial information presented under "Pro Forma" was compiled assuming 1,978,531 shares of German American common shares are issued to First Security shareholders, which assumes 2,478,741 shares of First Security common stock will be exchanged for German American shares at the closing of the merger. The assumed number of First Security shares represents the sum of 2,296,831 shares of First Security common stock outstanding on May 21, 2018, plus 209,450 shares of First Security common stock issuable upon conversion of convertible subordinated debentures, less 27,540 shares of First Security common stock held in the KSOP, and assumes that there are no dissenters.

German American and First Security present this information to reflect the value of shares of German American common stock that First Security shareholders will receive in the merger for each share of First Security common stock exchanged.

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We expect that we will incur reorganization and restructuring expenses as a result of combining our two companies. We also anticipate that the merger will provide the combined company with financial benefits that include reduced operating expenses (as compared to the sum of expenses from each company while operating separately) and the opportunity to earn more revenue. The pro forma information, while helpful in illustrating the financial characteristics of the combined company, does not take into account these expected expenses or these anticipated financial benefits, and does not attempt to predict or suggest future results. It also does not necessarily reflect what the historical results of the merged company would have been had our companies been merged during the periods presented.

The information in the following table is based on historical financial information of First Security and German American. The information with respect to German American is included in or derived from its annual and quarterly reports previously filed with the SEC. Certain historical financial information of German American has been incorporated into this document by reference. See "WHERE YOU CAN FIND MORE INFORMATION" on page [•] for a description of documents that we incorporate by reference into this document and how to obtain copies of them. First Security does not have a class of securities registered under Section 12 of the Exchange Act, is not subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act and, accordingly, does not file documents and reports with the SEC to be incorporated by reference.

	German American Historical	First Security Historical	Pro forma(1)
Net income per share			
Three months ended March 31, 2018			
Basic	$ 0.51	$ 0.32	$ 0.51
Diluted	$ 0.51	$ 0.32	$ 0.51
Twelve months ended December 31, 2017			
Basic	$ 1.77	$ 0.96	$ 1.76
Diluted	$ 1.77	$ 0.96	$ 1.76
Cash dividends per share			
Three months ended March 31, 2018	$ 0.15	$ 0.17	$ 0.15
Twelve months ended December 31, 2017	$ 0.52	$ 0.68	$ 0.52
Book value per share			
At March 31, 2018	$ 15.85	$ 26.40	$ 17.37
At December 31, 2017	$ 15.90	$ 26.13	$ 17.42

(1) See "UNAUDITED PRO FORMA SUMMARY OF SELECTED FINANCIAL DATA" on page [•] of this proxy statement/prospectus for certain supporting information.

SELECTED CONSOLIDATED FINANCIAL DATA

The following tables set forth certain summary historical consolidated financial data for each of our companies. The financial data at and for each of the five years in the period ended December 31, 2017 is derived from each of German American's and First Security's respective audited financial statements (which data and financial statements are presented for each company on a consolidated basis). The financial data at and for the three months ended March 31, 2018 and March 31, 2017 is derived from the unaudited financial statements of German American and First Security and, in the opinion of each such company's management, its respective statements and data reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of such information at and for those dates. Ratios for the three months ended March 31, 2018 and March 31, 2017 are annualized.

The following tables also set forth certain summary unaudited pro forma consolidated financial information for German American and First Security reflecting the merger. The pro forma disclosures are being presented to provide additional information in support of the pro forma data included under the "Comparative Per Share Data" section of this SUMMARY. As a result, this condensed pro forma presentation is not intended to comply with the disclosure requirements under Article 11 of Regulation S-X. The income statement information presented gives effect to the merger as if it occurred on the first day of the first pro forma period presented. The balance sheet information presented gives effect to the merger as if it occurred on March 31, 2018.

The pro forma information reflects the purchase method of accounting, with First Security's assets and liabilities recorded at their estimated fair values as of March 31, 2018. The actual fair value adjustments to the assets and the liabilities of First Security will be made on the basis of appraisals and evaluations that will be made as of the date the merger is completed. Thus, the actual fair value adjustments may differ significantly from those reflected in these pro forma financial statements. In the opinion of German American's management, the estimates used in the preparation of these pro forma financial statements are reasonable under the circumstances.

As stated previously, we expect that we will incur reorganization and restructuring expenses as a result of combining our two companies. We also anticipate that the merger will provide the combined company with financial benefits that include reduced operating expenses (as compared to the sum of expenses from each company while operating separately) and the opportunity to earn more revenue. The pro forma information, while helpful in illustrating the financial characteristics of the combined company, does not take into account these expected expenses or these anticipated financial benefits, and does not attempt to predict or suggest future results. It also does not necessarily reflect what the historical results of the merged company would have been had our companies been merged during the periods presented.

This selected financial data is only a summary and you should read it in conjunction with German American's consolidated financial statements and related notes incorporated into this document by reference. See "WHERE YOU CAN FIND MORE INFORMATION" on page [•] for a description of documents that we incorporate by reference into this document and how to obtain copies of such documents. First Security does not have a class of securities registered under Section 12 of the Exchange Act, is not subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act and, accordingly, does not file documents and reports with the SEC to be incorporated by reference.

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GERMAN AMERICAN
FIVE YEAR SUMMARY OF SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA
(Dollars in Thousands, Except Per Share Amounts)

	For the Three Months Ended March 31,		For the Years Ended December 31,				
	2018	2017	2017	2016	2015	2014	2013
	(unaudited)						
Summary of Operations							
Interest income	$ 29,145	$ 27,033	$ 111,030	$ 103,365	$ 81,620	$ 80,386	$ 75,672
Interest expense	3,535	2,308	11,121	8,461	6,068	6,047	7,155
Net interest income	25,610	24,725	99,909	94,904	75,552	74,339	68,517
Provision for loan losses	350	500	1,750	1,200		150	350
Net interest income after provision for loan losses	25,260	24,225	98,159	93,704	75,552	74,189	68,167
Non-interest income	9,492	8,188	31,854	32,013	27,444	23,937	23,615
Non-interest expense	20,455	19,036	77,803	76,587	61,326	57,713	54,905
Net income before income tax	14,297	13,377	52,210	49,130	41,670	40,413	36,877
Income tax expense	2,484	3,821	11,534	13,946	11,606	12,069	11,464
Net income	$ 11,813	$ 9,556	$ 40,676	$ 35,184	$ 30,064	$ 28,344	$ 25,413
Per Share Data							
Net income							
Basic	$ 0.51	$ 0.42	$ 1.77	$ 1.57	$ 1.51	$ 1.43	$ 1.32
Diluted	$ 0.51	$ 0.42	$ 1.77	$ 1.57	$ 1.51	$ 1.43	$ 1.32
Cash dividends	$ 0.15	$ 0.13	$ 0.52	$ 0.48	$ 0.45	$ 0.43	$ 0.40
Book value at end of period	$ 15.85	$ 14.88	$ 15.90	$ 14.42	$ 12.67	$ 11.54	$ 10.13
Selected Balance Sheet (End of Period Balances)							
Total assets	$ 3,125,018	$ 2,933,144	$ 3,144,360	$ 2,955,994	$ 2,373,701	$ 2,237,099	$ 2,163,827
Total loans net of unearned income	2,150,546	1,983,572	2,141,638	1,989,955	1,564,347	1,447,982	1,382,382
Total deposits	2,467,	$ 0.52	$ 1.30	$ 1.31			
Diluted earnings per common share	$ 0.71	$ 0.52	$ 1.30		$ 1.31		

(1) Stock options, SARs and RSUs outstanding of 46,000 at June 30, 2014 and 99,500 at June 30, 2013 have not been included in diluted earnings per share because to do so would have been anti-dilutive for the periods

presented.

(3) SECURITIES

Securities are identified as either held-to-maturity or available-for-sale based upon various factors, including asset/liability management strategies, liquidity and profitability objectives, and regulatory requirements. Held-to-maturity securities are carried at cost, adjusted for amortization of premiums or accretion of discounts. Available-for-sale securities are securities that may be sold prior to maturity based upon asset/liability management decisions. Securities identified as available-for-sale are carried at fair value. Unrealized gains or losses on available-for-sale securities are recorded as accumulated other comprehensive income in stockholders equity, net of taxes. Amortization of premiums or accretion of discounts on mortgage-backed securities is periodically adjusted for estimated prepayments. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain (loss) on sale of securities. The cost of securities sold is based on the specific identification method.

At June 30, 2014, our net unrealized gain on the available-for-sale securities portfolio was $2.4 million compared to $2.5 million at December 31, 2013. As a percent of outstanding balances, the unrealized gain was 5.08% and 4.13% at June 30, 2014 and December 31, 2013, respectively. The increase in the percent of outstanding balances at June 30, 2014 related to change in market value.

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The following is a summary of securities (in thousands):

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities:				
Residential mortgage-backed securities	$ 33,491	$ 2,511	$	$ 36,002
Municipals	5,930	22		5,952
Equity securities[1]	7,522	11	(157)	7,376
	$ 46,943	$ 2,544	$ (157)	$ 49,330

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities:				
Residential mortgage-backed securities	$ 38,786	$ 2,676	$	$ 41,462
Municipals	14,401	104		14,505
Equity securities[1]	7,522		(275)	7,247
	$ 60,709	$ 2,780	$ (275)	$ 63,214

(1) Equity securities consist of Community Reinvestment Act funds.

The amortized cost and estimated fair value of securities are presented below by contractual maturity (in thousands, except percentage data):

	June 30, 2014				
	Less Than One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total
Available-for-sale:					
Residential mortgage-backed securities:[1]					
Amortized cost	$ 13	$ 11,711	$ 6,504	$ 15,263	$ 33,491
Estimated fair value	13	12,447	7,266	16,276	36,002
Weighted average yield[3]	6.50%	4.80%	5.53%	2.36%	3.83%
Municipals:[2]					
Amortized cost	3,614	2,316			5,930

Estimated fair value	3,627	2,325	5,952
Weighted average yield[3]	5.85%	5.75%	5.92%
Equity securities:[4]			
Amortized cost	7,522		7,522
Estimated fair value	7,376		7,376
Total available-for-sale securities:			
Amortized cost			$ 46,943
Estimated fair value			$ 49,330

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	December 31, 2013				
	Less Than One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total
Available-for-sale:					
Residential mortgage-backed securities:[1]					
Amortized cost	$ 238	$ 14,720	$ 7,718	$ 16,110	$ 38,786
Estimated fair value	252	15,641	8,456	17,113	41,462
Weighted average yield[3]	4.32%	4.78%	5.56%	2.40%	3.94%
Municipals:[2]					
Amortized cost	7,749	6,652			14,401
Estimated fair value	7,818	6,687			14,505
Weighted average yield[3]	5.76%	5.71%			5.73%
Equity securities:[4]					
Amortized cost	7,522				7,522
Estimated fair value	7,247				7,247
Total available-for-sale securities:					
Amortized cost					$ 60,709
Estimated fair value					$ 63,214

(1) Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.
(2) Yields have been adjusted to a tax equivalent basis assuming a 35% federal tax rate.
(3) Yields are calculated based on amortized cost.
(4) These equity securities do not have a stated maturity.

Securities with carrying values of approximately $37.5 million were pledged to secure certain borrowings and deposits at June 30, 2014. Of the pledged securities at June 30, 2014, approximately $10.0 million were pledged for certain deposits, and approximately $27.5 million were pledged for repurchase agreements.

The following table discloses, as of June 30, 2014 and December 31, 2013, our investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months (in thousands):

June 30, 2014	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Equity securities	$	$	$ 6,343	$ (157)	$ 6,343	$ (157)

December 31, 2013	Less Than 12 Months	12 Months or Longer	Total

	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Equity securities	$ 7,247	$ (275)	$	$	$ 7,247	$ (275)

At June 30, 2014, there was one security with an unrealized loss position. This security is a publicly traded equity fund and is subject to market pricing volatility. We do not believe this unrealized loss is other than temporary . We have evaluated the near-term prospects of the investment in relation to the severity and duration of the impairment and based on that evaluation have the ability and intent to hold the investment until recovery of fair value. We have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on this security.

Unrealized gains or losses on our available-for-sale securities (after applicable income tax expense or benefit) are included in accumulated other comprehensive income (loss), net. Comprehensive income for the six months ended June 30, 2014 and 2013 included a net after-tax loss of $77,000 and $1.1 million, respectively, due to changes in the net unrealized gains/losses on securities available-for-sale.

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(4) LOANS AND ALLOWANCE FOR LOAN LOSSES

At June 30, 2014 and December 31, 2013, loans were as follows (in thousands):

	June 30, 2014	December 31, 2013
Commercial	$ 5,295,368	$ 5,020,565
Mortgage finance	3,700,253	2,784,265
Construction	1,567,667	1,262,905
Real estate	2,231,630	2,146,228
Consumer	15,847	15,350
Leases	95,914	93,160
Gross loans held for investment	12,906,679	11,322,473
Deferred income (net of direct origination costs)	(53,711)	(51,899)
Allowance for loan losses	(91,114)	(87,604)
Total	$ 12,761,854	$ 11,182,970

Commercial Loans and Leases. Our commercial loan and lease portfolio is comprised of lines of credit for working capital and term loans and leases to finance equipment and other business assets. Our energy production loans are generally collateralized with proven reserves based on appropriate valuation standards. Our commercial loans and leases are underwritten after carefully evaluating and understanding the borrower s ability to operate profitably. Our underwriting standards are designed to promote relationship banking rather than making loans on a transactional basis. Our lines of credit typically are limited to a percentage of the value of the assets securing the line. Lines of credit and term loans typically are reviewed annually and are supported by accounts receivable, inventory, equipment and other assets of our clients businesses.

Mortgage Finance Loans. Our mortgage finance loans consist of ownership interests purchased in single-family residential mortgages funded through our warehouse lending group. These interests are typically on our balance sheet for 10 to 20 days or less. We have agreements with mortgage lenders and purchase interests in individual loans they originate. All loans are underwritten consistent with established programs for permanent financing with financially sound investors. Substantially all loans are conforming loans. Balances are stated net of participations sold.

Construction Loans. Our construction loan portfolio consists primarily of single- and multi-family residential properties and commercial projects used in manufacturing, warehousing, service or retail businesses. Our construction loans generally have terms of one to three years. We typically make construction loans to developers, builders and contractors that have an established record of successful project completion and loan repayment and have a substantial equity investment in the borrowers. However, construction loans are generally based upon estimates of costs and value associated with the completed project. Sources of repayment for these types of loans may be pre-committed permanent loans from other lenders, sales of developed property, or an interim loan commitment from us until permanent financing is obtained. The nature of these loans makes ultimate repayment extremely sensitive to overall economic conditions. Borrowers may not be able to correct conditions of default in loans, increasing risk of exposure to classification, non-performing status, reserve allocation and actual credit loss and foreclosure. These loans typically have floating rates.

Real Estate Loans. A portion of our real estate loan portfolio is comprised of loans secured by properties other than market risk or investment-type real estate. Market risk loans are real estate loans where the primary source of repayment is expected to come from the sale, permanent financing or lease of the real property collateral. We generally provide temporary financing for commercial and residential property. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Our real estate loans generally have maximum terms of five to seven years, and we provide loans with both floating and fixed rates. We generally avoid long-term loans for commercial real estate held for investment. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Appraised values may be highly variable due to market conditions and the impact of the inability of potential purchasers and lessees to obtain financing and lack of transactions at comparable values.

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Portfolio Geographic Concentration

As of June 30, 2014, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. The risks created by this concentration have been considered by management in the determination of the appropriateness of the allowance for loan losses. Management believes the allowance for loan losses is appropriate to cover probable losses inherent in the loan portfolio at each balance sheet date.

At June 30, 2014 and December 31, 2013, we had a blanket floating lien based on certain real estate loans used as collateral for Federal Home Loan Bank (FHLB) borrowings.

Summary of Loan Loss Experience

The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an appropriate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than $500,000 are specifically reviewed for loss potential. For loans deemed to be impaired, a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate a reserve assigned to off-balance sheet commitments, specifically unfunded loan commitments and letters of credit, and any needed reserve is recorded in other liabilities. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management s judgment, should be charged off.

We have several pass credit grades that are assigned to loans based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to watch credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of monitoring. Within our criticized/classified credit grades are special mention, substandard, and doubtful. Special mention loans are those that are currently protected by the current sound worth and paying capacity of the borrower, but that are potentially weak and constitute an additional credit risk. The loan has the potential to deteriorate to a substandard grade due to the existence of financial or administrative deficiencies. Substandard loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Some substandard loans are insufficiently protected by the current sound worth and paying capacity of the borrower and of the collateral pledged and may be considered impaired. Substandard loans can be accruing or can be on non-accrual depending on the circumstances of the individual loans. Loans classified as doubtful have all the weaknesses inherent in substandard loans with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high. All doubtful loans are on nonaccrual.

The reserve allocation percentages assigned to each credit grade have been developed based primarily on an analysis of our historical loss rates. The allocations are adjusted for certain qualitative factors for such things as general economic conditions, changes in credit policies and lending standards. Historical loss rates are adjusted to account for current environmental conditions which we believe are likely to cause loss rates to be higher or lower than past experience. Each quarter we produce an adjustment range for environmental factors unique to us and our market.

Changes in the trend and severity of problem loans can cause the estimation of losses to differ from past experience. In addition, the reserve reflects the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio. The portion of the allowance that is not derived by the allowance allocation percentages compensates for the uncertainty and complexity in estimating loan and lease losses including factors and conditions that may not be fully reflected in the determination and application of the allowance allocation percentages. We evaluate many factors and conditions in determining the unallocated portion of the allowance, including the economic and business conditions affecting key lending areas, credit quality trends and general growth in the portfolio. The allowance is considered appropriate, given management s assessment of potential losses within the portfolio as of the evaluation date, the significant growth in the loan and lease portfolio, current economic conditions in the Company s market areas and other factors.

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The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans is evaluated with new information. As our portfolio has matured, historical loss ratios have been closely monitored, and our reserve adequacy relies primarily on our loss history. The review of the reserve adequacy is performed by executive management and presented to a committee of our board of directors for their review. The committee reports to the board as part of the board s review on quarterly basis of the Company s consolidated financial statements.

The following tables summarize the credit risk profile of our loan portfolio by internally assigned grades and non-accrual status as of June 30, 2014 and December 31, 2013 (in thousands):

June 30, 2014

	Commercial	Mortgage Finance	Construction	Real Estate	Consumer	Leases	Total
Grade:							
Pass	$ 5,171,053	$ 3,700,253	$ 1,567,667	$ 2,195,165	$ 15,790	$ 91,205	$ 12,741,133
Special mention	38,450			9,218		183	47,851
Substandard-accruing	60,320			11,249	57	4,504	76,130
Non-accrual	25,545			15,998		22	41,565
Total loans held for investment	$ 5,295,368	$ 3,700,253	$ 1,567,667	$ 2,231,630	$ 15,847	$ 95,914	$ 12,906,679

December 31, 2013

	Commercial	Mortgage Finance	Construction	Real Estate	Consumer	Leases	Total
Grade:							
Pass	$ 4,908,944	$ 2,784,265	$ 1,261,995	$ 2,099,450	$ 15,251	$ 89,317	$ 11,159,222
Special mention	24,132		102	6,338		51	30,623
Substandard-accruing	74,593		103	21,770	45	3,742	100,253
Non-accrual	12,896		705	18,670	54	50	32,375
Total loans held for investment	$ 5,020,565	$ 2,784,265	$ 1,262,905	$ 2,146,228	$ 15,350	$ 93,160	$ 11,322,473

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The following table details activity in the reserve for loan losses by portfolio segment for the six months ended June 30, 2014 and June 30, 2013. Allocation of a portion of the reserve to one category of loans does not preclude its availability to absorb losses in other categories.

June 30, 2014

(in thousands)	Commercial	Mortgage Finance	Construction	Real Estate	Consumer	Leases	Unallocated	Total
Beginning balance	$ 39,868	$	$ 14,553	$ 24,210	$ 149	$ 3,105	$ 5,719	$ 87,604
Provision for loan losses	13,714		199	(3,891)	114	(1,930)	(139)	8,067
Charge-offs	7,526			296	101			7,923
Recoveries	2,239			47	31	1,049		3,366
Net charge-offs (recoveries)	5,287			249	70	(1,049)		4,557
Ending balance	$ 48,295	$	$ 14,752	$ 20,070	$ 193	$ 2,224	$ 5,580	$ 91,114
Period end amount allocated to:								
Loans individually evaluated for impairment	$ 6,293	$	$	$ 722	$	$ 3	$	$ 7,018
Loans collectively evaluated for impairment	42,002		14,752	19,348	193	2,221	5,580	84,096
Ending balance	$ 48,295	$	$ 14,752	$ 20,070	$ 193	$ 2,224	$ 5,580	$ 91,114

June 30, 2013

(in thousands)	Commercial	Mortgage Finance	Construction	Real Estate	Consumer	Leases	Unallocated	Total
Beginning balance	$ 21,547	$	$ 12,097	$ 30,893	$ 226	$ 2,460	$ 7,114	$ 74,337
Provision for loan losses	13,139		615	(2,905)	11	343	(2,528)	8,675
Charge-offs	4,474			131	45			4,650
Recoveries	745			15	45	261		1,066
Net charge-offs (recoveries)	3,729			116		(261)		3,584
Ending balance	$ 30,957	$	$ 12,712	$ 27,872	$ 237	$ 3,064	$ 4,586	$ 79,428
Period end amount allocated to:								
Loans individually evaluated for impairment	$ 2,934	$	$	$ 548	$ 1	$ 10	$	$ 3,493
Loans collectively evaluated for impairment	28,023		12,712	27,324	236	3,054	4,586	75,935

Ending balance	$ 30,957	$	$ 12,712	$ 27,872	$ 237	$ 3,064	$ 4,586	$ 79,428

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Our recorded investment in loans as of June 30, 2014, December 31, 2013 and June 30, 2013 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of our impairment methodology was as follows (in thousands):

June 30, 2014

	Commercial	Mortgage Finance	Construction	Real Estate	Consumer	Leases	Total
Loans individually evaluated for impairment	$ 27,679	$	$	$ 19,790	$	$ 22	$ 47,491
Loans collectively evaluated for impairment	5,267,689	3,700,253	1,567,667	2,211,840	15,847	95,892	12,859,188
Total	$ 5,295,368	$ 3,700,253	$ 1,567,667	$ 2,231,630	$ 15,847	$ 95,914	$ 12,906,679

December 31, 2013

	Commercial	Mortgage Finance	Construction	Real Estate	Consumer	Leases	Total
Loans individually evaluated for impairment	$ 15,139	$	$ 705	$ 24,028	$ 54	$ 50	$ 39,976
Loans collectively evaluated for impairment	5,005,426	2,784,265	1,262,200	2,122,200	15,296	93,110	11,282,497
Total	$ 5,020,565	$ 2,784,265	$ 1,262,905	$ 2,146,228	$ 15,350	$ 93,160	$ 11,322,473

June 30, 2013

	Commercial	Mortgage Finance	Construction	Real Estate	Consumer	Leases	Total
Loans individually evaluated for impairment	$ 19,475	$	$	$ 23,666	$ 9	$ 65	$ 43,215
Loans collectively evaluated for impairment	4,451,387	2,838,234	969,071	1,991,378	24,017	77,046	10,351,133
Total	$ 4,470,862	$ 2,838,234	$ 969,071	$ 2,015,044	$ 24,026	$ 77,111	$ 10,394,348

We have traditionally maintained an unallocated reserve component to allow for uncertainty in economic and other conditions affecting the quality of the loan portfolio. The unallocated portion of our loan loss reserve has remained consistent since December 31, 2013. We believe the level of unallocated reserves at June 30, 2014 is warranted due to the continued uncertain economic environment which has produced losses, including those resulting from fraud by borrowers, that are not necessarily correlated with historical loss trends or general economic conditions. Our methodology used to calculate the allowance considers historical losses, however, the historical loss rates for specific product types or credit risk grades may not fully incorporate the effects of continued weakness in the economy.

Generally we place loans on non-accrual when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectability is questionable, then cash payments are applied to principal. As of June 30, 2014, $480,000 of our non-accrual loans were earning on a cash basis. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. The table below summarizes our non-accrual loans by type and purpose as of June 30, 2014 and December 31, 2013 (in thousands):

	June 30, 2014	December 31, 2013
Commercial		
Business loans	$ 24,245	$ 12,896
Energy	1,300	
Construction		
Market risk		705
Real estate		
Market risk	9,539	15,607
Commercial	4,079	508
Secured by 1-4 family	2,380	2,555
Consumer		54
Leases	22	50
Total non-accrual loans	$ 41,565	$ 32,375

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As of June 30, 2014, non-accrual loans included in the table above included $16.2 million related to loans that met the criteria for restructured compared to $17.8 million at December 31, 2013.

A loan held for investment is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement. In accordance with *ASC 310 Receivables*, we have also included all restructured loans in our impaired loan totals. The following tables detail our impaired loans, by portfolio class as of June 30, 2014 and December 31, 2013 (in thousands):

June 30, 2014

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial					
Business loans	$ 9,226	$ 11,475	$	$ 5,412	$
Energy	425	425		609	
Construction					
Market risk				235	
Real estate					
Market risk	8,089	8,089		9,936	
Commercial	3,595	3,595		2,023	
Secured by 1-4 family	1,320	1,320		1,320	
Consumer					
Leases					
Total impaired loans with no allowance recorded	$ 22,655	$ 24,904	$	$ 19,535	$
With an allowance recorded:					
Commercial					
Business loans	$ 17,153	$ 17,853	$ 6,162	$ 17,163	$
Energy	875	875	131	987	
Construction					
Market risk					
Real estate					
Market risk	4,103	4,103	360	5,332	
Commercial	484	484	73	918	
Secured by 1-4 family	2,199	2,231	289	2,335	
Consumer				22	
Leases	22	22	3	41	
Total impaired loans with an allowance recorded	$ 24,836	$ 25,568	$ 7,018	$ 26,798	$
Combined:					
Commercial					
Business loans	$ 26,379	$ 29,328	$ 6,162	$ 22,575	$

Energy	1,300	1,300	131	1,596	
Construction					
Market risk				235	
Real estate					
Market risk	12,192	12,192	360	15,268	
Commercial	4,079	4,079	73	2,941	
Secured by 1-4 family	3,519	3,551	289	3,655	
Consumer				22	
Leases	22	22	3	41	
Total impaired loans	$ 47,491	$ 50,472	$ 7,018	$ 46,333	$

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December 31, 2013

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial					
Business loans	$ 2,005	$ 2,005	$	$ 4,265	$
Energy	1,614	3,443		969	
Construction					
Market risk	705	705		3,111	114
Real estate					
Market risk	13,524	13,524		9,796	
Commercial	508	508		5,458	
Secured by 1-4 family	1,320	1,320		2,464	
Consumer					
Leases					
Total impaired loans with no allowance recorded	$ 19,676	$ 21,505	$	$ 26,063	$ 114
With an allowance recorded:					
Commercial					
Business loans	$ 11,060	$ 12,425	$ 1,946	$ 14,240	$
Energy	460	460	69	913	
Construction					
Market risk				160	
Real estate					
Market risk	6,289	6,289	822	7,912	
Commercial				477	
Secured by 1-4 family	2,387	2,387	321	914	
Consumer	54	54	8	43	
Leases	50	50	8	72	
Total impaired loans with an allowance recorded	$ 20,300	$ 21,665	$ 3,174	$ 24,731	$
Combined:					
Commercial					
Business loans	$ 13,065	$ 14,430	$ 1,946	$ 18,505	$
Energy	2,074	3,903	69	1,882	
Construction					
Market risk	705	705		3,271	114
Real estate					
Market risk	19,813	19,813	822	17,708	
Commercial	508	508		5,935	
Secured by 1-4 family	3,707	3,707	321	3,378	
Consumer	54	54	8	43	
Leases	50	50	8	72	
Total impaired loans	$ 39,976	$ 43,170	$ 3,174	$ 50,794	$ 114

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Average impaired loans outstanding during the six months ended June 30, 2014 and 2013 totaled $46.3 million and $56.9 million, respectively.

The table below provides an age analysis of our past due loans that are still accruing as of June 30, 2014 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days and Accruing[1]	Total Past Due	Current	Total
Commercial						
Business loans	$ 16,215	$ 4,333	$ 4,793	$ 25,341	$ 4,282,751	$ 4,308,092
Energy	2,170			2,170	959,561	961,731
Mortgage finance loans					3,700,253	3,700,253
Construction						
Market risk	883			883	1,545,656	1,546,539
Secured by 1-4 family					21,128	21,128
Real estate						
Market risk	8,328			8,328	1,645,288	1,653,616
Commercial	6,001			6,001	464,534	470,535
Secured by 1-4 family	261			261	91,220	91,481
Consumer					15,847	15,847
Leases					95,892	95,892
Total loans held for investment	$ 33,858	$ 4,333	$ 4,793	$ 42,984	$ 12,822,130	$ 12,865,114

(1) Loans past due 90 days and still accruing includes premium finance loans of $4.6 million. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

Restructured loans are loans on which, due to the borrower s financial difficulties, we have granted a concession that we would not otherwise consider for borrowers of similar credit quality. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, or forgiveness of either principal or accrued interest. As of June 30, 2014 and December 31, 2013, we had $249,000 and $1.9 million, respectively, in loans considered restructured that are not on non-accrual. These loans did not have unfunded commitments at June 30, 2014 or December 31, 2013. Of the non-accrual loans at June 30, 2014 and December 31, 2013, $16.2 million and $17.8 million, respectively, met the criteria for restructured. These loans had no unfunded commitments at their respective balance sheet dates. A loan continues to qualify as restructured until a consistent payment history or change in borrower s financial condition has been evidenced, generally no less than twelve months. Assuming that the restructuring agreement specifies an interest rate at the time of the restructuring that is greater than or equal to the rate that we are willing to accept for a new extension of credit with comparable risk, then the loan no longer has to be considered a restructuring if it is in compliance with modified terms in calendar years after the year of the restructure.

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The following tables summarize, for the six months ended June 30, 2014 and 2013, loans that were restructured during 2014 and 2013 (in thousands):

June 30, 2014	Number of Restructured Loans	Pre-Restructuring Outstanding Recorded Investment	Post-Restructuring Outstanding Recorded Investment
Real estate commercial	1	$ 1,441	$ 1,430
Total new restructured loans in 2014	1	$ 1,441	$ 1,430

June 30, 2013	Number of Restructured Loans	Pre-Restructuring Outstanding Recorded Investment	Post-Restructuring Outstanding Recorded Investment
Commercial business loans	1	$ 1,945	$ 1,898
Total new restructured loans in 2013	1	$ 1,945	$ 1,898

The restructured loans generally include terms to temporarily place loans on interest only, extend the payment terms or reduce the interest rate. We did not forgive any principal on the above loans. The restructuring of the loans did not have a significant impact on our allowance for loan losses at June 30, 2014 or 2013.

The following table provides information on how restructured loans were modified during the six months ended June 30, 2014 and 2013 (in thousands):

	Six months ended June 30, 2014	2013
Extended maturity	$ 1,430	$
Combination of maturity extension and payment schedule adjustment		1,898
Total	$ 1,430	$ 1,898

As of June 30, 2014 and 2013, we did not have any loans that were restructured within the last 12 months that subsequently defaulted.

(5) OREO AND VALUATION ALLOWANCE FOR LOSSES ON OREO

The table below presents a summary of the activity related to OREO (in thousands):

	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Beginning balance	$ 2,420	$ 14,426	$ 5,110	$ 15,991
Additions		912	851	912
Sales	(1,735)	(1,902)	(5,276)	(3,396)
Valuation allowance for OREO		(164)		(164)
Direct write-downs		(219)		(290)
Ending balance	$ 685	$ 13,053	$ 685	$ 13,053

(6) FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit which involve varying degrees of credit risk in excess of the amount recognized in the consolidated balance sheets. The Bank s exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is

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represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The amount of collateral obtained, if deemed necessary, is based on management s credit evaluation of the borrower.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer s credit-worthiness on a case-by-case basis.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The table below summarizes our off-balance sheet financial instruments whose contract amounts represented credit risk (in thousands):

	June 30, 2014	December 31, 2013
Commitments to extend credit	$ 4,497,052	$ 3,674,391
Standby letters of credit	173,531	145,662

(7) REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory (and possibly additional discretionary) actions by regulators that, if undertaken, could have a direct material effect on the Company s and the Bank s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company s and the Bank s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company s and the Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets, each as defined in the regulations. Management believes, as of June 30, 2014, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

Financial institutions are categorized as well capitalized or adequately capitalized, based on minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios. As shown in the table below, the Company s capital ratios exceed the regulatory definition of adequately capitalized as of June 30, 2014 and December 31, 2013. Based upon the information in its most recently filed call report, the Bank meets the capital ratios necessary to be well capitalized. The regulatory authorities can apply changes in classification of assets and such change may retroactively subject the Company to change in capital ratios. Any such change could result in reducing one or more capital ratios below well-capitalized status. In addition, a change may result in imposition of additional assessments by the FDIC or could result in regulatory actions that could have a material effect on condition and results of operations.

The table below summarizes our capital ratios:

	June 30, 2014	December 31, 2013
Company		
Risk-based capital:		
Tier 1 capital	9.09%	9.15%
Total capital	11.67%	10.73%
Leverage	10.94%	10.87%

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Dividends that may be paid by subsidiary banks are routinely restricted by various regulatory authorities. The amount that can be paid in any calendar year without prior approval of the Bank s regulatory agencies cannot exceed the lesser of the net profits (as defined) for that year plus the net profits for the preceding two calendar years, or retained earnings. The Basel III Capital Rules, effective for us on January 1, 2015, will further limit the amount of dividends that may be paid by our bank. No dividends were declared or paid on common stock during the six months ended June 30, 2014 or 2013.

On March 28, 2013, we completed a sale of 6.0 million shares of 6.5% non-cumulative preferred stock, par value $0.01, with a liquidation preference of $25 per share, in a public offering. Dividends on the preferred stock are not cumulative and will be paid when declared by our board of directors to the extent that we have lawfully available funds to pay dividends. If declared, dividends will accrue and be payable quarterly, in arrears, on the liquidation preference amount, on a non-cumulative basis, at a rate of 6.50% per annum. We paid $4.9 million in dividends on the preferred stock for the six months ended June 30, 2014. Holders of preferred stock will not have voting rights, except with respect to authorizing or increasing the authorized amount of senior stock, certain changes in the terms of the preferred stock, certain dividend non-payments and as otherwise required by applicable law. Net proceeds from the sale totaled $145.0 million. The additional equity was used for general corporate purposes, including funding regulatory capital infusions into the Bank.

During January 2014, we completed an offering of 1.9 million shares of our common stock. Net proceeds from the sale totaled $106.5 million. On January 31, 2014, the Bank issued $175.0 million of subordinated notes in an offering to institutional investors exempt from registration under Section 3(a)(2) of the Securities Act of 1933 and 12 C.F.R. Part 16. Net proceeds from the transaction were $172.4 million. The notes mature in January 2026 and bear interest at a rate of 5.25% per annum, payable semi-annually. The notes are unsecured and are subordinate to the Bank s obligations to its deposits, its obligations under banker s acceptances and letters of credit, certain obligations to Federal Reserve Banks and the FDIC and the Bank s obligations to its other creditors, except any obligations which expressly rank on a parity with or junior to the notes. The notes are expected to qualify as Tier 2 capital for regulatory capital purposes, subject to applicable limitations. The net proceeds of both offerings were available to the Company for general corporate purposes, including retirement of $15.0 million of short-term debt that was outstanding at December 31, 2013, and additional capital to support continued loan growth.

(8) STOCK-BASED COMPENSATION

The fair value of our stock option and stock appreciation right (SAR) grants are estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide the best single measure of the fair value of our employee stock options.

Stock-based compensation consists of SARs and RSUs granted from 2007 through 2013.

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(in thousands)	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Stock- based compensation expense recognized:				
SARs	$ 148	$ 134	$ 291	$ 282
RSUs	1,118	804	2,237	1,561
Total compensation expense recognized	$ 1,266	$ 938	$ 2,528	$ 1,843

(in thousands)	June 30, 2014 Options	June 30, 2014 SARs and RSUs
Unrecognized compensation expense related to unvested awards	$	$ 12,252
Weighted average period over which expense is expected to be recognized, in years	N/A	3.6

In connection with the 2010 Long-term Incentive Plan, the Company has issued cash-based performance units. A summary of the compensation cost for these units is as follows (in thousands):

	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Cash-based performance units	$ 1,312	$ 8,368	$ 4,705	$ 9,407

(9) DISCONTINUED OPERATIONS

Subsequent to the end of the first quarter of 2007, we and the purchaser of our residential mortgage loan division (RML) agreed to terminate and settle the contractual arrangements related to the sale of the division, which had been completed as of the end of the third quarter of 2006. Historical operating results of RML are reflected as discontinued operations in the financial statements.

We hold approximately $290,000 in loans held for sale from discontinued operations that are carried at the estimated market value at quarter-end, which is less than the original cost. We plan to sell these loans, but timing and price to be realized cannot be determined at this time due to market conditions. In addition, we continue to address requests from investors related to repurchasing loans previously sold. While the balances as of June 30, 2014 include a liability for exposure to additional contingencies, including the risk of having to repurchase loans previously sold, we recognize that market conditions may result in additional exposure to loss and the extension of time necessary to complete the discontinued mortgage operation.

(10) FAIR VALUE DISCLOSURES

ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), defines fair value, establishes a framework for measuring fair value under GAAP and requires enhanced disclosures about fair value measurements. Fair value is defined under ASC 820 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date.

We determine the fair market values of our assets and liabilities measured at fair value on a recurring and nonrecurring basis using the fair value hierarchy as prescribed in ASC 820. The standard describes three levels of inputs that may be used to measure fair value as provided below.

Level 1	Quoted prices in active markets for identical assets or liabilities.
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 2 assets include U.S. government and agency mortgage-backed debt securities, municipal bonds, and Community Reinvestment Act funds. This category includes derivative assets and liabilities where values are obtained from independent pricing services.

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Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation. This category includes impaired loans and OREO where collateral values have been based on third party appraisals; however, due to current economic conditions, comparative sales data typically used in appraisals may be unavailable or more subjective due to lack of market activity.

Assets and liabilities measured at fair value at June 30, 2014 and December 31, 2013 are as follows (in thousands):

	Fair Value Measurements Using		
June 30, 2014	Level 1	Level 2	Level 3
Available for sale securities:(1)			
Residential mortgage-backed securities	$	$ 36,002	$
Municipals		5,952	
Equity securities(2)		7,376	
Loans(3) (5)			24,068
OREO(4) (5)			685
Derivative assets(6)		24,453	
Derivative liabilities(6)		(24,453)	
December 31, 2013			
Available for sale securities:(1)			
Residential mortgage-backed securities	$	$ 41,462	$
Municipals		14,505	
Equity securities(2)		7,247	
Loans(3) (5)			13,474
OREO(4) (5)			5,110
Derivative assets(6)		9,317	
Derivative liabilities(6)		(9,317)	

(1) Securities are measured at fair value on a recurring basis, generally monthly.
(2) Equity securities consist of Community Reinvestment Act funds.
(3) Includes impaired loans that have been measured for impairment at the fair value of the loan s collateral.
(4) OREO is transferred from loans to OREO at fair value less selling costs.
(5) Fair value of loans and OREO is measured on a nonrecurring basis, generally annually or more often as warranted by market and economic conditions.
(6) Derivative assets and liabilities are measured at fair value on a recurring basis, generally quarterly.

Level 3 Valuations

Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. Currently, we measure fair value for certain loans and OREO on a nonrecurring basis as described below.

Loans

During the three months and six months ended June 30, 2014, certain impaired loans were reevaluated and reported at fair value through a specific allocation of the allowance for loan losses based upon the fair value of the underlying collateral. The $24.1 million total above includes impaired loans at June 30, 2014 with a carrying value of $29.2 million that were reduced by specific allowance allocations totaling $5.1 million for a total reported fair value of $24.1 million based on collateral valuations utilizing Level 3 valuation inputs. Fair values were based on third party appraisals.

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OREO

Certain foreclosed assets, upon initial recognition, are valued based on third party appraisals less estimated selling costs. At June 30, 2014, OREO had a carrying value of $685,000 with no specific valuation allowance. The fair value of OREO was computed based on third party appraisals, which are Level 3 valuation inputs.

Fair Value of Financial Instruments

Generally accepted accounting principles require disclosure of fair value information about financial instruments, whether or not recognized on the balance sheet, for which it is practical to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. This disclosure does not and is not intended to represent the fair value of the Company.

A summary of the carrying amounts and estimated fair values of financial instruments is as follows (in thousands):

	June 30, 2014		December 31, 2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and cash equivalents	$ 357,142	$ 357,142	$ 153,911	$ 153,911
Securities, available-for-sale	49,330	49,330	63,214	63,214
Loans held for sale from discontinued operations	290	290	294	294
Loans held for investment, net	12,761,854	12,766,383	11,182,970	11,179,145
Derivative assets	24,453	24,453	9,317	9,317
Deposits	10,757,316	10,757,495	9,257,379	9,257,574
Federal funds purchased	273,041	273,041	148,650	148,650
Customer repurchase agreements	27,491	27,491	21,954	21,954
Other borrowings	700,016	700,016	855,026	855,026
Subordinated notes	286,000	286,066	111,000	96,647
Trust preferred subordinated debentures	113,406	113,406	113,406	113,406
Derivative liabilities	24,453	24,453	9,317	9,317

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents

The carrying amounts reported in the consolidated balance sheet for cash and cash equivalents approximate their fair value, which is characterized as a Level 1 asset in the fair value hierarchy.

Securities

The fair value of investment securities is based on prices obtained from independent pricing services which are based on quoted market prices for the same or similar securities, which is characterized as a Level 2 asset in the fair value hierarchy. We have obtained documentation from the primary pricing service we use about their processes and controls over pricing. In addition, on a quarterly basis we independently verify the prices that we receive from the service provider using two additional independent pricing sources. Any significant differences are investigated and resolved.

Loans, net

Loans are characterized as Level 3 assets in the fair value hierarchy. For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are generally based on carrying values. The fair value for all other loans is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of accrued interest approximates its fair value. The carrying amount of loans held for sale approximates fair value.

Derivatives

The estimated fair value of the interest rate swaps are obtained from independent pricing services based on quote market prices for the same or similar derivative contracts and are characterized as a Level 2 asset in the fair value hierarchy. On a quarterly basis, we independently verify the fair value using an additional independent pricing source.

Deposits

Deposits are characterized as Level 3 liabilities in the fair value hierarchy. The carrying amounts for variable-rate money market accounts approximate their fair value. Fixed-term certificates of deposit fair values are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities.

Federal funds purchased, customer repurchase agreements, other borrowings, subordinated notes and trust preferred subordinated debentures

The carrying value reported in the consolidated balance sheet for Federal funds purchased, customer repurchase agreements and other short-term, floating rate borrowings approximates their fair value, which is characterized as a Level 1 asset in the fair value hierarchy. The fair value of any fixed rate short-term borrowings and trust preferred subordinated debentures are estimated using a discounted cash flow calculation that applies interest rates currently being offered on similar borrowings, which is characterized as a Level 3 liability in the fair value hierarchy. The subordinated notes are publicly traded and are valued based on market prices, which is characterized as a Level 2 liability in the fair value hierarchy.

(11) DERIVATIVE FINANCIAL INSTRUMENTS

The fair value of derivative positions outstanding is included in other assets and other liabilities in the accompanying consolidated balance sheets.

During 2014 and 2013, we entered into certain interest rate derivative positions that are not designated as hedging instruments. These derivative positions relate to transactions in which we enter into an interest rate swap, cap and/or floor with a customer while at the same time entering into an offsetting interest rate swap, cap and/or floor with another financial institution. In connection with each swap transaction, we agree to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, we agree to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows our customer to effectively convert a variable rate loan to a fixed rate. Because we act as an intermediary for our customer, changes in the fair value of the underlying derivative contracts substantially offset each other and do not have a material impact on our results of operations.

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The notional amounts and estimated fair values of interest rate derivative positions outstanding at June 30, 2014 and December 31, 2013 are presented in the following tables (in thousands):

	June 30, 2014		December 31, 2013	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Non-hedging interest rate derivative:				
Commercial loan/lease interest rate swaps	$ 835,562	$ 23,422	$ 764,939	$ 8,652
Commercial loan/lease interest rate swaps	(835,562)	(23,422)	(764,939)	(8,652)
Commercial loan/lease interest rate caps	(54,428)	(1,031)	(58,706)	(665)
Commercial loan/lease interest rate caps	54,428	1,031	58,706	665

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

	June 30, 2014		December 31, 2013	
	Weighted-Average Interest Rate		Weighted-Average Interest Rate	
	Received	Paid	Received	Paid
Non-hedging interest rate swaps	4.84%	2.85%	2.99%	4.89%

The weighted-average strike rate for outstanding interest rate caps was 1.51% at June 30, 2014 and 1.87% at December 31, 2013.

Our credit exposure on interest rate swaps and caps is limited to the net favorable value and interest payments of all swaps and caps by each counterparty. In such cases collateral may be required from the counterparties involved if the net value of the swaps and caps exceeds a nominal amount considered to be immaterial. Our credit exposure, net of any collateral pledged, relating to interest rate swaps and caps was approximately $24.5 million at June 30, 2014 and approximately $9.3 million at December 31, 2013, all of which relates to bank customers. Collateral levels are monitored and adjusted on a regular basis for changes in interest rate swap and cap values. At June 30, 2014 and December 31, 2013, we had $23.5 million and $10.7 million, respectively, in cash collateral pledged for these derivatives included in interest-bearing deposits.

(12) STOCKHOLDERS EQUITY

On March 28, 2013, we completed a sale of 6.0 million shares of 6.5% non-cumulative preferred stock, par value $0.01, with a liquidation preference of $25 per share, in a public offering. Dividends on the preferred stock are not cumulative and will be paid if and when declared by our board of directors to the extent that we have lawfully available funds to pay dividends. If declared, dividends will accrue and be payable quarterly, in arrears, on the liquidation preference amount, on a non-cumulative basis, at a rate of 6.50% per annum. For the six months ended June 30, 2014, we paid $4.9 million in dividends on the preferred stock. Holders of preferred stock do not have voting rights, except with respect to authorizing or increasing the authorized amount of senior stock, certain changes in the terms of the preferred stock, certain dividend non-payments and as otherwise required by applicable law. Net proceeds from the sale totaled $145.0 million. The proceeds were used for general corporate purposes, including funding regulatory capital infusions into the Bank.

During January 2014, we completed an offering of 1.9 million shares of our common stock. Net proceeds from the sale totaled $106.5 million. The net proceeds of the offering were available to the Company for general corporate purposes, including retirement of $15.0 million of short-term debt that was outstanding at December 31, 2013, and additional capital to support continued loan growth.

(13) NEW ACCOUNTING PRONOUNCEMENTS

ASU 2014-04 Receivables (Topic 310) Troubled Debt Restructurings by Creditors (ASU 2014-04) amends Topic 310 Receivables to clarify the terms defining when an in substance repossession or foreclosure occurs, which determines when the receivable should be derecognized and the real estate property is recognized. ASU 2013-04 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. It is not expected to have a significant impact on our financial statements.

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QUARTERLY FINANCIAL SUMMARY UNAUDITED

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

	For the three months ended June 30, 2014			For the three months ended June 30, 2013		
	Average Balance	Revenue/ Expense[1]	Yield/ Rate	Average Balance	Revenue/ Expense[1]	Yield/ Rate
Assets						
Securities taxable	$ 44,216	$ 410	3.72%	$ 60,063	$ 594	3.97%
Securities non-taxable[2]	6,271	94	6.01%	18,843	275	5.85%
Federal funds sold	14,997	8	0.21%	54,448	13	0.10%
Deposits in other banks	183,061	100	0.22%	91,177	60	0.26%
Loans held for investment, mortgage finance loans	2,822,560	23,231	3.30%	2,406,246	22,440	3.74%
Loans held for investment	8,984,230	101,003	4.51%	7,152,323	83,978	4.71%
Less reserve for loan losses	90,105			75,006		
Loans, net of reserve	11,716,685	124,234	4.25%	9,483,563	106,418	4.50%
Total earning assets	11,965,230	124,846	4.19%	9,708,094	107,360	4.44%
Cash and other assets	396,938			402,898		
Total assets	$ 12,362,168			$ 10,110,992		
Liabilities and Stockholders Equity						
Transaction deposits	$ 895,827	$ 170	0.08%	$ 1,051,199	$ 233	0.09%
Savings deposits	4,679,140	3,395	0.29%	3,340,420	2,292	0.28%
Time deposits	401,024	390	0.39%	397,868	407	0.41%
Deposits in foreign branches	350,043	291	0.33%	340,713	296	0.35%
Total interest bearing deposits	6,326,034	4,246	0.27%	5,130,200	3,228	0.25%
Other borrowings	666,405	300	0.18%	727,158	354	0.20%
Subordinated notes	286,000	4,241	5.95%	111,000	1,829	6.61%
Trust preferred subordinated debentures	113,406	619	2.19%	113,406	633	2.24%
Total interest bearing liabilities	7,391,845	9,406	0.51%	6,081,764	6,044	0.40%
Demand deposits	3,629,941			2,914,341		
Other liabilities	98,595			91,608		
Stockholders equity	1,241,787			1,023,279		
Total liabilities and stockholders equity	$ 12,362,168			$ 10,110,992		
Net interest income[2]		$ 115,440			$ 101,316	

Net interest margin				3.87%				4.19%
Net interest spread				3.67%				4.04%
Loan spread				4.08%				4.34%
Additional information from discontinued operations:								
Loans held for sale	$ 291				$ 299			
Borrowed funds	291				299			
Net interest income		$ 7				$ 6		
Net interest margin consolidated				3.87%				4.19%

(1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income.
(2) Taxable equivalent rates used where applicable.

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QUARTERLY FINANCIAL SUMMARY UNAUDITED

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

	For the six months ended June 30, 2014			For the six months ended June 30, 2013		
	Average Balance	Revenue/ Expense[1]	Yield/ Rate	Average Balance	Revenue/ Expense[1]	Yield/ Rate
Assets						
Securities taxable	$ 45,614	$ 852	3.77%	$ 65,611	$ 1,323	4.07%
Securities non-taxable[2]	8,401	245	5.88%	20,499	598	5.88%
Federal funds sold	44,209	48	0.22%	39,698	19	0.10%
Deposits in other banks	206,548	259	0.25%	84,982	112	0.27%
Loans held for sale	2,427,109	40,013	3.32%	2,384,566	45,081	3.81%
Loans held for investment	8,851,835	200,093	4.56%	6,998,400	164,519	4.74%
Less reserve for loan losses	88,902			74,726		
Loans, net of reserve	11,190,042	240,106	4.33%	9,308,240	209,600	4.54%
Total earning assets	11,494,814	241,510	4.24%	9,519,030	211,652	4.48%
Cash and other assets	389,608			402,299		
Total assets	$ 11,884,422			$ 9,921,329		
Liabilities and Stockholders Equity						
Transaction deposits	$ 839,378	$ 250	0.06%	$ 1,027,598	$ 486	0.10%
Savings deposits	4,635,559	6,699	0.29%	3,293,806	4,589	0.28%
Time deposits	388,364	741	0.38%	400,476	821	0.41%
Deposits in foreign branches	352,934	586	0.33%	338,004	577	0.34%
Total interest bearing deposits	6,216,235	8,276	0.27%	5,059,884	6,473	0.26%
Other borrowings	480,740	471	0.20%	883,497	783	0.18%
Subordinated notes	256,995	7,720	6.06%	111,000	3,658	6.65%
Trust preferred subordinated debentures	113,406	1,235	2.20%	113,406	1,267	2.25%
Total interest bearing liabilities	7,067,376	17,702	0.51%	6,167,787	12,181	0.40%
Demand deposits	3,506,407			2,723,196		
Other liabilities	101,040			91,076		
Stockholders equity	1,209,599			939,270		
Total liabilities and stockholders equity	$ 11,884,422			$ 9,921,329		
Net interest income[2]		$ 223,808			$ 199,471	

Net interest margin			3.93%			4.23%
Net interest spread			3.73%			4.08%
Loan spread			4.16%			4.37%
Additional information from discontinued operations:						
Loans held for sale	$ 292			$ 300		
Borrowed funds	292			300		
Net interest income		$ 14			$ 12	
Net interest margin consolidated			3.93%			4.23%

(1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income.

(2) Taxable equivalent rates used where applicable.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

Statements and financial analysis contained in this report that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the Act). In addition, certain statements may be contained in our future filings with SEC, in press releases, and in oral and written statements made by us or with our approval that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Forward-looking statements describe our future plans, strategies and expectations and are based on certain assumptions. Words such as believes , anticipates , plans , goals , objective expects , intends , seeks , likely , targeted , continue , remain , will , should , may and other similar exp to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements are subject to various risks and uncertainties, which change over time, are based on management s expectations and assumptions at the time the statements are made and are not guarantees of future results. Important factors that could cause actual results to differ materially from the forward-looking statements are disclosed under the heading Risk Factors in our 2013 Form 10-K and include, but are not limited to, the following:

Deterioration of the credit quality of our loan portfolio, increased default rates and loan losses or adverse changes in the industry concentrations of our loan portfolio.

Developments adversely affecting our commercial, entrepreneur and professional customers.

Changes in the value of commercial and residential real estate securing our loans or in the demand for credit to support the purchase and ownership of such assets.

The failure of assumptions supporting our allowance for loan losses causing it to become inadequate as loan quality decreases and losses and charge-offs increase.

A failure to effectively manage our interest rate risk resulting from unexpectedly large or sudden changes in interest rates or rate or maturity imbalances in our assets and liabilities, where such changes could affect the results of operations.

Failure to execute our business strategy, including any inability to expand into new markets and lines of business in Texas, regionally and nationally.

Loss of access to capital market transactions and other sources of funding, or a failure to effectively balance our funding sources with cash demands by depositors and borrowers.

Failure to successfully develop and launch new lines of business and new products and services within the expected time frames and budgets, or failure to anticipate and appropriately manage the associated risks.

The failure to attract and retain key personnel or the loss of key individuals or groups of employees.

Changes in the U.S. economy in general or the Texas economy specifically resulting in deterioration of credit quality or reduced demand for credit or other financial services we offer.

Legislative and regulatory changes imposing further restrictions and costs on our business, a failure to remain well capitalized or regulatory enforcement actions against us.

An increase in the incidence or severity of fraud, illegal payments, security breaches and other illegal acts impacting our bank and our customers.

Structural changes in the markets for origination, sale and servicing of residential mortgages.

Increased or more effective competition from banks and other financial service providers in our markets.

Material failures of our accounting estimates and risk management processes based on management judgment, or the supporting analytical and forecasting models.

Unavailability of funds obtained from capital transactions or from our bank to fund our obligations.

Failures of counterparties or third party vendors to perform their obligations.

Failures or breaches of our information systems that are not effectively managed.

Severe weather, natural disasters, acts of war or terrorism and other external events.

Incurrence of material costs and liabilities associated with claims and litigation.

Failure of our risk management strategies and procedures, including failure or circumvention of our controls.

Actual outcomes and results may differ materially from what is expressed in our forward-looking statements and from our historical financial results due to the factors discussed elsewhere in this report or disclosed in our other SEC filings. Forward-looking statements included herein should not be relied upon as representing our expectations or beliefs as of any date subsequent to the date of this report. Except as required by law, we undertake no obligation to update or revise any forward-looking statements contained in this report or our other SEC filings, whether as a result of new information, future events or otherwise. The factors discussed herein are not intended to be a complete summary of all risks and uncertainties that may affect our businesses. Though we strive to monitor and mitigate risk, we cannot anticipate all potential economic, operational and financial developments that may adversely impact our operations and our financial results. Forward-looking statements should not be viewed as predictions and should not be the primary basis upon which investors evaluate an investment in our securities.

Overview of Our Business Operations

We commenced our banking operations in December 1998. An important aspect of our growth strategy has been our ability to service and effectively manage a large number of loans and deposit accounts in multiple markets in Texas. Accordingly, we have created an operations infrastructure sufficient to support state-wide lending and banking operations that we continue to build out as needed to serve a larger customer base and specialized industries.

The following discussion and analysis presents the significant factors affecting our financial condition as of June 30, 2014 and December 31, 2013 and results of operations for three and six months in the periods ended June 30, 2014 and 2013. This discussion should be read in conjunction with our consolidated financial statements and notes to the financial statements appearing in Part I, Item 1 of this report.

Except as otherwise noted, all amounts and disclosures throughout this document reflect continuing operations. See Part I, Item 1 herein for a discussion of discontinued operations and at Note 9 Discontinued Operations.

Results of Operations

Summary of Performance

We reported net income of $33.4 million and net income available to common stockholders of $31.0 million, or $0.71 per diluted common share, for the second quarter of 2014 compared to net income of $24.1 million and net income available to common stockholders of $21.6 million, or $0.52 per diluted common share, for the second quarter of 2013. Return on average common equity (ROE) was 11.38% and return on average assets was 1.08% for the second quarter of 2014, compared to 9.94% and 0.95%, respectively, for the second quarter of 2013. Net income and net income available to common stockholders for the six months ended June 30, 2014 totaled $61.7 million and $56.8 million, respectively, or $1.30 per diluted common share, compared to net income and net income available to common stockholders of $57.2 million and $54.7 million, respectively, or $1.31 per diluted common share, for the same period in 2013. Return on average common equity was 10.81% and return on average assets was 1.05% for the six months ended June 30, 2014, compared to 11.74% and 1.36%, respectively, for the six months ended June 30, 2013. During January 2014, we completed an equity offering of 1.9 million shares, which increased diluted shares. We also completed a $175.0 million subordinated debt offering, which resulted in an additional $3.9 million in interest expense for the six months ended June 30, 2014. The sale of 1.9 million common shares during the first quarter of 2014 increased common equity by $106.5 million and had the effect of reducing ROE.

Net income increased $9.3 million, or 39%, for the three months ended June 30, 2014 as compared to the same period in 2013. The increase was primarily the result of a $14.2 million increase in net interest income and a $3.0 million decrease in the provision for credit losses, offset by a $595,000 decrease in non-interest income, a $1.0 million increase in non-interest expense and a $6.2 million increase in income tax expense. Net income increased $4.5 million, or 8%, during the six months ended June 30, 2014 primarily as the result of a $24.5 million increase in net interest income offset by a $1.5 million decrease in non-interest income, a $14.7 million increase in non-interest expense and a $3.8 million increase in income tax expense.

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

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Net Interest Income

Net interest income was $115.4 million for the second quarter of 2014, compared to $101.2 million for the second quarter of 2013. The increase was due to an increase in average earning assets of $2.3 billion as compared to the second quarter of 2013. The increase in average earning assets included a $2.2 billion increase in average net loans and a $52.4 million increase in average liquidity assets, offset by a $28.4 million decrease in average securities. For each of the quarters ended June 30, 2014 and June 30, 2013, average net loans, liquidity assets and securities represented approximately 98%, 2% and less than 1%, respectively, of average earning assets.

Average interest-bearing liabilities for the quarter ended June 30, 2014 increased $1.3 billion from the second quarter of 2013, which included a $1.2 billion increase in interest-bearing deposits and a $175.0 million increase in long-term debt as a result of the Bank s issuance of subordinated notes in January 2014, offset by a $60.8 million decrease in other borrowings. Average demand deposits increased from $2.9 billion at June 30, 2013 to $3.6 billion at June 30, 2014. The average cost of total deposits and borrowed funds increased from .16% for the second quarter of 2013 to .17% for the second quarter of 2014. The total cost of interest-bearing liabilities included $2.3 million attributable to $175.0 million in long-term debt issued in January 2014. Including the increase in long-term debt, the cost of interest-bearing liabilities increased from .40% for the quarter ended June 30, 2013 to .51% for the same period of 2014.

Net interest income was $223.7 million for the six months ended June 30, 2014, compared to $199.3 million for the same period in 2013. The increase was due to an increase in average earning assets of $2.0 billion as compared to the six months ended June 30, 2013. The increase in average earning assets included a $1.9 billion increase in average net loans and a $126.1 million increase in average liquidity assets, offset by a $32.1 million decrease in average securities. For the six months ended June 30, 2014, average net loans, liquidity assets and securities represented approximately 97%, 2% and 1%, respectively, of average earning assets compared to 98%, 1% and 1%, respectively, in the same period of 2013.

Average interest-bearing liabilities for the six months ended June 30, 2014 increased $899.6 million from the first six months of 2013, which included a $1.2 billion increase in interest-bearing deposits and a $146.0 million increase in subordinated notes, offset by a $402.8 million decrease in other borrowings. Average demand deposits increased from $2.7 billion at June 30, 2013 to $3.5 billion at June 30, 2014. The average cost of total deposits and borrowed funds remained at .17% for the six months ended June 30, 2014 compared to the same period in the prior year. The total cost of interest-bearing liabilities included $3.9 million attributable to $175.0 million of long-term debt issued in January 2014. Including the increase in long-term debt, the cost of interest-bearing liabilities, including long-term debt, increased from .40% for the six months ended June 30, 2013 to .51% for the same period of 2014.

The following table presents the changes (in thousands) in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities.

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	Three months ended June 30, 2014/2013			Six months ended June 30, 2014/2013		
	Net	Change Due To(1)		Net	Change Due To(1)	
	Change	Volume	Yield/Rate	Change	Volume	Yield/Rate
Interest income:						
Securities(2)	$ (365)	$ (340)	$ (25)	$ (824)	$ (756)	$ (68)
Loans held for investment, mortgage finance loans	791	3,882	(3,091)	(5,068)	804	(5,872)
Loans held for investment	17,025	21,509	(4,484)	35,574	43,571	(7,997)
Federal funds sold	(5)	(9)	4	29	2	27
Deposits in other banks	40	60	(20)	147	160	(13)
Total	17,486	25,102	(7,616)	29,858	43,781	(13,923)
Interest expense:						
Transaction deposits	(63)	(34)	(29)	(236)	(89)	(147)
Savings deposits	1,103	919	184	2,110	1,869	241
Time deposits	(17)	3	(20)	(80)	(25)	(55)
Deposits in foreign branches	(5)	8	(13)	9	25	(16)
Borrowed funds	(54)	(30)	(24)	(312)	(357)	45
Long-term debt	2,398	2,884	(486)	4,030	4,811	(781)
Total	3,362	3,750	(388)	5,521	6,234	(713)
Net interest income	$ 14,124	$ 21,352	$ (7,228)	$ 24,337	$ 37,547	$ (13,210)

(1) Changes attributable to both volume and yield/rate are allocated to both volume and yield/rate on an equal basis.
(2) Taxable equivalent rates used where applicable and assume a 35% tax rate.

Net interest margin, the ratio of net interest income to average earning assets, was 3.87% for the second quarter of 2014 compared to 4.19% for the second quarter of 2013. The year over year decrease is due to the growth in loans with lower yields, the impact of the subordinated note offering and the $52.4 million increase in average balances of liquidity assets, which includes Federal funds sold and deposits from other banks. Funding costs, including demand deposits and borrowed funds, increased to .17% for the second quarter of 2014 compared to .16% for the second quarter of 2013. The spread on total earning assets, net of the cost of deposits and borrowed funds, was 4.02% for the second quarter of 2014 compared to 4.28% for the second quarter of 2013. The decrease resulted from the reduction in yields on total loans, primarily due to the increased proportion of mortgage finance loans to total loans. Total funding costs, including all deposits, long-term debt and stockholders equity increased to ..31% for the second quarter of 2014 compared to .24% for the second quarter of 2013. Average long-term debt increased by $175.0 million from the second quarter of 2013 and the average interest rate on long-term debt for the second quarter of 2014 was 4.88% compared to 4.40% for the same period of 2013.

Non-interest Income

The components of non-interest income were as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Service charges on deposit accounts	$ 1,764	$ 1,749	$ 3,460	$ 3,450
Trust fee income	1,242	1,269	2,524	2,510
Bank owned life insurance (BOLI) income	521	463	1,030	961
Brokered loan fees	3,357	4,778	6,181	9,522
Swap fees	410	981	1,634	2,633
Other	3,239	1,888	6,060	3,333
Total non-interest income	$ 10,533	$ 11,128	$ 20,889	$ 22,409

Non-interest income decreased $595,000 during the three months ended June 30, 2014 compared to the same period of 2013. This decrease was primarily due to a $1.4 million decrease in brokered loan fees as a result of lower per loan fees during the second quarter of 2014. Swap fee income decreased $571,000 during the three months ended June 30, 2014 compared to the same period of 2013. These fees fluctuate from quarter to quarter based on the number and volume of transactions closed during the quarter. Swap fees are fees related to customer swap transactions and are received from the institution that is our counterparty on the transaction. Offsetting these decreases was a $1.4 million increase in other non-interest income. Other non-interest income includes such items as letter of credit fees and other general operating income, none of which account for 1% or more of total interest income and non-interest income.

Non-interest income decreased $1.5 million during the six months ended June 30, 2014 compared to the same period of 2013. This decrease was primarily due to a $3.3 million decrease in brokered loan fees as a result of lower per loan fees. Swap fee income decreased $999,000 during the six months ended June 30, 2014 compared to the same period of 2013. These fees fluctuate from quarter to quarter based on the number and volume of transactions closed during the quarter. Swap fees are fees related to customer swap transactions and are received from the institution that is our counterparty on the transaction. Offsetting these decreases was a $2.7 million increase in other non-interest income. Other non-interest income includes such items as letter of credit fees and other general operating income, none of which account for 1% or more of total interest income and non-interest income.

While management expects continued growth in certain components of non-interest income, the future rate of growth could be affected by increased competition from nationwide and regional financial institutions. In order to achieve continued growth in non-interest income, we may need to introduce new products or enter into new lines of business or expand existing lines of business. Any new product introduction or new market entry could place additional demands on capital and managerial resources.

Non-interest Expense

The components of non-interest expense were as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Salaries and employee benefits	$ 39,896	$ 45,191	$ 81,952	$ 78,732
Net occupancy expense	5,073	4,135	9,841	7,992
Marketing	3,795	4,074	7,554	8,046
Legal and professional	7,181	4,707	12,583	8,647
Communications and technology	4,361	3,347	8,285	6,469
FDIC insurance assessment	2,544	699	5,269	1,777
Allowance and other carrying costs for OREO	11	482	56	912
Other[1]	6,907	6,099	13,549	11,859
Total non-interest expense	$ 69,768	$ 68,734	$ 139,089	$ 124,434

(1) Other expense includes such items as courier expenses, regulatory assessments other than FDIC insurance, due from bank charges and other general operating expenses, none of which account for 1% or more of total interest income and non-interest income.

Non-interest expense for the second quarter of 2014 increased $1.1 million, or 1%, to $69.8 million from $68.7 million in the second quarter of 2013. The increase is primarily attributable to a $2.5 million increase in legal and professional expense. Our legal and professional expense will continue to fluctuate and could increase in the future with growth and as we respond to continued regulatory changes and strategic initiatives. We expect to continue to see a decrease in the cost of resolving problem assets under improving economic conditions.

Salaries and employee benefits for the second quarter of 2014 decreased $5.3 million as the second quarter of 2013 included expenses of $7.7 million related to the succession announced last year that were non-recurring.

Net occupancy expense for the three months ended June 30, 2014 increased $1.0 million as a result of general business growth and continued build-out needed to support that growth.

Communications and technology expense for the three months ended June 30, 2014 increased $1.0 million due to general business growth.

FDIC insurance assessment expense for the three months ended June 30, 2014 increased $1.8 million compared to the same quarter in 2013 as a result of the difference in rates applied to banks with over $10 billion in assets.

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Non-interest expense for the six months ended June 30, 2014 increased $14.7 million, or 12%, to $139.1 million from $124.4 million compared to the same period in 2013. The increase is primarily attributable to a $3.9 million increase in legal and professional expense. Our legal and professional expense will continue to fluctuate and could increase in the future with growth and as we respond to continued regulatory changes and strategic initiatives. We expect to continue to see a decrease in the cost of resolving problem assets under improving economic conditions.

Salaries and employee benefits for the six months ended June 30, 2014 increased $3.2 million due to general business growth, offset by the expenses of $7.7 million related to the succession announced last year that were non-recurring.

Net occupancy expense for the six months ended June 30, 2014 increased $1.8 million as a result of general business growth and continued build-out needed to support that growth.

Communications and technology expense for the six months ended June 30, 2014 increased $1.8 million due to general business growth.

FDIC insurance assessment expense for the six months ended June 30, 2014 increased $3.5 million compared to the same period in 2013 as a result of the difference in rates applied to banks with over $10 billion in assets.

Analysis of Financial Condition

Loan Portfolio

Total loans net of allowance for loan losses at June 30, 2014 increased $1.6 billion from December 31, 2013 to $12.8 billion. Our business plan focuses primarily on lending to middle market businesses and successful professionals and entrepreneurs, and as such, commercial, real estate and construction loans have comprised a majority of our loan portfolio. Consumer loans generally have represented 1% or less of the portfolio. Mortgage finance loans relate to our mortgage warehouse lending operations in which we invest in mortgage loan ownership interests that are typically sold within 10 to 20 days. Volumes fluctuate based on the level of market demand in the product and the number of days between purchase and sale of the loans, as well as overall market interest rates.

We originate a substantial majority of all loans held for investment. We also participate in syndicated loan relationships, both as a participant and as an agent. As of June 30, 2014, we had $1.4 billion in syndicated loans, $409.5 million of which we acted as agent. All syndicated loans, whether we act as agent or participant, are underwritten to the same standards as all other loans we originate. In addition, as of June 30, 2014, none of our syndicated loans were on non-accrual.

Loans were as follows as of the dates indicated (in thousands):

	June 30, 2014	December 31, 2013
Commercial	$ 5,295,368	$ 5,020,565
Mortgage finance	3,700,253	2,784,265
Construction	1,567,667	1,262,905
Real estate	2,231,630	2,146,228
Consumer	15,847	15,350
Leases	95,914	93,160

Gross loans held for investment	12,906,679	11,322,473
Deferred income (net of direct origination costs)	(53,711)	(51,899)
Allowance for loan losses	(91,114)	(87,604)
Total loans held for investment, net	$ 12,761,854	$ 11,182,970

Commercial Loans and Leases. Our commercial loan and lease portfolio is comprised of lines of credit for working capital and term loans and leases to finance equipment and other business assets. Our energy production loans are generally collateralized with proven reserves based on appropriate valuation standards.

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Our commercial loans and leases are underwritten after carefully evaluating and understanding the borrower s ability to operate profitably. Our underwriting standards are designed to promote relationship banking rather than making loans on a transactional basis. Our lines of credit typically are limited to a percentage of the value of the assets securing the line. Lines of credit and term loans typically are reviewed annually and are supported by accounts receivable, inventory, equipment and other assets of our clients businesses.

Mortgage finance loans. Our mortgage finance loans consist of ownership interests purchased in single-family residential mortgages funded through our warehouse lending group. These loans are typically on our balance sheet for 10 to 20 days or less. We have agreements with mortgage lenders and purchase interests in individual loans they originate. All loans are underwritten consistent with established programs for permanent financing with financially sound investors. Substantially all loans are conforming loans. Mortgage finance loans as of June 30, 2014 are net of $93.8 million of participations sold.

Construction Loans. Our construction loan portfolio consists primarily of single- and multi-family residential properties and commercial projects used in manufacturing, warehousing, service or retail businesses. Our construction loans generally have terms of one to three years. We typically make construction loans to developers, builders and contractors that have an established record of successful project completion and loan repayment and have a substantial equity investment in the borrowers equity. However, construction loans are generally based upon estimates of costs and value associated with the completed project. Sources of repayment for these types of loans may be pre-committed permanent loans from other lenders, sales of developed property, or an interim loan commitment from us until permanent financing is obtained. The nature of these loans makes ultimate repayment extremely sensitive to overall economic conditions. Borrowers may not be able to correct conditions of default in loans, increasing risk of exposure to classification, non-performing status, reserve allocation and actual credit loss and foreclosure. These loans typically have floating rates and commitment fees.

Real Estate Loans. A portion of our real estate loan portfolio is comprised of loans secured by properties other than market risk or investment-type real estate. Market risk loans are real estate loans where the primary source of repayment is expected to come from the sale or lease of the real property collateral. We generally provide temporary financing for commercial and residential property. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Our real estate loans generally have maximum terms of five to seven years, and we provide loans with both floating and fixed rates. We generally avoid long-term loans for commercial real estate held for investment. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Appraised values may be highly variable due to market conditions and the impact of the inability of potential purchasers and lessees to obtain financing and lack of transactions at comparable values.

Portfolio Geographic Concentration

As of June 30, 2014, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. The risks created by this concentration have been considered by management in the determination of the appropriateness of the allowance for loan losses. Management believes the allowance for loan losses is appropriate to cover estimated losses on loans at each balance sheet date.

Summary of Loan Loss Experience

The provision for credit losses is a charge to earnings to maintain the reserve for loan losses at a level consistent with management s assessment of the loan portfolio in light of current economic conditions and market trends. We recorded a provision of $4.0 million during the second quarter of 2014 compared to $5.0 million in the first quarter of 2014 and

$7.0 million in the second quarter of 2013. Despite experiencing improvements in credit quality, we have seen levels of reserves and provision increase due to growth in the portfolio. We continue to maintain an unallocated reserve component to allow for continued uncertainty in the economic environment which has produced losses, including those resulting from fraud by borrowers, that are not necessarily correlated with historical loss trends or general economic conditions. Our methodology used to calculate the allowance considers historical losses, however, the historical loss rates for specific product types or credit risk grades may not fully incorporate the effects of continued weakness in the economy.

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The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an appropriate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than $500,000 are specifically reviewed for loss potential. For loans deemed to be impaired, a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate a reserve assigned to off-balance sheet commitments, specifically unfunded loan commitments and letters of credit. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management s judgment, should be charged off.

The reserve allocation percentages assigned to each credit grade have been developed based primarily on an analysis of our historical loss rates. The allocations are adjusted for certain qualitative factors, including general economic conditions, changes in credit policies and lending standards. Changes in the trend and severity of problem loans can cause the estimation of losses to differ from past experience. In addition, the reserve considers the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio. The portion of the allowance that is not derived by the allowance allocation percentages compensates for the uncertainty and complexity in estimating loan and lease losses including factors and conditions that may not be fully reflected in the determination and application of the allowance allocation percentages. We evaluate many factors and conditions in determining the unallocated portion of the allowance, including the economic and business conditions affecting key lending areas, credit quality trends and general growth in the portfolio. The allowance is considered appropriate, given management s assessment of potential losses within the portfolio as of the evaluation date, the significant growth in the loan and lease portfolio, current economic conditions in the Company s market areas and other factors.

The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans is evaluated with new information. As our portfolio has matured, historical loss ratios have been closely monitored, and our reserve adequacy relies primarily on our loss history. The review of the reserve adequacy is performed by executive management and presented to a committee of our board of directors for their review. The committee reports to the board as part of the board s review on quarterly basis of the Company s consolidated financial statements.

The combined reserve for credit losses, which includes a liability for losses on unfunded commitments, totaled $96.7 million at June 30, 2014, $92.3 million at December 31, 2013 and $83.6 million at June 30, 2013. Due to the growth in loans, the total reserve percentage decreased to 1.06% at June 30, 2014 from 1.09% and 1.11% of loans excluding mortgage finance loans at December 31, 2013 and June 30, 2013, respectively. The combined reserve percentage has trended down as we recognize losses on loans for which there were specific or general allocations of reserves and see improvement in our overall credit quality. The overall reserve for loan losses continues to result from consistent application of the loan loss reserve methodology as described above. At June 30, 2014, we believe the reserve is sufficient to cover all expected losses in the portfolio and has been derived from consistent application of the methodology described above. Should any of the factors considered by management in evaluating the adequacy of the allowance for loan losses change or prove to be inaccurate, our estimate of inherent losses in the portfolio could also change or become insufficient, which would affect the level of future provisions for loan losses.

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Activity in the reserve for loan losses is presented in the following table (in thousands):

	Six months ended June 30, 2014	Year ended December 31, 2013	Six months ended June 30, 2013
Reserve for loan losses:			
Beginning balance	$ 87,604	$ 74,337	$ 74,337
Loans charged-off:			
Commercial	7,526	6,575	4,474
Real estate	296	144	131
Consumer	101	45	45
Leases		2	
Total charge-offs	7,923	6,766	4,650
Recoveries:			
Commercial	3,150	1,203	745
Real estate	43	270	15
Consumer	31	73	45
Leases	142	322	261
Total recoveries	3,366	1,868	1,066
Net charge-offs	4,557	4,898	3,584
Provision for loan losses	8,067	18,165	8,675
Ending balance	$ 91,114	$ 87,604	$ 79,428
Reserve for off-balance sheet credit losses:			
Beginning balance	$ 4,690	$ 3,855	$ 3,855
Provision for off-balance sheet credit losses	933	835	325
Ending balance	$ 5,623	$ 4,690	$ 4,180
Total reserve for credit losses	$ 96,737	$ 92,294	$ 83,608
Total provision for credit losses	$ 9,000	$ 19,000	$ 9,000
Reserve for loan losses to loans	0.71%	0.78%	0.77%
Reserve for loan losses to loans excluding mortgage finance loans(2)	1.00%	1.03%	1.06%
Net charge-offs to average loans(1)	0.08%	0.05%	0.08%
Net charge-offs to average loans excluding mortgage finance loans(1) (2)	0.10%	0.07%	0.10%
Total provision for credit losses to average loans	0.16%	0.19%	0.19%
Total provision for credit losses to average loans excluding mortgage finance loans(2)	0.21%	0.25%	0.26%
Recoveries to total charge-offs	42.48%	27.61%	22.92%
Reserve for off-balance sheet credit losses to off-balance sheet credit commitments	0.12%	0.12%	0.14%

Combined reserves for credit losses to loans held for investment	0.75%	0.82%	0.81%
Combined reserves for credit losses to loans held for investment excluding mortgage finance loans(2)	1.06%	1.09%	1.11%
Non-performing assets:			
Non-accrual loans(5)	$ 41,565	$ 32,375	$ 38,450
OREO(4)	685	5,110	13,053
Other repossessed assets			19
Total	$ 42,250	$ 37,485	$ 51,522
Restructured loans	$ 249	$ 1,935	$ 4,765
Loans past due 90 days and still accruing(3)	4,793	9,325	7,633
Reserve as a percent of non-performing loans	2.2x	2.7x	2.1x

(1) Interim period ratios are annualized.

(2) Mortgage finance loans were previously classified as loans held for sale but have been reclassified as loans held for investment as described in Note 1 Operations and Summary of Significant Accounting Policies. The indicated ratios are presented excluding the mortgage finance loans because the risk profile of our mortgage finance loans is different than our other loans held for investment. No provision is allocated to these loans based on the internal risk grade assigned.

(3) At June 30, 2014, December 31, 2013 and June 30, 2013, loans past due 90 days and still accruing includes premium finance loans of $4.6 million, $3.8 million and $4.2 million, respectively. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

(4) At June 30, 2014, we did not have a valuation allowance recorded against the OREO balance. At December 31, 2013 and June 30, 2013, OREO balance is net of a $5.6 million and a $4.6 million valuation allowance, respectively.

(5) As of June 30, 2014, December 31, 2013 and June 30, 2013, non-accrual loans included $16.2 million, $17.8 million and $16.4 million, respectively, in loans that met the criteria for restructured.

Non-performing Assets

Non-performing assets include non-accrual loans and leases and repossessed assets. The table below summarizes our non-accrual loans by type and OREO (in thousands):

	June 30, 2014	December 31, 2013	June 30, 2013
Non-accrual loans:			
Commercial	$ 25,545	$ 12,896	$ 17,577
Construction		705	
Real estate	15,998	18,670	20,799
Consumer		54	9
Leases	22	50	65
Total non-accrual loans	41,565	32,375	38,450
Repossessed assets:			
OREO	685	5,110	13,053
Other repossessed assets			19
Total repossessed assets	685	5,110	13,072
Total non-performing assets	$ 42,250	$ 37,485	$ 51,522

The table below summarizes the non-accrual loans as segregated by loan type and type of property securing the credit as of June 30, 2014 (in thousands):

Non-accrual loans:	
Commercial	
Lines of credit secured by the following:	
Oil and gas properties	$ 820

Assets of the borrowers	22,409
Other	2,316
Total commercial	25,545
Real estate	
Secured by:	
Commercial property	9,482
Unimproved land and/or undeveloped residential lots	3,945
Other	2,571
Total real estate	15,998
Leases (commercial leases primarily secured by assets of the lessor)	22
Total non-accrual loans	$ 41,565

Generally, we place loans on non-accrual when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectability is questionable, then cash payments are applied to principal. As of June 30, 2014, $480,000 of our non-accrual loans were earning on a cash basis. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the original loan agreement. All loans classified as restructured loans are also considered impaired. Reserves on impaired loans are measured based on the present value of the expected future cash flows discounted at the loan s effective interest rate or the fair value of the underlying collateral.

At June 30, 2014, we had $4.8 million in loans past due 90 days and still accruing interest. At June 30, 2014, $4.6 million of the loans past due 90 days and still accruing are premium finance loans. These loans are primarily secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

Restructured loans are loans on which, due to the borrower s financial difficulties, we have granted a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, or forgiveness of either principal or accrued interest. As of June 30, 2014, we had $249,000 in loans considered restructured that are not on non-accrual. Of the non-accrual loans at June 30, 2014, $16.2 million met the criteria for restructured. A loan continues to qualify as restructured until a consistent payment history or change in borrower s financial condition has been evidenced, generally no less than twelve months. Assuming that the restructuring agreement specifies an interest rate at the time of the restructuring that is greater than or equal to the rate that we are willing to accept for a new extension of credit with comparable risk, the loan no longer has to be considered a restructuring if it is in compliance with modified terms in calendar years after the year of the restructuring.

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which we have concerns about the borrower s ability to comply with repayment terms because of the borrower s potential financial difficulties. We monitor these loans closely and review their performance on a regular basis. At June 30, 2014 and 2013, we had $14.8 million and $9.3 million, respectively, in loans of this type which were not included in either non-accrual or 90 days past due categories.

The table below presents a summary of the activity related to OREO (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Beginning balance	$ 2,420	$ 14,426	$ 5,110	$ 15,991
Additions		912	851	912
Sales	(1,735)	(1,902)	(5,276)	(3,396)
Valuation allowance for OREO		(164)		(164)
Direct write-downs		(219)		(290)
Ending balance	$ 685	$ 13,053	$ 685	$ 13,053

The following table summarizes the assets held in OREO at June 30, 2014 (in thousands):

Undeveloped land and residential lots	$ 487
Other	198
Total OREO	$ 685

When foreclosure occurs, fair value, which is generally based on appraised values, may result in partial charge-off of a loan upon taking property, and so long as property is retained, subsequent reductions in appraised values will result in valuation adjustments taken as non-interest expense. In addition, if the decline in value is believed to be permanent and not just driven by market conditions, a direct write-down to the OREO balance may be taken. We generally pursue sales of OREO when conditions warrant, but we may choose to hold certain properties for a longer term, which can result in additional exposure related to the appraised values during that holding period. During the six months ended June 30, 2014 we did not record a valuation expense compared to $454,000 recorded during the same period of 2013. Of the $454,000 recorded for the six months ended June 30, 2013, $164,000 related to direct write-downs and $290,000 related to increasing the valuation allowance.

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Liquidity and Capital Resources

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies, which are formulated and monitored by our senior management and our Balance Sheet Management Committee (BSMC), and which take into account the demonstrated marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. For the year ended December 31, 2013 and for the six months ended June 30, 2014, our principal source of funding has been our customer deposits, supplemented by our short-term and long-term borrowings, primarily from Federal funds purchased and Federal Home Loan Bank (FHLB) borrowings.

Our liquidity needs for support of growth in loans held for investment have been fulfilled through growth in our core customer deposits. Our goal is to obtain as much of our funding for loans held for investment and other earnings assets as possible from deposits of these core customers. These deposits are generated principally through development of long-term relationships with customers and stockholders, with a significant focus on treasury management products. In addition to deposits from our core customers, we also have access to deposits through brokered customer relationships. For regulatory purposes, these relationship brokered deposits are now categorized as brokered deposits; however, since these deposits arise from a customer relationship, we consider these deposits to be core deposits for our reporting purposes. We also have access to incremental deposits through brokered retail certificates of deposit, or CDs. These traditional brokered deposits are generally of short maturities, 30 to 90 days, and are used to supplement temporary differences in the growth in loans, including growth in loans held for sale or other specific categories of loans, compared to customer deposits. The following table summarizes our period-end and average year-to-date core customer deposits and brokered deposits (in millions):

	June 30, 2014	December 31, 2013	June 30, 2013
Deposits from core customers	$ 8,642.9	$ 7,840.1	$ 6,900.9
Deposits from core customers as a percent of total deposits	80.4%	84.7%	86.5%
Relationship brokered deposits	$ 1,863.0	$ 1,417.3	$ 1,079.7
Relationship brokered deposits as a percent of total deposits	17.3%	15.3%	13.5%
Traditional brokered deposits	$ 251.4	$	$
Traditional brokered deposits as a percent of total deposits	2.3%	0.0%	0.0%
Average deposits from core customers(1)	$ 8,062.9	$ 7,040.4	$ 6,715.8
Average deposits from core customers as a percent of total quarterly average deposits(1)	83.0%	84.1%	86.3%
Average relationship brokered deposits(1)	$ 1,618.0	$ 1,334.5	$ 1,067.2
Average relationship brokered deposits as a percent of total quarterly average deposits(1)	16.6%	15.9%	13.7%
Average traditional brokered deposits(1)	$ 41.7	$	$
Average traditional brokered deposits as a percent of total quarterly average deposits(1)	0.4%	0.0%	0.0%

(1) Annual averages presented for December 31, 2013.

We have access to, and have periodically utilized, sources of brokered deposits of not less than an additional $3.2 billion. Customer deposits (total deposits, including relationship brokered deposits, minus brokered CDs) increased by $997.1 million from December 31, 2013 and increased $2.3 billion from June 30, 2013.

Additionally, we have borrowing sources available to supplement deposits and meet our funding needs. Such borrowings are generally used to fund our loans held for sale, due to their liquidity, short duration and interest spreads available. These borrowing sources typically include Federal funds purchased from our downstream

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correspondent bank relationships (which consist of banks that are smaller than our bank) and from our upstream correspondent bank relationships (which consist of banks that are larger than our bank), customer repurchase agreements, treasury, tax and loan notes, and advances from the FHLB and the Federal Reserve. The following table summarizes our borrowings as of June 30, 2014 (in thousands):

Federal funds purchased	$ 273,041
Repurchase agreements	27,491
FHLB borrowings	700,016
Subordinated notes	286,000
Trust preferred subordinated debentures	113,406
Total borrowings	$ 1,399,954
Maximum borrowings outstanding at any month-end during the year	$ 1,709,096

The following table summarizes our other borrowing capacities in excess of balances outstanding at June 30, 2014 (in thousands):

FHLB borrowing capacity relating to loans	$ 1,147,413
FHLB borrowing capacity relating to securities	3,561
Total FHLB borrowing capacity	$ 1,150,974
Unused Federal funds lines available from commercial banks	$ 925,000

At June 30, 2014, we had a non-revolving amortizing line of credit with $100.0 million of unused capacity. This line of credit matures on December 15, 2014. The loan proceeds may be used for general corporate purposes including funding regulatory capital infusions into the Bank. The loan agreement contains customary financial covenants and restrictions. At June 30, 2014, no borrowings were outstanding compared to $15.0 million outstanding at December 31, 2013.

Our equity capital, including $150 million in preferred stock, averaged $1.2 billion for the six months ended June 30, 2014, as compared to $939.3 million for the same period in 2013 when the average balance of preferred stock outstanding was $78.7 million. We have not paid any cash dividends on our common stock since we commenced operations and have no plans to do so in the near future.

On January 29, 2014, we completed a sale of 1.9 million shares of our common stock in a public offering. Net proceeds from the sale totaled $106.5 million. On January 31, 2014, the Bank issued $175.0 million of subordinated notes in an offering to institutional investors exempt from registration under Section 3(a)(2) of the Securities Act of 1933 and 12 C.F.R. Part 16. Net proceeds from the transaction were $172.4 million. The notes mature in January 2026 and bear interest at a rate of 5.25% per annum, payable semi-annually. The notes are unsecured and are subordinate to the Bank s obligations to its deposit-holders, its obligations under banker s acceptances and letters of credit, certain obligations to Federal Reserve Banks and the FDIC and the Bank s obligations to its other creditors, except any obligations which expressly rank on a parity with or junior to the notes. The notes are expected to qualify as Tier 2 capital for regulatory capital purposes, subject to applicable limitations. The net proceeds of both offerings were available to the Company for general corporate purposes, including retirement of $15.0 million of short-term debt that was outstanding at December 31, 2013, and additional capital to support continued loan growth.

Our capital ratios remain above the levels required to be well capitalized. We believe that periodic capital raising transactions, along with the addition of loan and deposit relationships, will allow us to continue to grow organically.

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Commitments and Contractual Obligations

The following table presents significant fixed and determinable contractual obligations to third parties by payment date. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. As of June 30, 2014, our significant fixed and determinable contractual obligations to third parties, excluding interest, were as follows (in thousands):

	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years	Total
Deposits without a stated maturity	$ 9,801,592	$	$	$	$ 9,801,592
Time deposits	937,724	15,170	2,756	74	955,724
repurchase agreements	300,532				300,532
FHLB borrowings	700,016				700,016
Operating lease obligations(1)	14,111	28,884	28,556	56,477	128,028
Subordinated notes				286,000	286,000
Total contractual obligations	$ 11,753,975	$	$	$ 113,406	$ 113,406

(1) Non-balance sheet item.

Critical Accounting Policies

SEC guidance requires disclosure of critical accounting policies. The SEC defines critical accounting policies as those that are most important to the presentation of a company s financial condition and results, and require management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

We follow financial accounting and reporting policies that are in accordance with accounting principles generally accepted in the United States. The more significant of these policies are summarized in Note 1 to the consolidated financial statements. Not all these significant accounting policies require management to make difficult, subjective or complex judgments. However, the policy noted below could be deemed to meet the SEC s definition of a critical accounting policy.

Management considers the policies related to the allowance for loan losses as the most critical to the financial statement presentation. The total allowance for loan losses includes activity related to allowances calculated in accordance with ASC 310, *Receivables*, and ASC 450, *Contingencies*. The allowance for loan losses is established through a provision for loan losses charged to current earnings. The amount maintained in the allowance reflects management s continuing evaluation of the loan losses inherent in the loan portfolio. The allowance for loan losses is comprised of specific reserves assigned to certain classified loans and general reserves. Factors contributing to the determination of specific reserves include the credit-worthiness of the borrower, and more specifically, changes in the expected future receipt of principal and interest payments and/or in the value of pledged collateral. A reserve is recorded when the carrying amount of the loan exceeds the discounted estimated cash flows using the loan s initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. For purposes of determining the general reserve, the portfolio is segregated by product types in order to recognize differing risk profiles among categories, and then further segregated by credit grades. See Summary of Loan Loss Experience above and Note 4 Loans and Allowance for Loan Losses in the accompanying notes to the consolidated financial statements included elsewhere in this report for further discussion of the risk factors considered by management in establishing the allowance for loan losses.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is a broad term for the risk of economic loss due to adverse changes in the fair value of a financial instrument. These changes may be the result of various factors, including interest rates, foreign exchange rates, commodity prices, or equity prices. Additionally, the financial instruments subject to market risk can be classified either as held for trading purposes or held for other than trading.

We are subject to market risk primarily through the effect of changes in interest rates on our portfolio of assets held for purposes other than trading. The effect of other changes, such as foreign exchange rates, commodity prices, and/or equity prices do not pose significant market risk to us.

The responsibility for managing market risk rests with the BSMC, which operates under policy guidelines established by our board of directors. The negative acceptable variation in net interest revenue due to a 200 basis point increase or decrease in interest rates is generally limited by these guidelines to +/- 5%. These guidelines also establish maximum levels for short-term borrowings, short-term assets and public and brokered deposits. They also establish minimum levels for unpledged assets, among other things. Compliance with these guidelines is the ongoing responsibility of the BSMC, with exceptions reported to our board of directors on a quarterly basis.

Interest Rate Risk Management

Our interest rate sensitivity is illustrated in the following table. The table reflects rate-sensitive positions as of June 30, 2014, and is not necessarily indicative of positions on other dates. The balances of interest rate sensitive assets and liabilities are presented in the periods in which they next reprice to market rates or mature and are aggregated to show the interest rate sensitivity gap. The mismatch between repricings or maturities within a time period is commonly referred to as the gap for that period. A positive gap (asset sensitive), where interest rate sensitive assets exceed interest rate sensitive liabilities, generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite results on the net interest margin. To reflect anticipated prepayments, certain asset and liability categories are shown in the table using estimated cash flows rather than contractual cash flows. The Company employs interest rate floors in certain variable rate loans to enhance the yield on those loans at times when market interest rates are extraordinarily low. The degree of asset sensitivity, spreads on loans and net interest margin may be reduced until rates increase by an amount sufficient to eliminate the effects of floors. The adverse effect of floors as market rates increase may also be offset by the positive gap, the extent to which rates on deposits and other funding sources lag increasing market rates and changes in composition of funding.

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Interest Rate Sensitivity Gap Analysis

June 30, 2014

(In thousands)

	0-3 mo Balance	4-12 mo Balance	1-3 yr Balance	3+ yr Balance	Total Balance
Assets:					
Securities[1]	$ 4,000	$ 36,906	4,062	$ 4,362	$ 49,330
Total variable loans	11,230,542	54,067	5,333	25	11,289,967
Total fixed loans	790,344	409,392	205,670	211,306	1,616,712
Total loans[2]	12,020,886	463,459	211,003	211,331	12,906,679
Total interest sensitive assets	$ 12,024,886	$ 500,365	$ 215,065	$ 215,693	$ 12,956,009
Liabilities:					
Interest-bearing customer deposits	$ 5,710,622	$	$	$	$ 5,710,622
CDs & IRAs	404,001	191,538	15,170	2,830	613,539
Traditional brokered deposits	251,381				251,381
Total interest-bearing deposits	6,366,004	191,538	15,170	2,830	6,575,542
Repurchase agreements, Federal funds purchased, FHLB borrowings	1,000,548				1,000,548
Subordinated notes				286,000	286,000
Trust preferred subordinated debentures				113,406	113,406
Total borrowings	1,000,548			399,406	1,399,954
Total interest sensitive liabilities	$ 7,366,552	$ 191,538	$ 15,170	$ 402,236	$ 7,975,496
GAP	$ 4,658,334	$ 308,827	$ 199,895	$ (186,543)	$
Cumulative GAP	4,658,334	4,967,161	5,167,056	4,980,513	4,980,513
Demand deposits					$ 4,181,774
Stockholders equity					1,262,816
Total					$ 5,444,590

(1) Securities based on fair market value.

(2) Loans are stated at gross.

The table above sets forth the balances as of June 30, 2014 for interest bearing assets, interest bearing liabilities, and the total of non-interest bearing deposits and stockholders equity. While a gap interest table is useful in analyzing interest rate sensitivity, an interest rate sensitivity simulation provides a better illustration of the sensitivity of earnings to changes in interest rates. Earnings are also affected by the effects of changing interest rates on the value of funding derived from demand deposits and stockholders equity. We perform a sensitivity analysis to identify interest rate risk exposure on net interest income. We quantify and measure interest rate risk exposure using a model to dynamically simulate the effect of changes in net interest income relative to changes in interest rates and loan and deposit account balances over the next twelve months based on three interest rate scenarios. These are a most likely rate scenario and two shock test scenarios.

The most likely rate scenario is based on the consensus forecast of future interest rates published by independent sources. These forecasts incorporate future spot rates and relevant spreads of instruments that are actively traded in the open market. The Federal Reserve s Federal funds target affects short-term borrowing; the prime lending rate and the LIBOR are the basis for most of our variable-rate loan pricing. The 10-year mortgage rate is also monitored because of its effect on prepayment speeds for mortgage-backed securities. We believe these are our primary interest rate exposures. We are not currently using derivatives to manage our interest rate exposure.

The two shock test scenarios assume a sustained parallel 100 and 200 basis point increase in interest rates. As short-term rates have remained low through 2014, we do not believe that analysis of an assumed decrease in interest rates would provide meaningful results. We will continue to evaluate these scenarios as interest rates change, until short-term rates rise above 3.0%.

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Our interest rate risk exposure model incorporates assumptions regarding the level of interest rate or balance changes on indeterminable maturity deposits (demand deposits, interest-bearing transaction accounts and savings accounts) for a given level of market rate changes. These assumptions have been developed through a combination of historical analysis and future expected pricing behavior. Changes in prepayment behavior of mortgage-backed securities, residential and commercial mortgage loans in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. The impact of planned growth and new business activities is factored into the simulation model. This modeling indicated interest rate sensitivity as follows (in thousands):

	Anticipated Impact Over the Next Twelve Months as Compared to Most Likely Scenario	
	100 bp Increase	200 bp Increase
	June 30, 2014	
Change in net interest income	$ 54,031	$ 119,028

The simulations used to manage market risk are based on numerous assumptions regarding the effect of changes in interest rates on the timing and extent of repricing characteristics, future cash flows, and customer behavior. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results may differ from simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and management strategies, among other factors.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the supervision and participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, we have concluded that, as of the end of such period, our disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to the Company s management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to various claims and legal actions related to operating activities that arise in the ordinary course of business. Management does not currently expect the ultimate disposition of these matters to have a material adverse impact on our financial statements.

ITEM 1A. RISK FACTORS

There have been no material change in the risk factors previously disclosed in the Company s 2013 Form 10-K for the fiscal year ended December 31, 2013.

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ITEM 6. EXHIBITS

on 302 of the Sarbanes-Oxley Act of 2002, filed herewith.

on 302 of the Sarbanes-Oxley Act of 2002, filed herewith.

as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.

as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.

March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Income, (ii) Consolida

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SIGNATURES

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

TEXAS CAPITAL BANCSHARES, INC.

Date: July 24, 2014

/s/ Peter B. Bartholow
Peter B. Bartholow
Chief Financial Officer
(Duly authorized officer and principal financial officer)

EXHIBIT INDEX

Exhibit Number	
10.1	Form of Indemnification Agreement for directors and officers of Texas Capital Bancshares, Inc. and its subsidiaries.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.
32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.
101	The following materials from Texas Capital Bancshares, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Income, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements