GENERAL MOTORS CORP
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March 25, 2009

million compared to $2.1 million at December 31, 2011.

Our deposits increased $30.2 million to $2.35 billion at December 31, 2012 from $2.32 billion at December 31, 2011. Our deposits, net of brokered deposits, increased $174.6 million. The increase in our deposits during 2012 was primarily due to an an increase in public fund deposits and to a lesser extent an increase in deposits from branch expansion and increased market penetration. During 2012, our public fund deposits increased $112.2 million while our brokered deposits decreased $144.4 million. Total FHLB advances decreased $102.5 million to $520.1 million at December 31, 2012, from $622.5 million at December 31, 2011. Short-term FHLB advances decreased $210.8 million to $151.0 million at December 31, 2012 from $361.8 million at December 31, 2011. Long-term FHLB advances increased $108.4 million to $369.1 million at December 31, 2012 from $260.7 million at December 31, 2011. During 2010 and 2011, we entered into the option to purchase, between one and a half years and two years forward from the advance commitment date $200 million par in long-term advance commitments from FHLB at the FHLB rates on the date the option was purchased. During the year ended December 31, 2012, $150 million par of long-term commitments expired unexercised. Other borrowings at December 31, 2012 and 2011 totaled $61.5 million and $63.5 million, respectively, and at December 31, 2012 consisted of $1.2 million of short-term borrowings and $60.3 million of long-term debt.

Assets under management in our trust department increased during 2012 and were approximately $758.3 million at December 31, 2012 compared to $718.5 million at December 31, 2011.

Shareholders' equity at December 31, 2012 totaled $257.8 million compared to $258.9 million at December 31, 2011. The decrease primarily reflects cash dividends paid of $19.1 million, a decrease in accumulated other comprehensive income of $11.8 million and the purchase of treasury stock of $7.4 million. This was partially offset by the net income of $34.7 million recorded for the year ended December 31, 2012 and the common stock issued of $1.9 million as a result of our dividend reinvestment plan. The decrease in accumulated other comprehensive income is comprised primarily of a decrease of $6.3 million, net of tax, in the unrealized gain on securities, net of reclassification adjustment and a decrease of $5.5 million, net of tax, related to the change in the unfunded status of our defined benefit plan. See "Note 3 – Comprehensive Income (Loss)" to our consolidated financial statements included in this report.

Our market areas to date, have not experienced the level of downturn in the economy and real estate prices that some of the harder hit areas of the country have experienced. However, we did experience some weakening conditions associated with the real estate led downturn during 2008 through 2011. Many economists predict growth for the economy during 2013, however we are well aware that any economic recovery could be uneven. We cannot predict whether current economic conditions will improve, remain the same or decline.

Key financial indicators management follows include, but are not limited to, numerous interest rate sensitivity and interest rate risk indicators, credit risk, operations risk, liquidity risk, capital risk, regulatory risk, competition risk, yield curve risk, U.S. agency mortgage-backed securities prepayment risk, and economic risk indicators.

BALANCE SHEET STRATEGY

We utilize wholesale funding and securities to enhance our profitability and balance sheet composition by determining acceptable levels of credit, interest rate and liquidity risk consistent with prudent capital management. This balance sheet strategy consists of borrowing a combination of long and short-term funds from the FHLB and, when determined appropriate, issuing brokered CDs. These funds are invested primarily in U.S. agency mortgage-backed

securities, and to a lesser extent, long-term

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municipal securities.  Although U.S. agency mortgage-backed securities often carry lower yields than traditional mortgage loans and other types of loans we make, these securities generally (i) increase the overall quality of our assets because of either the implicit or explicit guarantees of the U.S. Government, (ii) are more liquid than individual loans and (iii) may be used to collateralize our borrowings or other obligations.  While the strategy of investing a substantial portion of our assets in U.S. agency mortgage-backed securities and municipal securities has historically resulted in lower interest rate spreads and margins, we believe that the lower operating expenses and reduced credit risk combined with the managed interest rate risk of this strategy have enhanced our overall profitability over the last several years.  At this time, we utilize this balance sheet strategy with the goal of enhancing overall profitability by maximizing the use of our capital.

Risks associated with the asset structure we maintain include a lower net interest rate spread and margin when compared to our peers, changes in the slope of the yield curve, which can reduce our net interest rate spread and margin, increased interest rate risk, the length of interest rate cycles, changes in volatility spreads associated with the mortgage-backed securities and municipal securities, the unpredictable nature of mortgage-backed securities prepayments and credit risks associated with the municipal securities.  See "Part I - Item 1A.  Risk Factors – Risks Related to Our Business" for a discussion of risks related to interest rates.  Our asset structure, net interest spread and net interest margin require us to closely monitor our interest rate risk.  An additional risk is the change in fair value of the AFS securities portfolio as a result of changes in interest rates.  Significant increases in interest rates, especially long-term interest rates, could adversely impact the fair value of the AFS securities portfolio, which could also significantly impact our equity capital.  Due to the unpredictable nature of mortgage-backed securities prepayments, the length of interest rate cycles, and the slope of the interest rate yield curve, net interest income could fluctuate more than simulated under the scenarios modeled by our ALCO and described under "Item 7A.  Quantitative and Qualitative Disclosures about Market Risk" in this report.

Determining the appropriate size of the balance sheet is one of the critical decisions any bank makes.  Our balance sheet is not merely the result of a series of micro-decisions, but rather the size is controlled based on the economics of assets compared to the economics of funding.  The current low interest rate environment and investment and economic landscape make it unlikely that we will experience asset growth driven by an increase in the securities portfolio until one or more of these conditions change.

The management of our securities portfolio as a percentage of earning assets is guided by changes in our overall loan and deposit levels, combined with changes in our wholesale funding levels.  If adequate quality loan growth is not available to achieve our goal of enhancing profitability by maximizing the use of capital, as described above, then we could purchase additional securities, if appropriate, which could cause securities as a percentage of earning assets to increase.  Should we determine that increasing the securities portfolio or replacing the current securities maturities and principal payments is not an efficient use of capital, we could decrease the level of securities through proceeds from maturities, principal payments on mortgage-backed securities or sales.  Our balance sheet strategy is designed such that our securities portfolio should help mitigate financial performance associated with slower loan growth and higher credit costs.

The year ended December 31, 2012 was marked by proactive management of the securities portfolio which included restructuring a portion of the portfolio.  During the year ended December 31, 2012, interest rates remained low and prepayments on our mortgage-backed securities increased, so we continued to sell primarily longer duration municipal securities and more prepayment volatile mortgage-backed securities and replaced a portion of them with primarily shorter duration municipal securities, U.S Government agency debentures and fixed and floating rate U.S. agency mortgage-backed securities. The sale of these securities resulted in a gain on the sale of available for sale securities of $4.4 million during the three months ended December 31, 2012.  During the quarter we purchased fewer fixed rate mortgage-backed securities because the risk/reward of this class of securities decreased due to increased prepayment speeds and continued high purchase prices.  During the quarter ended December 31, 2012, our investment securities

and U.S. agency mortgage-backed securities decreased from $1.72 billion at September 30, 2012, to $1.67 billion at December 31, 2012.  The average coupon of the mortgage-backed securities portfolio decreased to 5.11% at December 31, 2012 from 6.12% at December 31, 2011, primarily as a result of the sale of the securities carried at fair value through income combined with reinvestment into coupons on average below 6.00% and the purchase of some lower coupon floating rate U.S. agency mortgage-backed securities.  At December 31, 2012, securities as a percentage of assets decreased to 51.6%, when compared to 53.4% at September 30, 2012 and 61.0% at December 31, 2011 primarily as a result of the increase in loans and the reduced risk/reward opportunities in mortgage-backed securities as prepayments have increased during 2012.  Our balance sheet management strategy is dynamic and will be continually reevaluated as market conditions warrant.  As interest rates, yield curves, mortgage-backed securities prepayments, funding costs, security spreads and loan and deposit portfolios change, our determination of the proper types and maturities of securities to own, proper amount of securities to own and funding needs and funding sources will continue to be reevaluated.  Should the economics of purchasing securities remain the same or decrease, we will likely allow this part of the balance sheet to shrink through run-off or security sales.  However, should the economics become more attractive, we might strategically increase the securities portfolio and the balance sheet.

With respect to liabilities, we will continue to utilize a combination of FHLB advances and deposits to achieve our strategy of minimizing cost while achieving overall interest rate risk objectives as well as the liability management objectives of the ALCO.  FHLB funding is the primary wholesale funding source we are currently utilizing.  Our FHLB borrowings at December 31, 2012 decreased 2.5%, or $13.1 million, to $520.1 million from $533.2 million at September 30, 2012 primarily as a result of a decrease in the securities portfolio.  During 2010 and 2011 we entered into the option to purchase, between one and a half and two years forward from the advance commitment date, $200 million par in long-term advance commitments from FHLB at the FHLB rates on the date the option was purchased.  During the year ended December 31, 2012, $150 million par of long-term commitments expired unexercised.  As of December 31, 2012, we had $19.5 million in brokered CDs of which all were long-term.  All of the long-term brokered CDs, except for one $5.0 million CD, have short-term calls that we control.  We utilized long-term callable brokered CDs because the brokered CDs better matched overall ALCO objectives at the time of issuance by protecting us with fixed rates should interest rates increase, while providing us options to call the funding should interest rates decrease.  We are actively evaluating the callable brokered CDs and may exercise the call option if there is an economic benefit.  Our wholesale funding policy currently allows maximum brokered CDs of $180 million; however, this amount could be increased to match changes in ALCO objectives.  The potential higher interest expense and lack of customer loyalty are risks associated with the use of brokered CDs.  During 2012, overall growth in deposits, not including brokered CDs, combined with a decrease in wholesale funding resulted in a decrease in our total wholesale funding as a percentage of deposits, not including brokered CDs, to 23.1% at December 31, 2012, from 36.4% at December 31, 2011. The decrease in wholesale funding at December 31, 2012, when compared to 2011 is the result of the decrease in total assets and the increase in deposits not including brokered CDs.

RESULTS OF OPERATIONS

Our results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on assets (loans and investments) and interest expense due on our funding sources (deposits and borrowings) during a particular period. Results of operations are also affected by our noninterest income, provision for loan losses, noninterest expenses and income tax expense. General economic and competitive conditions, particularly changes in interest rates, changes in interest rate yield curves, prepayment rates of mortgage-backed securities and loans, repricing of loan relationships, government policies and actions of regulatory authorities, also significantly affect our results of operations. Future changes in applicable law, regulations or government policies may also have a material impact on us.

NET INTEREST INCOME

Net interest income is one of the principal sources of a financial institution's earnings stream and represents the difference or spread between interest and fee income generated from interest earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in interest rates or interest rate yield curves, as well as repricing characteristics and volume and changes in the mix of interest earning assets and interest bearing liabilities, materially impact net interest income.

| | Years ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (in thousands) | | |
| Interest income | | | |
| Loans | $69,462 | $66,736 | $69,973 |
| Investment securities – taxable | 519 | 64 | 91 |
| Investment securities – tax-exempt | 13,644 | 12,520 | 10,889 |
| Mortgage-backed and related securities | 32,118 | 51,467 | 50,130 |
| FHLB stock and other investments | 240 | 233 | 259 |
| Other interest earning assets | 37 | 18 | 32 |
| Total interest income | 116,020 | 131,038 | 131,374 |
| Interest expense | | | |
| Deposits | 10,841 | 15,647 | 18,969 |
| Short-term obligations | 6,340 | 6,577 | 7,563 |
| Long-term obligations | 9,714 | 13,407 | 18,775 |
| Total interest expense | 26,895 | 35,631 | 45,307 |
| Net interest income | $89,125 | $95,407 | $86,067 |

Net interest income for the year ended December 31, 2012 decreased $6.3 million, or 6.6%, compared to the same period in 2011 and increased $9.3 million, or 10.9%, for the year ended December 31, 2011 compared to the same period in 2010. The overall decrease in net interest income during 2012, was primarily the result of a decrease in interest income from mortgage-backed and related securities due to an increase in prepayments which increased our amortization expense combined with a decrease in the average balance of these securities. This was partially offset by an increase in interest income from loans, an increase in interest income from tax-exempt investment securities and a decrease in interest expense on deposits, short-term and long-term obligations. The overall increase in net interest income during 2011 was primarily the result of a decrease in total interest expense and increases in interest income from tax-exempt investment securities and mortgage-backed and related securities. This was partially offset by a decrease in interest income from loans.

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During the year ended December 31, 2012, total interest income decreased $15.0 million, or 11.5%, when compared to the same period in 2011, and during the year ended December 31, 2011, decreased $336,000, or 0.3%, when compared to same period in 2010. The decrease in total interest income was the result of a decrease in the average yield on average interest earning assets from 5.01% for the year ended December 31, 2010 to 4.82% for the year ended December 31, 2011 to 4.13% for the year ended December 31, 2012 which more than offset the increase in average interest earning assets of $126.4 million, or 4.5%, from $2.80 billion to $2.93 billion from 2010 to 2011 and $141.8 million, or 4.8%, from $2.93 billion to $3.07 billion from 2011 to 2012. The decrease in the yield on interest earning assets during the year ended December 31, 2012 is reflective of a 46 basis point decrease in the yield on loans and a 93 basis point decrease in the yield on our securities portfolio due to lower overall interest rates and increased amortization expense on our mortgage-backed securities as a result of increased prepayment speeds. The decrease in the yield on interest earning assets during the year ended December 31, 2011 is reflective of a 41 basis point decrease in the yield on loans and a 6 basis point decrease in the yield on our securities portfolio due to lower overall interest rates.

Total interest expense decreased $8.7 million, or 24.5%, during the year ended December 31, 2012. The decrease was attributable to a decrease in the average yield on interest bearing liabilities for the year ended December 31, 2012, to 1.11% from 1.48% for the same period in 2011 which was partially offset by an increase in average interest bearing liabilities of $23.4 million, or 1.0%, from $2.40 billion to $2.43 billion. The decrease in the average yield on interest bearing liabilities of 37 basis points is a result of overall lower interest rates. Total interest expense decreased $9.7 million, or 21.4%, during the year ended December 31, 2011. The decrease was attributable to a decrease in the average yield on interest bearing liabilities for the year ended December 31, 2011, to 1.48% from 1.94% for the same period in 2010 which was partially offset by an increase in average interest bearing liabilities of $64.1 million, or 2.7%, from $2.34 billion to $2.40 billion. The decrease in the average yield on interest bearing liabilities of 46 basis points is a result of overall lower interest rates. For the year ended December 31, 2012, our net interest spread decreased to 3.02% from 3.34%, and our net interest margin decreased to 3.26% from 3.60% when compared to the same period in 2011. For the year ended December 31, 2011, our net interest spread increased to 3.34% from 3.07%, and our net interest margin increased to 3.60% from 3.39% when compared to the same period in 2010.

During the year ended December 31, 2012, average loans increased $125.2 million, or 11.9%, to $1.18 billion from $1.05 billion, compared to the same period in 2011. During the year ended December 31, 2011, average loans increased $23.0 million, or 2.2%, from $1.03 billion to $1.05 billion, compared to the same period in 2010. Residential 1-4 family loans and municipal loans represent a large part of this increase for both years. The average yield on loans decreased from 6.69% for the year ended December 31, 2011 to 6.23% for the year ended December 31, 2012. The increase in interest income on loans of $2.7 million, or 4.1%, for the year ended December 31, 2012 was the result of an increase in the average balance which more than offset the decrease in the average yield. The average yield on loans decreased from 7.10% for the year ended December 31, 2010 to 6.69% for the year ended December 31, 2011. The decrease in interest income on loans of $3.2 million, or 4.6%, for the year ended December 31, 2011 was the result of a decrease in the average yield which more than offset the increase in the average balance. The decrease in the yield on loans for 2012 and 2011 was due to overall lower interest rates.

Average investment and mortgage-backed securities increased slightly $2.1 million, or 0.1%, from $1.83 billion to $1.84 billion, for the year ended December 31, 2012 when compared to the same period in 2011 and increased $118.1 million, or 6.9%, from $1.72 billion to $1.83 billion, for the year ended December 31, 2011 when compared to the same period in 2010. This increase was the result of securities purchased due to buying opportunities available throughout most of 2011. At December 31, 2012, most of our mortgage-backed securities were fixed rate securities and approximately eight percent were variable rate mortgage-backed securities compared to approximately one percent in 2011. The overall yield on average investment and mortgage-backed securities decreased to 2.90% during the year ended December 31, 2012 from 3.83% during the same period in 2011 and decreased to 3.83% during the

year ended December 31, 2011 from 3.89% during the same period in 2010. The decrease in the average yield during 2012 primarily reflects increased prepayment speeds on mortgage-backed securities that increased amortization expense combined with overall lower interest rates and the decrease in the average yield during 2011 primarily reflects tighter spreads on mortgage-backed and municipal securities and overall lower interest rates. Interest income on investment and mortgage-backed securities decreased $17.8 million in 2012, or 27.7%, as the decrease in the average yield more than offset the increase in the average balance.  A further decrease in long-term interest rate levels combined with lower credit spreads could negatively impact our net interest margin in the future due to increased prepayments and repricings. Interest income on investment and mortgage-backed securities increased $2.9 million in 2011, or 4.8%, due to an increase in the average balance which was partially offset by a decrease in the average yield.

Average FHLB stock and other investments increased $3.3 million, or 10.5%, to $34.2 million, for the year ended December 31, 2012, when compared to $30.9 million for 2011 due to the increase in average FHLB advances during 2012 and the corresponding requirement to hold stock associated with those advances.  Average FHLB stock and other investments decreased $7.0 million, or 18.5%, to $30.9 million, for the year ended December 31, 2011, when compared to $38.0 million for 2010 due to the decrease in average FHLB advances during 2011 and the corresponding requirement to hold stock associated with those

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advances. Interest income from our FHLB stock and other investments increased $7,000, or 3.0%, during 2012, due to an increase in the average balance which more than offset the decrease in the average yield from 0.75% for the year ended December 31, 2011 compared to 0.70% for the same period in 2012. Interest income from our FHLB stock and other investments decreased $26,000, or 10.0%, during 2011, due to a decrease in the average balance while partially offset by an increase in the average yield from 0.68% for the year ended December 31, 2010 compared to 0.75% for the same period in 2011. The FHLB stock is a variable instrument with the rate typically tied to the federal funds rate. We are required as a member of FHLB to own a specific amount of stock that changes as the level of our FHLB advances and asset size change.

Average interest earning deposits increased $13.0 million, or 165.7%, to $20.8 million, for the year ended December 31, 2012, when compared to $7.8 million for 2011. Interest income from interest earning deposits increased $19,000, or 105.6%, for the year ended December 31, 2012, when compared to 2011, as a result of the increase in the average balance. Average interest earning deposits decreased $6.0 million, or 43.6%, to $7.8 million, for the year ended December 31, 2011, when compared to $13.9 million for 2010. Interest income from interest earning deposits decreased $14,000, or 43.8%, for the year ended December 31, 2011, when compared to 2010, as a result of the decrease in the average balance.

During the year ended December 31, 2012, our average loans increased more than our average securities compared to 2011 when average loans increased less than average securities. As a result, the mix of our average interest earning assets changed as our average total securities as a percentage of total average interest earning assets averaged 60.9% during 2012 compared to 63.6% during 2011 and 62.5% during 2010. Average loans were 38.4% of average total interest earning assets during 2012 compared to 36.1% during 2011 and 37.0% during 2010. Other interest earning asset categories averaged 0.7% of average interest earning assets during 2012 compared to 0.3% during 2011 and 0.5% during 2010.

Total interest expense decreased $8.7 million, or 24.5%, during the year ended December 31, 2012 and $9.7 million, or 21.4%, during the year ended December 31, 2011. The decreases were primarily attributable to decreased funding costs as the average yield on interest bearing liabilities decreased from 1.94% for 2010 to 1.48% for 2011 to 1.11% for the year ended December 31, 2012, which more than offset increases in average interest bearing liabilities in 2012 and 2011. The increase in average interest bearing liabilities included an increase in long-term FHLB advances of $40.3 million, or 13.8%, that was partially offset by a decrease in interest bearing deposits of $3.7 million, or 0.2%, and other short-term obligations of $13.2 million, or 4.4%, during 2012. The increase in average interest bearing liabilities during the year ended December 31, 2011 included an increase in deposits of $214.7 million, or 13.9%, that was partially offset by a decrease in long-term FHLB advances of $138.9 million, or 32.3%, and other short-term obligations of $11.7 million, or 3.8%.

The following table sets forth our deposit averages by category for the years ended December 31, 2012, 2011 and 2010:

COMPOSITION OF DEPOSITS

| | Years Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2012 | | | 2011 | | | 2010 | | |
| | Average Balance | Average Yield | | Average Balance | Average Yield | | Average Balance | Average Yield | |
| | (dollars in thousands) | | | | | | | | |
| Interest Bearing Demand Deposits | $892,798 | 0.39 | % | $807,344 | 0.52 | % | $723,315 | 0.71 | % |
| Savings Deposits | 96,854 | 0.15 | % | 86,417 | 0.25 | % | 74,668 | 0.43 | % |
| Time Deposits | 761,030 | 0.95 | % | 860,614 | 1.30 | % | 741,712 | 1.82 | % |
| Total Interest Bearing Deposits | 1,750,682 | 0.62 | % | 1,754,375 | 0.89 | % | 1,539,695 | 1.23 | % |
| Noninterest Bearing Demand Deposits | 564,007 | N/A | | 459,594 | N/A | | 415,162 | N/A | |
| Total Deposits | $2,314,689 | 0.47 | % | $2,213,969 | 0.71 | % | $1,954,857 | 0.97 | % |

Average interest bearing deposits decreased $3.7 million, or 0.2%, and the average rate paid decreased from 0.89% for the year ended December 31, 2011 to 0.62% for the year ended December 31, 2012 and increased $214.7 million, or 13.9%, while the average rate paid decreased from 1.23% for the year ended December 31, 2010 to 0.89% for the year ended December 31, 2011. Average time deposits decreased $99.6 million, or 11.6%, and the average rate paid decreased 35 basis points for the year ended December 31, 2012 and increased $118.9 million, or 16.0%, while the average rate paid decreased 52 basis points for the year ended December 31, 2011. Average interest bearing demand deposits increased $85.5 million, or 10.6%, while the average rate paid decreased 13 basis points and increased $84.0 million, or 11.6%, while the average rate paid decreased 19 basis points for the year ended December 31, 2011. Average savings deposits increased $10.4 million, or 12.1%, while the average rate paid decreased 10 basis points and increased $11.7 million, or 15.7%, while the average rate paid decreased 18 basis points for the year ended December 31, 2011. Average noninterest bearing demand deposits increased $104.4 million, or 22.7%, during 2012 and increased $44.4 million, or 10.7%, during 2011. Interest expense for interest bearing deposits for the year ended December 31, 2012 decreased $4.8 million, or 30.7%, when compared to the same period in 2011 due to the decrease in the average yield and the decrease in the average balance. Interest expense for interest bearing deposits for the year ended December 31, 2011, decreased $3.3 million, or 17.5%, when compared to the same period in 2010 due to the decrease in the average yield which more than offset the increase in the average balance. The latter three categories, which are considered the lowest cost deposits, comprised 67.1% of total average deposits during the year ended December 31, 2012 compared to 61.1% during 2011 and 62.1% during 2010. The increase in our average total deposits during 2012 and 2011 is primarily the result of an increase in deposits from municipalities and to a lesser extent, deposit growth due to branch expansion, and continued market penetration.

At December 31, 2012, total brokered CDs issued were $19.5 million compared to $163.8 million at December 31, 2011. This represented a decrease of $144.4 million, or 88.1%, from 2011 and an increase of $2.5 million, or 1.5%, from $161.3 million at December 31, 2010, when compared to 2011. At December 31, 2012, all of the brokered CDs had maturities of one to five years. During 2012 we called brokered CDs and replaced them with lower cost longer duration FHLB advances. All of the long-term brokered CDs, except for one $5.0 million CD, have short-term calls that we control. We utilize long-term callable brokered CDs because the brokered CDs better match overall ALCO objectives at the time of issuance by protecting us with fixed rates should interest rates increase, while providing us options to call the funding should interest rates decrease. At December 31, 2012, brokered CDs represented 0.8% of deposits compared to 7.1% of deposits at December 31, 2011 and 7.6% at December 31, 2010. Our wholesale

funding policy currently allows maximum brokered CDs of $180 million; however, this amount could be increased to match changes in ALCO objectives. The potential higher interest cost and lack of customer loyalty are risks associated with the use of brokered CDs.

Average short-term interest bearing liabilities, consisting primarily of FHLB advances and federal funds purchased and repurchase agreements, were $284.7 million, a decrease of $13.2 million, or 4.4%, for the year ended December 31, 2012 when compared to the same period in 2011. For the year ended 2011, the decrease was $11.7 million, or 3.8% to $298.0 million when compared to the same period in 2010. Interest expense associated with short-term interest bearing liabilities decreased $237,000, or 3.6%, while the average rate paid increased 2 basis points to 2.23% for the year ended December 31, 2012, when compared to

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2.21% for the same period in 2011. Interest expense associated with short-term interest bearing liabilities decreased $986,000, or 13.0%, and the average rate paid decreased 23 basis points to 2.21% for the year ended December 31, 2011, when compared to 2.44% for the same period in 2010. The increase in the average rate paid during 2012 is due to higher priced long-term advances rolling into short-term. The decrease in the interest expense during 2012 was due to a decrease in the average balance which more than offset the increase in the average rate. The decrease in the interest expense during 2011 was due to a decrease in the average rate paid and the average balance.

Average long-term interest bearing liabilities consisting of FHLB advances increased $40.3 million, or 13.8%, during the year ended December 31, 2012 to $331.9 million as compared to $291.6 million at December 31, 2011. The increase in the average long-term FHLB advances is due primarily to the purchase of long-term advances to replace brokered CDs that we called and advances purchased as interest rates decreased. Average long-term interest bearing liabilities consisting of FHLB advances decreased $138.9 million, or 32.3%, during the year ended December 31, 2011 from $430.5 million at December 31, 2010. The decrease in the average long-term FHLB advances is due primarily to advances classified as long-term at December 31, 2010 rolling into the short-term category, the use of more short-term FHLB advances during the period and the decision to enter into $200 million par in long-term advance commitments from the FHLB. In order to obtain these commitments from the FHLB we paid fees of $10.95 million. At December 31, 2012, the remaining FHLB advance option fees recorded on the balance sheet were fully impaired. Interest expense associated with long-term FHLB advances decreased $3.5 million, or 34.6%, and the average rate paid decreased 148 basis points to 2.00% for the year ended December 31, 2012 when compared to 3.48% for the same period in 2011. The decrease in interest expense was due to the decrease in the average rate paid, which more than offset the increase in the average balance. Interest expense associated with long-term FHLB advances decreased $5.4 million, or 34.6%, and the average rate paid decreased 12 basis points to 3.48% for the year ended December 31, 2011 when compared to 3.60% for the same period in 2010. The decrease in interest expense was due to the decrease in the average balance of long-term interest bearing liabilities and the decrease in the average rate paid. FHLB advances are collateralized by FHLB stock, securities and nonspecific real estate loans.

Average long-term debt, consisting of our junior subordinated debentures issued in 2003 and 2007 and the junior subordinated debentures acquired in the purchase of FWBS, was $60.3 million for the three years ended December 31, 2012, 2011, and 2010. Interest expense associated with long-term debt decreased $181,000, or 5.5%, to $3.1 million for the year ended December 31, 2012 when compared to $3.3 million for the same period in 2011 as a result of the decrease in the average yield of 30 basis points. Interest expense associated with long-term debt decreased $9,000, or 0.3%, to $3.3 million for the year ended December 31, 2011 when compared to $3.3 million for the same period in 2010 as a result of the decrease in the average yield of one basis point. The interest rate on the $20.6 million of long-term debentures issued to Southside Statutory Trust III adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points. The interest rate on the $23.2 million of long-term debentures issued to Southside Statutory Trust IV adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points. The interest rate on the $12.9 million of long-term debentures issued to Southside Statutory Trust V adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points The interest rate on the $3.6 million of long-term debentures issued to Magnolia Trust Company I, assumed in the purchase of FWBS, adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

AVERAGE BALANCES AND YIELDS

The following table presents average balance sheet amounts and average yields for the years ended December 31, 2012, 2011 and 2010. The information should be reviewed in conjunction with the consolidated financial statements for the same years then ended. Two major components affecting our earnings are the interest earning assets and interest bearing liabilities. A summary of average interest earning assets and interest bearing liabilities is set forth below, together with the average yield on the interest earning assets and the average cost of the interest bearing liabilities.

AVERAGE BALANCES AND YIELDS
(dollars in thousands)
Years Ended

| | December 31, 2012 | | | December 31, 2011 | | | December 31, 2010 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest | Avg. Yield | Average Balance | Interest | Avg. Yield | Average Balance | Interest | Avg. Yield |
| ASSETS | | | | | | | | | |
| INTEREST EARNING ASSETS: | | | | | | | | | |
| Loans(1)(2) | $1,180,095 | $73,498 | 6.23 % | $1,054,882 | $70,533 | 6.69 % | $1,031,858 | $73,230 | 7.10 % |
| Loans Held For Sale | 1,694 | 59 | 3.48 % | 3,415 | 133 | 3.89 % | 5,123 | 189 | 3.69 % |
| Securities: | | | | | | | | | |
| Inv. Sec. (Taxable)(4) | 35,217 | 519 | 1.47 % | 6,056 | 64 | 1.06 % | 9,156 | 91 | 0.99 % |
| Inv. Sec. (Tax Exempt)(3)(4) | 387,284 | 20,552 | 5.31 % | 293,044 | 18,776 | 6.41 % | 245,874 | 16,515 | 6.72 % |
| Mortgage-backed and related Sec.(4) | 1,413,554 | 32,118 | 2.27 % | 1,534,837 | 51,467 | 3.35 % | 1,460,785 | 50,130 | 3.43 % |
| Total Securities | 1,836,055 | 53,189 | 2.90 % | 1,833,937 | 70,307 | 3.83 % | 1,715,815 | 66,736 | 3.89 % |
| FHLB stock and other investments, at cost | 34,191 | 240 | 0.70 % | 30,937 | 233 | 0.75 % | 37,973 | 259 | 0.68 % |
| Interest Earning Deposits | 20,809 | 37 | 0.18 % | 7,833 | 18 | 0.23 % | 13,880 | 32 | 0.23 % |
| Total Interest Earning Assets | 3,072,844 | 127,023 | 4.13 % | 2,931,004 | 141,224 | 4.82 % | 2,804,649 | 140,446 | 5.01 % |
| | | | | | | | | | |
| NONINTEREST EARNING ASSETS: | | | | | | | | | |
| Cash and Due From Banks | 42,938 | | | 41,280 | | | 43,881 | | |
| Bank Premises and Equipment | 50,392 | | | 50,627 | | | 48,709 | | |
| Other Assets | 163,402 | | | 137,166 | | | 124,052 | | |
| Less: Allowance for Loan Losses | (19,922 ) | | | (18,965 ) | | | (19,135 ) | | |
| Total Assets | $3,309,654 | | | $3,141,112 | | | $3,002,156 | | |

(1) Interest on loans includes net fees on loans that are not material in amount.

(2) Interest income includes taxable-equivalent adjustments of $4,095, $3,930 and $3,446 for the years ended December 31, 2012, 2011, and 2010, respectively.

(3) Interest income includes taxable-equivalent adjustments of $6,908, $6,256 and $5,626 for the years ended December 31, 2012, 2011, and 2010, respectively.

(4) For the purpose of calculating the average yield, the average balance of securities is presented at historical cost.

Note: As of December 31, 2012, 2011 and 2010, loans totaling $10,314, $10,299 and $14,524, respectively, were on nonaccrual status. The policy is to reverse previously accrued but unpaid interest on nonaccrual loans; thereafter, interest income is recorded to the extent received when appropriate.

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AVERAGE BALANCES AND YIELDS
(dollars in thousands)
Years Ended

| | December 31, 2012 | | | December 31, 2011 | | | December 31, 2010 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest | Avg. Yield | Average Balance | Interest | Avg. Yield | Average Balance | Interest | Avg. Yield |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | | | |
| INTEREST BEARING LIABILITIES: | | | | | | | | | |
| Savings Deposits | $96,854 | $145 | 0.15 % | $86,417 | $215 | 0.25 % | $74,668 | $324 | 0.43 % |
| Time Deposits | 761,030 | 7,256 | 0.95 % | 860,614 | 11,229 | 1.30 % | 741,712 | 13,514 | 1.82 % |
| Interest Bearing Demand Deposits | 892,798 | 3,440 | 0.39 % | 807,344 | 4,203 | 0.52 % | 723,315 | 5,131 | 0.71 % |
| Total Interest Bearing Deposits | 1,750,682 | 10,841 | 0.62 % | 1,754,375 | 15,647 | 0.89 % | 1,539,695 | 18,969 | 1.23 % |
| Short-term Interest Bearing Liabilities | 284,730 | 6,340 | 2.23 % | 297,960 | 6,577 | 2.21 % | 309,649 | 7,563 | 2.44 % |
| Long-term Interest Bearing Liabilities-FHLB Dallas | 331,898 | 6,629 | 2.00 % | 291,586 | 10,141 | 3.48 % | 430,485 | 15,500 | 3.60 % |
| Long-term Debt (5) | 60,311 | 3,085 | 5.12 % | 60,311 | 3,266 | 5.42 % | 60,311 | 3,275 | 5.43 % |
| Total Interest Bearing Liabilities | 2,427,621 | 26,895 | 1.11 % | 2,404,232 | 35,631 | 1.48 % | 2,340,140 | 45,307 | 1.94 % |
| NONINTEREST BEARING LIABILITIES: | | | | | | | | | |
| Demand Deposits | 564,007 | | | 459,594 | | | 415,162 | | |
| Other Liabilities | 47,668 | | | 34,614 | | | 28,132 | | |
| Total Liabilities | 3,039,296 | | | 2,898,440 | | | 2,783,434 | | |
| SHAREHOLDERS' EQUITY (6) | 270,358 | | | 242,672 | | | 218,722 | | |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $3,309,654 | | | $3,141,112 | | | $3,002,156 | | |
| NET INTEREST INCOME | | $100,128 | | | $105,593 | | | $95,139 | |
| NET INTEREST MARGIN ON AVERAGE EARNING ASSETS | | | 3.26 % | | | 3.60 % | | | 3.39 % |
| NET INTEREST SPREAD | | | 3.02 % | | | 3.34 % | | | 3.07 % |

(5) Represents junior subordinated debentures issued by us to Southside Statutory Trust III, IV, and V in connection with the issuance by Southside Statutory Trust III of $20 million of trust preferred securities, Southside Statutory Trust IV of $22.5 million of trust preferred securities, Southside Statutory Trust V of $12.5 million of trust preferred securities and junior subordinated debentures issued by FWBS to Magnolia Trust Company I in connection with the issuance by Magnolia Trust Company I of $3.5 million of trust preferred securities.

(6) Includes average equity of noncontrolling interest of $1,112 and $1,248 for the years ended December 31, 2011 and 2010, respectively.

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ANALYSIS OF CHANGES IN INTEREST INCOME AND INTEREST EXPENSE

The following tables set forth the dollar amount of increase (decrease) in interest income and interest expense resulting from changes in the volume of interest earning assets and interest bearing liabilities and from changes in yields (in thousands):

| | Years Ended December 31, 2012 Compared to 2011 | | |
|---|---|---|---|
| | Average Volume | Average Yield | Increase (Decrease) |
| INTEREST INCOME: | | | |
| Loans (1) | $8,008 | $(5,043) | $2,965 |
| Loans Held For Sale | (61) | (13) | (74) |
| Investment Securities (Taxable) | 421 | 34 | 455 |
| Investment Securities (Tax Exempt) (1) | 5,362 | (3,586) | 1,776 |
| Mortgage-backed and related Securities | (3,809) | (15,540) | (19,349) |
| FHLB stock and other investments | 23 | (16) | 7 |
| Interest Earning Deposits | 24 | (5) | 19 |
| Total Interest Income | 9,968 | (24,169) | (14,201) |
| INTEREST EXPENSE: | | | |
| Savings Deposits | 24 | (94) | (70) |
| Time Deposits | (1,194) | (2,779) | (3,973) |
| Interest Bearing Demand Deposits | 411 | (1,174) | (763) |
| Short-term Interest Bearing Liabilities | (294) | 57 | (237) |
| Long-term FHLB Advances | 1,256 | (4,768) | (3,512) |
| Long-term Debt | — | (181) | (181) |
| Total Interest Expense | 203 | (8,939) | (8,736) |
| Net Interest Income | $9,765 | $(15,230) | $(5,465) |

| | Years Ended December 31, 2011 Compared to 2010 | | |
|---|---|---|---|
| | Average Volume | Average Yield | Increase (Decrease) |
| INTEREST INCOME: | | | |
| Loans (1) | $1,608 | $(4,305) | $(2,697) |
| Loans Held For Sale | (66) | 10 | (56) |
| Investment Securities (Taxable) | (32) | 5 | (27) |
| Investment Securities (Tax Exempt) (1) | 3,051 | (790) | 2,261 |
| Mortgage-backed and related Securities | 2,501 | (1,164) | 1,337 |
| FHLB stock and other investments | (51) | 25 | (26) |
| Interest Earning Deposits | (14) | — | (14) |
| Total Interest Income | 6,997 | (6,219) | 778 |
| INTEREST EXPENSE: | | | |
| Savings Deposits | 45 | (154) | (109) |
| Time Deposits | 1,944 | (4,229) | (2,285) |
| Interest Bearing Demand Deposits | 548 | (1,476) | (928) |
| Short-term Interest Bearing Liabilities | (278) | (708) | (986) |
| Long-term FHLB Advances | (4,847) | (512) | (5,359) |
| Long-term Debt | — | (9) | (9) |

| | | | |
|---|---|---|---|
| Total Interest Expense | (2,588) | (7,088) | (9,676) |
| Net Interest Income | $9,585 | $869 | $10,454 |

(1) Interest yields on loans and securities that are nontaxable for federal income tax purposes are presented on a taxable equivalent basis.

Note: Volume/Yield variances (change in volume times change in yield) have been allocated to amounts attributable to changes in volumes and to changes in yields in proportion to the amounts directly attributable to those changes.

PROVISION FOR LOAN LOSSES

The provision for loan losses for the year ended December 31, 2012 was $10.7 million compared to $7.5 million for the year ended December 31, 2011 and $13.7 million for the year ended December 31, 2010. For the year ended December 31, 2012, net charge-offs of loans decreased $1.0 million, to $8.7 million when compared to $9.7 million for the same period in 2011 and decreased $3.3 million from $12.9 during 2010 when compared to 2011.

The decrease in net charge-offs for 2012 was due to a combination of a decrease in total charge-offs of $1.4 million and a decrease in total recoveries of $472,000. Net charge-offs for 1-4 family residential loans decreased $510,000, to $67,000. Net charge-offs for loans to individuals increased 1.9%, to $8.5 million and net charge-offs for commercial loans decreased $715,000, to $90,000. Net recoveries of construction loans increased $65,000, resulting in net recoveries of $80,000. Net charge-offs of other real estate loans increased $157,000, resulting in net charge-offs of $153,000.

The decrease in net charge-offs for 2011 was due to a combination of a decrease in total charge-offs of $3.9 million while partially offset by a decrease in total recoveries of $681,000. Net charge-offs for loans to individuals decreased $1.3 million, to $8.3 million and net charge-offs for commercial loans decreased $944,000, to $805,000. Net charge-offs of construction loans decreased $723,000, resulting in net recoveries of $15,000. Net charge-offs of other real estate loans decreased $581,000, resulting in net recoveries of $4,000. Net charge-offs for 1-4 family residential loans increased $302,000, to $577,000.

As of December 31, 2012, and 2011, our reviews of the loan portfolio indicated that loan loss allowances of $20.6 million and $18.5 million, respectively, were appropriate to cover probable losses in the portfolio.

NONINTEREST INCOME

Noninterest income consists of revenues generated from a broad range of financial services and activities including deposit related fee based services. The following schedule lists the accounts from which noninterest income was derived and gives totals for these accounts for the year ended December 31, 2012 and the comparable years ended December 31, 2011, and 2010:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (in thousands) | | |
| Deposit services | $15,433 | $15,943 | $16,819 |
| Gain on sale of securities available for sale | 17,966 | 11,795 | 25,789 |
| (Loss) gain on sale of securities carried at fair value through income | (498) | 937 | — |
| | | | |
| Total other-than-temporary impairment losses | (21) | — | (39) |
| Portion of loss recognized in other comprehensive income (before taxes) | (160) | — | (36) |
| Net impairment losses recognized in earnings | (181) | — | (75) |
| | | | |
| Fair value gain (loss) – securities | — | 6,693 | (598) |
| FHLB advance option impairment charges | (2,031) | (8,923) | — |
| Gain on sale of loans | 1,119 | 1,230 | 1,751 |
| Trust income | 2,794 | 2,610 | 2,368 |
| Bank owned life insurance income | 1,110 | 1,087 | 1,155 |
| Other | 4,309 | 3,950 | 3,589 |

| | | | |
|---|---|---|---|
| Total noninterest income | $40,021 | $35,322 | $50,798 |

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Total noninterest income for the year ended December 31, 2012 increased 13.3%, or $4.7 million, compared to 2011 and decreased 30.5%, or $15.5 million during the year ended December 31, 2011, when compared to the same period in 2010. During the years ended December 31, 2012, 2011 and 2010, we had gains on sale of AFS securities of $18.0 million, $11.8 million, and $25.8 million, respectively. The fair value of the AFS securities portfolio at December 31, 2012 was $1.42 billion with a net unrealized gain on that date of $45.3 million. The net unrealized gain is comprised of $49.0 million in unrealized gains and $3.7 million in unrealized losses. The fair value of the AFS securities portfolio at December 31, 2011 was $999.1 million with a net unrealized gain on that date of $55.2 million. The net unrealized gain is comprised of $58.5 million in unrealized gains and $3.3 million in unrealized losses. The fair value of HTM securities portfolio at December 31, 2012 was $255.4 million with a net unrealized gain on that date of $8.9 million. The net unrealized gain is comprised of $8.9 million in unrealized gains and $47,000 in unrealized losses. The fair value of HTM securities portfolio at December 31, 2011 was $383.3 million with a net unrealized gain on that date of $16.2 million. The net unrealized gain is comprised of $16.2 million in unrealized gains and $54,000 in unrealized losses. During the quarter ended December 31, 2012, as interest rates remained low, we sold some of our longer maturity general market tax-free municipal securities when the market pricing for these securities caused the economics of purchasing this sector to become unattractive. We also sold some of our mortgage-backed securities with more volatile prepays and some of our agency debentures. During the year ended December 31, 2012, the size of the securities portfolio decreased due to increased prepayments on our mortgage-backed securities, sales of prepayment volatile mortgage-backed securities and the significantly reduced attractiveness of purchasing additional fixed rate mortgage-backed securities. There can be no assurance that the level of security gains reported during the year ended December 31, 2012, will continue in future periods.

During the year ended December 31, 2011, we had a gain on the sale of AFS securities of $11.8 million. During 2011, we continued to sell primarily lower yielding, longer duration municipal securities and lower coupon or more prepayment volatile mortgage-backed securities and replaced them with primarily shorter duration municipal securities and higher coupon and less prepayment volatile mortgage-backed securities. During 2011, we increased the size of the securities portfolio due to increased global economic concerns, U.S. deficit concerns, and the Federal Reserve signaling an extended period of low short-term interest rates.

During 2012, we sold all of our securities carried at fair value through income. The sale of these securities resulted in a loss on sale of securities carried at fair value through income of $498,000 compared to a $937,000 gain on sale of securities carried at fair value during 2011. During 2011, the fair value of our securities carried at fair value through income increased to $6.7 million from a fair value loss of $598,000 during 2010, and was recorded in noninterest income.

During 2012, the FHLB advance option fees were further impaired and were completely written down for a total charge of $2.0 million for the year ended December 31, 2012. During 2011, the value of the FHLB advance option fees became impaired resulting in a total impairment charge of $8.9 million in 2011.

Deposit services income decreased $510,000, or 3.2%, for the year ended December 31, 2012, as compared to the same period in 2011 and decreased $876,000, or 5.2%, for the year ended December 31, 2011, as compared to the same period in 2010 primarily due to a decrease in overdraft income.

Gain on sale of loans decreased $111,000, or 9.0%, for the year ended December 31, 2012, when compared to the same period in 2011. Gain on sale of loans decreased $521,000, or 29.8%, for the year ended December 31, 2011, when compared to the same period in 2010. This is primarily a result of a decrease in the dollar amount of loans sold and the related servicing release and secondary market fees. The decrease in loans sold was due to a greater emphasis on retaining loans for our own portfolio.

Trust income increased $184,000, or 7.0%, for the year ended December 31, 2012, as compared to the same period in 2011, and $242,000, or 10.2% for the year ended December 31, 2011, as compared to the same period in 2010 primarily due to the addition of several new accounts.

Other income increased $359,000, or 9.1%, for the year ended December 31, 2012, when compared to the same period in 2011, primarily as a result of increases in brokerage fee income, trading income and the fair value of written loan commitments. Other income increased $361,000, or 10.1%, for the year ended December 31, 2011, when compared to the same period in 2010 as a result of increases in brokerage fee income, Southside Select fee income, Master Card income and credit card fee income while offset by a decrease in the fair value of written loan commitments.

NONINTEREST EXPENSE

The following schedule lists the accounts which comprise noninterest expense, gives totals for these accounts for the years ended December 31, 2012 , 2011 and 2010:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (in thousands) | | |
| Salaries and employee benefits | $48,084 | $45,421 | $43,957 |
| Occupancy expense | 7,498 | 7,205 | 6,780 |
| Equipment expense | 2,169 | 2,055 | 1,899 |
| Advertising, travel and entertainment | 2,463 | 2,414 | 2,319 |
| ATM and debit card expense | 1,063 | 987 | 825 |
| Director fees | 1,213 | 914 | 950 |
| Supplies | 747 | 746 | 902 |
| Professional fees | 2,034 | 2,160 | 2,015 |
| Postage | 700 | 725 | 800 |
| Telephone and communications | 1,665 | 1,325 | 1,443 |
| FDIC insurance | 1,744 | 1,817 | 2,909 |
| Other | 6,727 | 6,579 | 6,515 |
| Total noninterest expense | $76,107 | $72,348 | $71,314 |

Noninterest expense for the year ended December 31, 2012 increased $3.8 million, or 5.2%, when compared to the year ended December 31, 2011 and increased $1.0 million, or 1.4%, when compared to the year ended December 31, 2010.

Salaries and employee benefits expense increased $2.7 million, or 5.9%, during the year ended December 31, 2012, when compared to the same period in 2011 and increased $1.5 million, or 3.3% during the year ended December 31, 2011, when compared to the same period in 2010. These increases were the result of the increases in personnel associated with our overall growth and expansion, an increase in retirement expense, normal salary increases for existing personnel, increases in incentive pay associated with the increased loan production and share based payment compensation. Direct salary expense and payroll taxes increased $1.2 million, or 3.0%, for the year ended December 31, 2012, when compared to the same period in 2011 and increased $1.3 million, or 3.4%, for the year ended December 31, 2011, when compared to the same period in 2010.

Retirement expense, included in salary and benefits, increased $863,000, or 24.8%, for the year ended December 31, 2012, when compared to the same period in 2011 and increased $445,000, or 14.7%, for the year ended December 31, 2011, when compared to the same period in 2010. The increase was primarily related to the increase in the defined benefit and restoration plans. The defined benefit and restoration plan increased primarily due to the changes in the actuarial assumptions used to determine net periodic pension costs for 2012 when compared to 2011 and for 2011 when compared to 2010. Specifically, the assumed long-term rate of return was 7.25% for 2012 and 2011 and 7.50% for 2010 and the assumed discount rate was decreased to 4.84% for 2012 compared to 5.63% for 2011 and 6.10% for 2010. We will continue to evaluate the assumed long-term rate of return and the discount rate to determine if either should be changed in the future. If either of these assumptions decreased, the cost and funding required for the retirement plan could increase.

Health and life insurance expense, included in salary and benefits, increased $636,000, or 17.6%, for the year ended December 31, 2012, when compared to the same period in 2011 due to increased health claims expense and plan administrative cost. Health and life insurance expense, included in salary and benefits, decreased $249,000, or 6.5%,

for the year ended December 31, 2011, when compared to the same period in 2010 due to decreased health claims expense and plan administrative cost during 2011. We have a self-insured health plan which is supplemented with stop loss insurance policies. Health insurance costs are rising nationwide and these costs may increase during 2013.

ATM and debit card expense increased $76,000, or 7.7%, for the year ended December 31, 2012, compared to the same period in 2011 and increased $162,000, or 19.6%, for the year ended December 31, 2011, compared to the same period in 2010 due to an increase in the volume of transactions and an increase in processing expenses.



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Director fees increased $299,000, or 32.7%, for the year ended December 31, 2012, compared to the same period in 2011. Effective January 5, 2012, Mr. B. G. Hartley retired as Chief Executive Officer of Southside Bancshares, Inc. and became a non-employee Chairman of the Board of Directors of the Company. The increase is due to the director fees Mr. Hartley received for serving as Chairman of the Board. Director fees decreased $36,000, or 3.8%, for year ended December 31, 2011, compared to the same period in 2010.

Supplies increased $1,000, or 0.1%, for the year ended December 31, 2012, compared to the same period in 2011 and decreased $156,000, or 17.3%, for the year ended December 31, 2011, compared to the same period in 2010 due primarily to the printing of our 50th anniversary logo on supplies purchased during 2010.

Telephone and communications increased $340,000, or 25.7%, for the year ended December 31, 2012, as compared to the same period in 2011 and decreased $118,000, or 8.2%, for the year ended December 31, 2011, as compared to the same period in 2010. The increase during 2012 was due to bank growth and upgraded systems.

FDIC insurance decreased $73,000, or 4.0%, for the year ended December 31, 2012, compared to the same period in 2011 and $1.1 million, or 37.5%, for the year ended December 31, 2011, compared to the same period in 2010 due to a change in the FDIC assessment calculation effective for the second quarter of 2011.

INCOME TAXES

Pre-tax income for the year ended December 31, 2012 was $42.3 million compared to $50.9 million for the year ended December 31, 2011, and $51.8 million for the year ended December 31, 2010.

Income tax expense was $7.6 million for the year ended December 31, 2012 and represented a decrease of $2.8 million, or 26.8%, when compared to the year ended December 31, 2011, and decreased $1.4 million, or 11.6%, to $10.4 million, when compared to the year ended December 31, 2010. The effective tax rate as a percentage of pre-tax income was 18.0% in 2012, 20.4% in 2011 and 22.7% in 2010. The decrease in the income tax expense and effective tax rate for the year ended December 31, 2012 and 2011 was due to an increase in tax exempt income as a percentage of taxable income as compared to the prior year and a decrease in income before tax expense for the year ended December 31, 2012, of $8.6 million when compared to 2011. The net deferred tax asset totaled $4.1 million at December 31, 2012 as compared to a net deferred tax liability of $3.5 million in 2011.

LENDING ACTIVITIES

One of our main objectives is to seek attractive lending opportunities in Texas, primarily in the counties in which we operate. Substantially all of our loan originations are made to borrowers who live in and conduct business in the counties in Texas in which we operate, with the exception of municipal loans which are made almost entirely in Texas, and purchases of automobile loan portfolios throughout the United States. Municipal loans are made to municipalities, counties, school districts, and colleges primarily throughout the state of Texas. Through SFG, we purchase portfolios of automobile loans from a variety of lenders throughout the United States. These high yield loans represent existing subprime automobile loans with payment histories that are collateralized by new and used automobiles. At December 31, 2012, the SFG loans totaled approximately $69.8 million.

Total loans as of December 31, 2012 increased $175.7 million, or 16.2%, and the average loan balance increased $125.2 million, or 11.9%, when compared to 2011.

Our market areas to date have not experienced the level of downturn in the economy and real estate prices that some of the harder hit areas of the country have experienced. However, we did experience weakening conditions associated with the real estate led downturn during 2008 through 2011 and strengthened our underwriting standards, especially related to all aspects of real estate lending. Our real estate loan portfolio does not have Alt-A or subprime mortgage exposure.

1-4 family residential loans increased $121.4 million, or 49.0%, from December 31, 2011. Other real estate loans increased $30.2 million, or 14.6%, and commercial loans increased $16.5 million, or 11.5%, from December 31, 2011 to December 31, 2012, respectively. Municipal loans as of December 31, 2012 increased $13.7 million, or 6.6%, from December 31, 2011. The increase in municipal loans is due to continued demand which provided additional opportunities for us to lend to municipalities during 2012. Construction loans increased $2.4 million, or 2.1%, from December 31, 2011. Loans to individuals decreased $8.4 million, or 4.9%, from December 31, 2011.

The increase in 1-4 family residential loans is due to the low interest rate environment, our competitive pricing for this type of loan and our decision to portfolio more of our originations. The increase in our construction loans, commercial loans and other real estate loans is due to an increase in loan demand for this type of loan. The decrease in loans to individuals reflects a decrease in this type of loan as financing for automobiles and other consumer products are available from manufacturers at rates that we are unable to offer. In our loan portfolio, loans dependent upon private household income represent a significant concentration. Due to the number of customers involved who work in all sectors of the numerous local, state and national economies, we believe the risk in this portion of the portfolio is adequately spread throughout the economic communities we serve, which assists in mitigating this concentration.

A significant portion of our loan portfolio is dependent on the medical community. Medical loan types include commercial loans and commercial real estate loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations. The medical community represents a concentration of risk in our Commercial loan and Commercial Real Estate loan portfolio. See “Item 1. Business – Market Area.” We believe that risk in the medical community is mitigated because it is spread among multiple practice types and multiple specialties. Should the government change the amount it pays the medical community through the various government health insurance programs or if new government regulation impacts the profitability of the medical community, the medical community could be adversely impacted which in turn could result in higher default rates by borrowers in the medical industry.

The aggregate amount of loans that we are permitted to make under applicable bank regulations to any one borrower, including non-affiliate related entities is 25% of Tier 1 capital.  Our legal lending limit at December 31, 2012, was approximately $70.7 million.  Our largest loan relationship at December 31, 2012 was approximately $23.4 million.

The average yield on loans for the year ended December 31, 2012, decreased to 6.23% from 6.69% for the year ended December 31, 2011.  This decrease was reflective of the overall lower interest rate environment during 2012 and the lower rates associated with the new loans added and repriced during 2012.



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LOAN PORTFOLIO COMPOSITION AND ASSOCIATED RISK

The following table sets forth loan totals for the years presented (in thousands):

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| Real Estate Loans: | | | | | |
| Construction | $113,744 | $111,361 | $115,094 | $105,268 | $132,666 |
| 1-4 Family Residential | 368,845 | 247,479 | 219,031 | 217,677 | 226,180 |
| Other | 236,760 | 206,519 | 200,723 | 212,731 | 184,629 |
| Commercial Loans | 160,058 | 143,552 | 148,761 | 159,529 | 165,558 |
| Municipal Loans | 220,947 | 207,261 | 196,594 | 150,111 | 134,986 |
| Loans to Individuals | 162,623 | 171,058 | 197,717 | 188,260 | 178,530 |
| Total Loans | $1,262,977 | $1,087,230 | $1,077,920 | $1,033,576 | $1,022,549 |

For purposes of this discussion, our loans are divided into Real Estate Loans, Commercial Loans, Municipal Loans and Loans to Individuals.

REAL ESTATE LOANS

Real estate loans represent our greatest concentration of loans. We attempt to mitigate the amount of risk associated with this group of loans through the type of loans originated and geographic distribution. At December 31, 2012, the majority of our real estate loans were collateralized by properties located in our market areas. Of the $719.3 million in real estate loans, $368.8 million, or 51.3%, represent loans collateralized by residential dwellings that are primarily owner-occupied. Historically, the amount of losses suffered on this type of loan has been significantly less than those on other properties. Beginning in the third quarter of 2007, there were well-publicized developments in the credit markets, beginning with a decline in the sub-prime mortgage lending market, which later extended to the markets for collateralized mortgage obligations, mortgage-backed securities and the lending markets generally. Initially our markets appeared to have been relatively resilient, not experiencing the significant effects associated with these market trends; however, beginning in the later half of 2008 as consumers all across the United States were impacted by the economic slowdown, our market areas began to experience more of a slowdown in economic activity. From 2009 and continuing into 2011, our markets did experience a slowdown as a result of the real estate led downturn across the country. During 2012 our markets appear to have stabilized and in some cases strengthened. A more severe decline in credit markets generally could adversely affect our financial condition and results of operation if we are unable to extend credit or sell loans into the secondary market. Our loan policy requires an appraisal or evaluation on the property, based on the size and complexity of the transaction, prior to funding any real estate loan and also outlines the requirements for appraisals on renewals.

We pursue an aggressive policy of reappraisal on any real estate loan that is in the process of foreclosure and potential exposures are recognized and reserved for or charged off as soon as they are identified. Our ability to liquidate certain types of properties that may be obtained through foreclosure could adversely affect the volume of our nonperforming real estate loans.

Real estate loans are divided into 1-4 Family Residential Mortgage Loans, Construction Loans and Other. The Other real estate consists of $230.4 million of commercial real estate loans, $4.3 million of loans secured by multi-family properties and $2.1 million of loans secured by farm land. The Commercial Real Estate portion of Other is discussed in more detail below.

1-4 Family Residential Mortgage Loans

Residential loan originations are generated by our loan officers, in-house origination staff, marketing efforts, present customers, walk-in customers and referrals from real estate agents and builders. We focus our lending efforts primarily on the origination of loans secured by first mortgages on owner-occupied, 1-4 family residences. Substantially all of our 1-4 family residential mortgage originations are secured by properties located in or near our market areas. Historically, we have originated a portion of our residential mortgage loans for sale into the secondary market. These loans are reflected on the balance sheet as loans held for sale. These secondary market investors typically pay us a service release premium in addition to a predetermined price based on the interest rate of the loan originated. We retain liabilities related to early prepayments, defaults, failure to adhere to origination and processing guidelines and other issues. We have internal controls in place to mitigate many of these liabilities and historically our realized liability has been extremely low. In addition, many of the retained liabilities expire inside of one year

from the date a loan is sold. We warehouse these loans until they are transferred to the secondary market investor, which usually occurs within 45 days.

Our 1-4 family residential mortgage loans generally have maturities ranging from five to 30 years. These loans are typically fully amortizing with monthly payments sufficient to repay the total amount of the loan or amortizing with a balloon feature, typically due in fifteen years or less. Our 1-4 family residential mortgage loans are made at both fixed and adjustable interest rates.

We review information concerning the income, financial condition, employment and credit history when evaluating the creditworthiness of the applicant.

We also make home equity loans, which are included as part of the 1-4 family residential mortgage loans, and at December 31, 2012, these loans totaled $82.3 million. Under Texas law, these loans, when combined with all other mortgage indebtedness for the property, are capped at 80% of appraised value.

Construction Loans

Our commercial construction loans and construction loans to individuals are collateralized by property located primarily in the market areas we serve. A majority of our construction loans are directed toward properties that will be owner-occupied. Construction loans for projects built on speculation are financed, but these typically have secondary sources of repayment and collateral. Our construction loans have both adjustable and fixed interest rates during the construction period. Construction loans to individuals are typically priced and made with the intention of granting the permanent loan on the property. During 2010 our construction loans experienced slight additional stress due to the general downturn in market conditions associated with this type of lending. During 2011, construction loans in our market areas stabilized and during 2012 they have rebounded and strengthened in many of our market areas.

Commercial Real Estate Loans

Commercial real estate loans primarily include commercial office buildings, retail, medical facilities and offices, warehouse facilities, hotels and churches. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Commercial real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years.

COMMERCIAL LOANS

Our commercial loans are diversified to meet most business needs. Loan types include short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type, other than the medical industry. Loans to borrowers in the medical industry include all loan types listed above for commercial loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations.

In our commercial loan underwriting, we assess the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

MUNICIPAL LOANS

We have a specific lending department that makes loans to municipalities and school districts throughout the state of Texas. The majority of the loans to municipalities and school districts have tax or revenue pledges and in some cases are additionally supported by collateral. Municipal loans made without a direct pledge of taxes or revenues are usually made based on some type of collateral that represents an essential service. Lending money directly to these municipalities allows us to earn a higher yield for similar durations than we could if we purchased municipal securities. Total loans to municipalities and school districts as of December 31, 2012 increased $13.7 million when compared to 2011. At December 31, 2012, we had total loans to municipalities and school districts of $220.9 million.

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LOANS TO INDIVIDUALS

Substantially all of our consumer loan originations are made to consumers in our market areas. The majority of loans to individuals outstanding are collateralized by titled equipment, which are primarily vehicles, and automobile loans purchased by SFG. At December 31, 2012, these types of loans accounted for approximately $133.7 million, or 82.2%, of total loans to individuals.

The total of SFG automobile loans included in loans to individuals at December 31, 2012 was $69.8 million. These high yield loans represent existing subprime automobile loans with payment histories that are primarily collateralized by used automobiles. Loan pools purchased through SFG are subjected to a modeling system to determine the risk associated with the expected defaults. Among other things, the model takes into consideration credit scores and estimated collateral values to determine the risk inherent in each pool.

Home equity loans, which are included in 1-4 family residential loans, have replaced some of the traditional loans to individuals. In addition, we make loans for a full range of other consumer purposes, which may be secured or unsecured depending on the credit quality and purpose of the loan.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards we employ for consumer loans include an application, a determination of the applicant's payment history on other debts, with the greatest weight being given to payment history with us, and an assessment of the borrower's ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount. Most of our loans to individuals are collateralized, which management believes should assist in limiting our exposure.

LOAN MATURITIES AND SENSITIVITY TO CHANGES IN INTEREST RATES

The following table represents loan maturities and sensitivity to changes in interest rates for our real estate construction, commercial and municipal loans. The amounts of these loans outstanding at December 31, 2012, which, based on remaining scheduled repayments of principal, are due in (1) one year or less, (2) more than one year but less than five years, and (3) more than five years, are shown in the following table. The amounts due after one year are classified according to the sensitivity to changes in interest rates.

| | Due in One Year or Less* | After One but Within Five Years | After Five Years |
|---|---|---|---|
| | (in thousands) | | |
| Real Estate Loans – Construction | $48,908 | $36,367 | $28,469 |
| Commercial Loans | 61,894 | 86,411 | 11,753 |
| Municipal Loans | 21,710 | 71,442 | 127,795 |
| Total | $132,512 | $194,220 | $168,017 |

| | | |
|---|---|---|
| Loans with Maturities After One Year for Which: | Interest Rates are Fixed or Predetermined | $230,629 |
| | Interest Rates are Floating or Adjustable | $131,608 |

* The volume of commercial loans due within one year reflects our general policy of attempting to limit these loans to a short-term maturity. Nonaccrual loans totaling $4.2 million are reflected in the due after five years column.

LOANS TO AFFILIATED PARTIES

In the normal course of business, we make loans to certain of our own executive officers and directors and their related interests. As of December 31, 2012 and 2011, these loans totaled $4.3 million and $4.1 million, respectively. These loans represented 1.7% and 1.6% of shareholders' equity as of December 31, 2012 and 2011, respectively. Such loans are made in the normal course of business at normal credit terms, including interest rate and collateral requirements and do not represent more than normal credit risks contained in the rest of the loan portfolio for loans of similar types.

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LOAN LOSS EXPERIENCE AND ALLOWANCE FOR LOAN LOSSES

Our allowance for loan losses was $20.6 million at December 31, 2012, or 1.6% of loans. The increase in the allowance for loan losses is due primarily to an 11.6% increase in nonperforming assets and a change in the loan mix as SFG, commercial and construction loans which require larger allowance for loan loss accruals, increased. The increase in loans during 2012 occurred primarily in 1-4 family residential and other real estate loans which require smaller allowance for loan loss accruals.

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

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

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

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

delinquency trends, estimated fair value of the underlying collateral, current economic conditions, the views of the bank regulators (who have the authority to require additional allowances in accordance with GAAP), and geographic and industry loan concentration.

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

New pools purchased are reserved at their estimated annual loss. Thereafter, the reserve is adjusted based on the actual performance versus projected performance. Additionally, we use data mining measures to track migration within risk tranches. Reserves are adjusted quarterly to match the migration metrics.

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After all of the data in the loan portfolio is accumulated the reserve allocations are separated into various loan classes detailed in the table below. At December 31, 2012, the unallocated portion of the allowance for loan loss was $1.2 million, or 0.1% of loans.

As of December 31, 2012, our review of the loan portfolio indicated that a loan loss allowance of $20.6 million was appropriate to cover probable losses in the portfolio. Changes in economic and other conditions may require future adjustments to the allowance for loan losses.

The following table presents information regarding the average amount of net loans outstanding, changes in the allowance for loan losses, selected asset quality ratios and an allocation of the allowance for loan losses (dollars in thousands).

LOAN LOSS EXPERIENCE AND ALLOWANCE FOR LOAN LOSSES

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| Average Net Loans Outstanding | $1,180,095 | $1,054,882 | $1,031,858 | $1,021,770 | $983,336 |
| Balance of Allowance for Loan Losses at Beginning of Period | $18,540 | $20,711 | $19,896 | $16,112 | $9,753 |
| Loan Charge-Offs: | | | | | |
| Real Estate-Construction | (41) | (46) | (873) | (932) | (111) |
| Real Estate-1-4 Family Residential | (239) | (675) | (288) | (267) | (11) |
| Real Estate-Other | (159) | (271) | (577) | (322) | — |
| Commercial Loans | (402) | (1,254) | (2,603) | (2,037) | (505) |
| Loans to Individuals | (10,188) | (10,231) | (12,072) | (9,589) | (8,570) |
| Total Loan Charge-Offs | (11,029) | (12,477) | (16,413) | (13,147) | (9,197) |
| Recovery of Loans Previously Charged-off: | | | | | |
| Real Estate-Construction | 121 | 61 | 165 | 2 | — |
| Real Estate-1-4 Family Residential | 172 | 98 | 13 | 5 | 1 |
| Real Estate-Other | 6 | 275 | — | — | 6 |
| Commercial Loans | 312 | 449 | 854 | 104 | 32 |
| Loans to Individuals | 1,727 | 1,927 | 2,459 | 1,727 | 1,842 |
| Total Recovery of Loans Previously Charged-Off | 2,338 | 2,810 | 3,491 | 1,838 | 1,881 |
| Net Loan Charge-Offs | (8,691) | (9,667) | (12,922) | (11,309) | (7,316) |
| Provision for Loan Losses | 10,736 | 7,496 | 13,737 | 15,093 | 13,675 |
| Balance of Allowance for Loan Losses at End of Period | $20,585 | $18,540 | $20,711 | $19,896 | $16,112 |
| Reserve for Unfunded Loan Commitments at Beginning of Period | $26 | $30 | $5 | $7 | $50 |
| Provision for Losses on Unfunded Loan Commitments | (21) | (4) | 25 | (2) | (43) |
| Reserve for Unfunded Loan Commitments at End of Period | $5 | $26 | $30 | $5 | $7 |
| Net Charge-Offs to Average Net Loans Outstanding | 0.74% | 0.92% | 1.25% | 1.11% | 0.74% |
| Allowance for Loan Losses to Nonaccruing Loans | 199.58 | 180.02 | 142.60 | 106.80 | 112.76 |
| | 139.87 | 140.58 | 116.95 | 84.83 | 102.10 |

| | | | | | |
|---|---|---|---|---|---|
| Allowance for Loan Losses to Nonperforming Assets | | | | | |
| Allowance for Loan Losses to Total Loans | 1.63 | 1.71 | 1.92 | 1.92 | 1.58 |

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Allocation of Allowance for Loan Losses (dollars in thousands):

| | Years Ended December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2011 | | 2010 | | 2009 | | 2008 | |
| | Amount | Percent of Loans To Total Loans | Amount | Percent of Loans To Total Loans | Amount | Percent of Loans To Total Loans | Amount | Percent of Loans To Total Loans | Amount | Percent of Loans To Total Loans |
| Real Estate | | | | | | | | | | |
| Construction | $2,355 | 9.0 % | $2,620 | 10.2 % | $2,585 | 10.7 % | $3,080 | 10.2 % | $2,757 | 12.9 % |
| 1-4 Family Residential | 3,545 | 29.2 % | 1,957 | 22.8 % | 1,988 | 20.3 % | 1,460 | 21.1 % | 1,567 | 22.1 % |
| Other | 2,290 | 18.7 % | 3,051 | 19.0 % | 3,354 | 18.6 % | 3,175 | 20.6 % | 2,701 | 18.1 % |
| Commercial Loans | 3,158 | 12.7 % | 2,877 | 13.2 % | 3,746 | 13.8 % | 3,184 | 15.4 % | 2,496 | 16.2 % |
| Municipal Loans | 633 | 17.5 % | 619 | 19.1 % | 607 | 18.3 % | 400 | 14.5 % | 341 | 13.2 % |
| Loans to Individuals | 7,373 | 12.9 % | 6,244 | 15.7 % | 7,978 | 18.3 % | 7,321 | 18.2 % | 6,206 | 17.5 % |
| Unallocated | 1,231 | 0.0 % | 1,172 | 0.0 % | 453 | 0.0 % | 1,276 | 0.0 % | 44 | 0.0 % |
| Ending Balance | $20,585 | 100.0 % | $18,540 | 100.0 % | $20,711 | 100.0 % | $19,896 | 100.0 % | $16,112 | 100.0 % |

See "Consolidated Financial Statements - Note 5 – Loans and Allowance for Probable Loan Losses."

NONPERFORMING ASSETS

Nonperforming assets consist of delinquent loans 90 days or more past due, nonaccrual loans, OREO, repossessed assets and restructured loans. Nonaccrual loans are those loans which are 90 days or more delinquent and collection in full of both the principal and interest is in doubt. Additionally, some loans that are not delinquent may be placed on nonaccrual status due to doubts about full collection of principal or interest. When a loan is categorized as nonaccrual, the accrual of interest is discontinued and any accrued balance is reversed for financial statement purposes. Restructured loans represent loans that have been renegotiated to provide a reduction or deferral of interest or principal because of deterioration in the financial position of the borrowers. The restructuring of a loan is considered a “troubled debt restructuring” if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Categorization of a loan as nonperforming is not in itself a reliable indicator of potential loan loss. Other factors, such as the value of collateral securing the loan and the financial condition of the borrower must be considered in judgments as to potential loan loss. OREO represents real estate taken in full or partial satisfaction of debts previously contracted. The dollar amount of OREO is based on a current evaluation of the OREO at the time it is recorded on our books, net of estimated selling costs. Updated valuations are obtained as needed and any additional impairments are recognized.

Total nonperforming assets at December 31, 2012 were $14.7 million representing an increase of $1.5 million, or 11.6%, from $13.2 million at December 31, 2011. From December 31, 2011 to December 31, 2012, nonaccrual loans increased $15,000, or 0.1%, to $10.3 million. Of this total, 19.4% are residential real estate loans, 13.2% are commercial real estate loans, 17.6% are commercial loans, 26.4% are loans to individuals, primarily SFG automobile loans, and 23.4% are construction loans. OREO increased $233,000, or 51.4%, to $686,000 from December 31, 2011

to December 31, 2012. We are actively marketing all properties and none are being held for investment purposes. Accruing loans past due more than 90 days increased $10,000, or 200.0% to $15,000 at December 31, 2012 from $5,000 at December 31, 2011. Restructured loans increased $889,000, or 42.2%, to $3.0 million. Repossessed assets increased $382,000, or 118.6%, to $704,000 at December 31, 2012 from $322,000 at December 31, 2011. Included in total nonperforming assets are $4.1 million loans classified as troubled debt restructurings at December 31, 2012 and $1.4 million at December 31, 2011.

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The following table presents information on nonperforming assets (dollars in thousands):

NONPERFORMING ASSETS

Years Ended December 31,

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Accruing Loans Past Due More Than 90 Days: | | | | | |
| Real Estate | $— | $— | $— | $289 | $404 |
| Loans to Individuals | 15 | 5 | 7 | 34 | 53 |
| Commercial | — | — | — | — | 136 |
| | 15 | 5 | 7 | 323 | 593 |
| Loans on Nonaccrual: | | | | | |
| Real Estate | 5,774 | 7,037 | 8,511 | 8,930 | 7,469 |
| Loans to Individuals | 2,728 | 1,909 | 4,214 | 7,461 | 5,976 |
| Commercial | 1,812 | 1,353 | 1,799 | 2,238 | 844 |
| | 10,314 | 10,299 | 14,524 | 18,629 | 14,289 |
| Restructured Loans: | | | | | |
| Real Estate | 2,135 | 762 | 36 | 87 | 91 |
| Loans to Individuals | 632 | 1,206 | 2,243 | 1,831 | 39 |
| Commercial | 231 | 141 | 41 | 54 | 18 |
| | 2,998 | 2,109 | 2,320 | 1,972 | 148 |
| Total Nonperforming Loans | 13,327 | 12,413 | 16,851 | 20,924 | 15,030 |
| Other Real Estate Owned | 686 | 453 | 220 | 1,875 | 318 |
| Repossessed Assets | 704 | 322 | 638 | 654 | 433 |
| Total Nonperforming Assets | $14,717 | $13,188 | $17,709 | $23,453 | $15,781 |
| Nonperforming Assets to Total Assets | 0.45 % | 0.40 % | 0.59 % | 0.78 % | 0.58 % |
| Nonperforming Assets to Total Loans | 1.17 | 1.21 | 1.64 | 2.27 | 1.54 |
| Nonaccrual Loans to Total Loans | 0.82 | 0.95 | 1.35 | 1.80 | 1.40 |
| Loans 90 Days Past Due to Total Loans | — | — | — | 0.03 | 0.06 |

Nonperforming assets at December 31, 2012, as a percentage of total assets increased to 0.45% from the previous year and as a percentage of loans decreased to 1.17%. Nonperforming assets hinder our ability to earn money. Decreases in earnings can result from both the loss of interest income and the costs associated with maintaining the OREO, for taxes, insurance and other operating expenses. In addition to the nonperforming assets, at December 31, 2012, in the opinion of management, we had $652,000 of loans identified as potential problem loans. A potential problem loan is a loan where information about possible credit problems of the borrower is known, causing management to have serious doubts about the ability of the borrower to comply with the present loan repayment terms and which may result in a future classification of the loan in one of the nonperforming asset categories.

The restructured loans to individuals referred to in the preceding table are primarily SFG loans which have had payment extensions or whose maturity has extended due to late payments on the contract. These loans continue to accrue interest on the principal balance.

The following is a summary of our recorded investment in loans (primarily nonaccrual loans) for which impairment has been recognized (in thousands):

| | December 31, 2012 | | |
|---|---|---|---|
| | Total | Valuation Allowance | Carrying Value |
| Real Estate Loans | $7,877 | $665 | $7,212 |
| Loans to Individuals | 3,360 | 1,428 | 1,932 |
| Commercial Loans | 2,043 | 630 | 1,413 |
| Total | $13,280 | $2,723 | $10,557 |

| | December 31, 2011 | | |
|---|---|---|---|
| | Total | Valuation Allowance | Carrying Value |
| Real Estate Loans | $7,765 | $1,297 | $6,468 |
| Loans to Individuals | 3,112 | 857 | 2,255 |
| Commercial Loans | 1,493 | 485 | 1,008 |
| Total | $12,370 | $2,639 | $9,731 |

The balances of impaired loans included above with no valuation allowances were approximately $1,000 and $4,000 at December 31, 2012 and 2011, respectively.

For the years ended December 31, 2012 and 2011, the average recorded investment in impaired loans was approximately $13.2 million and $14.4 million, respectively.

The amount of interest recognized on loans that were nonaccruing or restructured during the year was $572,000, $943,000 and $1.1 million for the years ended December 31, 2012, 2011 and 2010, respectively. If these loans had been accruing interest at their original contracted rates, related income would have been $1.3 million, $1.8 million and $2.2 million for the years ended December 31, 2012, 2011 and 2010, respectively.

SECURITIES ACTIVITY

Our securities portfolio plays a primary role in management of our interest rate sensitivity and, therefore, is managed in the context of the overall balance sheet. The securities portfolio generates a substantial percentage of our interest income and serves as a necessary source of liquidity.

We account for debt and equity securities as follows:

- Held to Maturity (“HTM”). Debt securities that management has the current intent and ability to hold until maturity are classified as HTM and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the level interest yield method over the estimated remaining term of the underlying security.

- Available for Sale (“AFS”). Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as AFS. These assets are carried at fair value. Fair value is determined using quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services. Unrealized gains and losses on AFS securities are excluded from earnings and reported net of tax as a

separate component of shareholders' equity until realized.

Securities Carried at Fair Value through Income. Debt securities purchased at significant premiums that contain an embedded derivative where the embedded derivative is not readily identifiable and measurable and as such cannot be bifurcated, are classified as securities carried at fair value through income. Fair value is determined using quoted market prices. If quoted market prices are not available, fair values are based on quoted market prices for similar

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securities or estimates from independent pricing services. Changes in fair value are reported through the income statement as fair value gain (loss) – securities.

Purchase of premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of HTM and AFS securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Securities with limited marketability, such as FHLB stock and other investments, are carried at cost, which approximates its fair value and assessed for other-than-temporary impairment.

Management attempts to deploy investable funds into instruments that are expected to provide a reasonable overall return on the portfolio given the current assessment of economic and financial conditions, while maintaining acceptable levels of capital, interest rate and liquidity risk. At December 31, 2012, the securities portfolio as a percentage of total assets was 52.5% and was larger than loans, which were 39.0% of total assets. For a discussion of our strategy in relation to the securities portfolio, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Balance Sheet Strategy.”

The following tables set forth the carrying amount of investment securities and mortgage-backed securities at December 31, 2012, 2011 and 2010 (in thousands):

| | December 31, | | |
|---|---|---|---|
| Available for Sale: | 2012 | 2011 | 2010 |
| Investment Securities: | | | |
| U.S. Treasury | $— | $— | $4,700 |
| U.S. Government Agency Debentures | 60,863 | — | — |
| State and Political Subdivisions | 545,688 | 282,457 | 294,262 |
| Other Stocks and Bonds | 11,156 | 499 | 382 |
| Mortgage-backed Securities: | | | |
| U.S. Government Agencies | 89,803 | 107,052 | 150,273 |
| Government-Sponsored Enterprises | 716,557 | 609,074 | 736,301 |
| Total | $1,424,067 | $999,082 | $1,185,918 |

| | December 31, | | |
|---|---|---|---|
| Securities Carried at Fair Value through Income: | 2012 | 2011 | 2010 |
| Mortgage-backed Securities: | | | |
| U.S. Government Agencies | $— | $30,413 | $5,392 |
| Government-Sponsored Enterprises | — | 617,346 | 66,784 |
| Total | $— | $647,759 | $72,176 |

| | December 31, | | |
|---|---|---|---|
| Held to Maturity: | 2012 | 2011 | 2010 |
| Investment Securities: | | | |
| State and Political Subdivisions | $1,009 | $1,010 | $1,012 |
| Other Stocks and Bonds | — | 486 | 483 |
| Mortgage-backed Securities: | | | |
| U.S. Government Agencies | 20,135 | 22,999 | 20,821 |

| | | | |
|---|---|---|---|
| Government-Sponsored Enterprises | 225,403 | 342,632 | 384,546 |
| Total | $246,547 | $367,127 | $406,862 |

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We invest in mortgage-backed and related securities, including mortgage participation certificates, which are insured or guaranteed by U.S. Government agencies and GSEs and Collateralized Mortgage Obligation ("CMOs") and real estate mortgage investment conduits ("REMICs"). Mortgage-backed securities (which also are known as mortgage participation certificates or pass-through certificates) represent a participation interest in a pool of single-family or multi-family mortgages, the principal and interest payments on which are passed from the mortgage originators, through intermediaries (generally U.S. Government agencies and GSEs) that pool and re-package the participation interests in the form of securities, to investors such as us. U.S. Government agencies, primarily Government National Mortgage Association ("GNMA") and GSEs, primarily Freddie Mac, and Fannie Mae guarantee the payment of principal and interest to investors. GSEs are not backed by the full faith and credit of the U.S. Government. Freddie Mac, Fannie Mae and FHLB are the primary GSEs from which we purchase securities. At December 31, 2012, all of our mortgage-backed securities were collateralized by U.S. Government agencies or GSEs.

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

Our mortgage-backed securities include CMOs, which include securities issued by entities that have qualified under the Internal Revenue Code of 1986, as amended, as REMICs. CMOs and REMICs (collectively CMOs) were developed in response to investor concerns regarding the uncertainty of cash flows associated with the prepayment option of the underlying mortgagor and are typically issued by governmental agencies, GSEs and special purpose entities, such as trusts, corporations or partnerships, established by financial institutions or other similar institutions. A CMO can be collateralized by loans or securities which are insured or guaranteed by Fannie Mae, Freddie Mac or GNMA. In contrast to pass-through mortgage-backed securities, in which cash flow is received pro rata by all security holders, the cash flow from the mortgages underlying a CMO is segmented and paid in accordance with a predetermined priority to investors holding various CMO classes. By allocating the principal and interest cash flows from the underlying collateral among the separate CMO classes, different classes of bonds are created, each with its own stated maturity, estimated average life, coupon rate and prepayment characteristics.

On October 24, 2011 the President of the United States and the FHFA announced programs designed to assist homeowners with refinancing their mortgage. These programs target homeowners that might not otherwise qualify for a new mortgage loan as a result of either loan-to-value issues or past due loan payment status or history. The FHFA is the agency responsible for Fannie Mae and Freddie Mac. Should these programs be successful in reaching borrowers targeted in large numbers, our MBS could see increased prepayment levels that we did not project at purchase.

Like most fixed income securities, mortgage-backed and related securities are subject to interest rate risk. However, unlike most fixed income securities, the mortgage loans underlying a mortgage-backed or related security generally may be prepaid at any time without penalty. The ability to prepay a mortgage loan generally results in significantly increased price and yield volatility (with respect to mortgage-backed and related securities) than is the case with noncallable fixed income securities. Most of our mortgage-backed securities were purchased at a premium. As these mortgage-backed securities prepay at a faster rate our yield on these securities will decrease. Conversely, as prepayments slow the yield on these mortgage-backed securities will increase.

Debt securities purchased at a significant premium that contain an embedded derivative where the embedded derivative is not readily identifiable and measurable and as such cannot be bifurcated, are classified as securities carried at fair value through income. As such, mortgage-backed securities purchased at a significant premium, which

we describe as any mortgage-backed security purchase at a price in excess of 111.111%, are classified as securities carried at fair value through income unless they are in a trading account.  At December 31, 2012, we had no securities carried at fair value through income compared to $647.8 million at December 31, 2011.    During 2012, we sold all of our securities carried at fair value through income as management determined it did not want additional, potentially significant, swings in net income associated with fair value changes for these securities.  The sale of these securities resulted in a loss on sale of securities carried at fair value through income of $498,000.  During 2012, as interest rates remained low, we continued to sell primarily lower yielding, longer duration municipal securities and more prepayment volatile mortgage-backed securities and replaced them with primarily shorter duration municipal securities.  The sale of these securities resulted in a gain on the sale of available for sale securities of $18.0 million.  There can be no assurance that the level of security gains reported during the year ended December 31, 2012, will continue in future periods.

The combined investment securities, mortgage-backed securities, and FHLB stock and other investments portfolio decreased to $1.70 billion at December 31, 2012, compared to $2.05 billion at December 31, 2011, a decrease of $349.3 million, or 17.0%.  This is primarily a result of a decrease in mortgage-backed securities of $677.6 million, or 39.2%, which was partially offset by a $263.2 million, or 92.9%, increase in our ownership of securities issued by state and political subdivisions during 2012 when compared to 2011.

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During 2012, the interest rate yield curve remained steep while at the same time credit and volatility spreads continued to tighten. We used this environment to reposition a portion of the securities portfolio. The decrease in mortgage-backed securities is due to sales of more prepay volatile securities, principal payments due primarily to prepayments and reduced purchases of fixed rate mortgage-backed securities as the risk/reward profile of these securities became less favorable. The addition of the Federal Reserve purchasing $40 billion of mortgage-backed securities per month will likely limit purchases until the economics in this sector change. To offset the decrease of the mortgage-backed securities portfolio we significantly increased our tax-free municipal security portfolio. Most of our purchases were in Texas with only limited purchases in other states. As we increased the municipal portfolio we sold some of our longer maturity lower coupon municipal securities to lower the overall duration of this portfolio.

The combined fair value of the AFS and HTM securities portfolio at December 31, 2012 was $1.68 billion, which represented a net unrealized gain as of that date of $54.2 million. The net unrealized gain was comprised of $57.9 million in unrealized gains and $3.7 million of unrealized losses. The fair value of the AFS securities portfolio at December 31, 2012 was $1.42 billion, which represented a net unrealized gain as of that date of $45.3 million. The net unrealized gain was comprised of $49.0 million of unrealized gains and $3.7 million of unrealized losses. The $3.7 million of unrealized losses is primarily resulting from our investment in three tranches of TRUPs and securities issued by government-sponsored enterprises. Net unrealized gains and losses on AFS securities, which is a component of shareholders' equity on the consolidated balance sheet, can fluctuate significantly as a result of changes in interest rates. Because management cannot predict the future direction of interest rates, the effect on shareholders' equity in the future cannot be determined; however, this risk is monitored through the use of shock tests on the AFS securities portfolio using an array of interest rate assumptions.

There were no securities transferred from AFS to HTM during 2012, 2011 and 2010. There were no sales from the HTM portfolio during the years ended December 31, 2012, 2011 or 2010. There were $246.5 million and $367.1 million of securities classified as HTM at December 31, 2012 and 2011, respectively. In conjunction with correcting errors in the first three quarters of 2011 that were restated related to securities carried at fair value through income, on October 1, 2010 we corrected $13.9 million in HTM securities which should have been originally classified as securities carried at fair value through income.

The maturities classified according to the sensitivity to changes in interest rates of the December 31, 2012 securities portfolio and the weighted yields are presented below. Tax-exempt obligations are shown on a taxable equivalent basis. Mortgage-backed securities are included in maturity categories based on their stated maturity date. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

| | MATURING | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Within 1 Year | | | After 1 But Within 5 Years | | | After 5 But Within 10 Years | | | After 10 Years | | |
| Available For Sale: | Amount | Yield | | Amount | Yield | | Amount | Yield | | Amount | Yield | |
| | (dollars in thousands) | | | | | | | | | | | |
| Investment Securities: | | | | | | | | | | | | |
| U.S. Government Agency Debentures | $— | — | | $— | — | | $38,554 | 1.30 | % | $22,309 | 2.06 | % |
| State and Political Subdivisions | 4,473 | 5.15 | % | 14,337 | 3.69 | % | 111,493 | 3.27 | % | 415,385 | 4.66 | % |
| Other Stocks and Bonds | — | — | | 7,791 | 1.62 | % | 2,375 | 2.03 | % | 990 | — | |
| Mortgage-backed Securities: | | | | | | | | | | | | |
| U.S. Government Agencies | — | — | | 747 | 4.76 | % | 2,743 | 3.95 | % | 86,313 | 2.22 | % |
| Government-Sponsored Enterprises | 64 | 5.57 | % | 4,403 | 3.52 | % | 12,709 | 3.73 | % | 699,381 | 1.70 | % |
| Total | $4,537 | 5.16 | % | $27,278 | 3.10 | % | $167,874 | 2.85 | % | $1,224,378 | 2.75 | % |

| | MATURING | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Within 1 Year | | | After 1 But Within 5 Years | | | After 5 But Within 10 Years | | | After 10 Years | | |
| Held to Maturity: | Amount | Yield | | Amount | Yield | | Amount | Yield | | Amount | Yield | |
| | (dollars in thousands) | | | | | | | | | | | |
| Investment Securities: | | | | | | | | | | | | |
| State and Political Subdivisions | $— | — | | $— | — | | $— | — | | $1,009 | 8.09 | % |
| Mortgage-backed Securities: | | | | | | | | | | | | |
| U.S. Government Agencies | — | — | | 248 | 4.59 | % | 12,112 | 2.98 | % | 7,775 | 0.19 | % |
| Government-Sponsored Enterprises | 519 | 3.96 | % | 17,032 | 3.12 | % | 113,253 | 1.70 | % | 94,599 | 3.44 | % |
| Total | $519 | 3.96 | % | $17,280 | 3.14 | % | $125,365 | 1.82 | % | $103,383 | 3.24 | % |

At December 31, 2012, there were no holdings of any one issuer, other than the U.S. Government, its agencies and its GSEs, in an amount greater than 10% of our shareholders' equity.

DEPOSITS AND BORROWED FUNDS

Deposits provide us with our primary source of funds. The increase of $30.2 million, or 1.3%, in total deposits during 2012 partially contributed to the decrease in FHLB advances. Deposits increased during 2012 primarily due to an increase in public funds, and to a lesser extent branch expansion and increased market penetration. During 2012, our public fund deposits increased $112.2 million to $713.4 million at December 31, 2012 from $601.1 million at December 31, 2011. At December 31, 2012, brokered CDs reflected a decrease of approximately $144.4 million when compared to December 31, 2011. Deposits, net of brokered deposits, at December 31, 2012, increased $174.6 million, or 8.1%, when compared to December 31, 2011. Time deposits, including brokered CDs issued decreased a total of $237.3 million, or 26.9%, during 2012 when compared to 2011. Noninterest bearing demand deposits increased $89.5 million, or 17.7%, during 2012. Interest bearing demand deposits increased $165.4 million, or 19.6%, and saving deposits increased $12.6 million, or 13.9%, during 2012. The latter three categories, which are considered the lowest cost deposits, comprised 72.6% of total deposits at December 31, 2012 compared to 62.0% at December 31, 2011.

The following table sets forth deposits by category at December 31, 2012, 2011, and 2010 (in thousands):

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Noninterest Bearing Demand Deposits | $595,093 | $505,594 | $423,304 |
| Interest Bearing Demand Deposits | 1,008,348 | 842,970 | 786,552 |
| Savings Deposits | 103,839 | 91,203 | 79,472 |
| Time Deposits | 644,617 | 881,904 | 845,100 |
| Total Deposits | $2,351,897 | $2,321,671 | $2,134,428 |

During the year ended December 31, 2012, total time deposits of $100,000 or more decreased $71.2 million, or 12.9%, to $481.7 million from $552.9 million at December 31, 2011.

The table below sets forth the maturity distribution of time deposits of $100,000 or more at December 31, 2012 and 2011 (in thousands):

| | December 31, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| | Time Certificates Of Deposit | Other Time Deposits | Total | Time Certificates Of Deposit | Other Time Deposits | Total |
| Three months or less | $95,548 | $28,000 | $123,548 | $80,226 | $28,000 | $108,226 |
| Over three to six months | 53,279 | 21,000 | 74,279 | 86,138 | 21,000 | 107,138 |
| Over six to twelve months | 106,818 | 7,000 | 113,818 | 197,911 | 7,000 | 204,911 |
| Over twelve months | 170,065 | — | 170,065 | 132,644 | — | 132,644 |
| Total | $425,710 | $56,000 | $481,710 | $496,919 | $56,000 | $552,919 |

At December 31, 2012, we had $19.5 million in long-term brokered CDs that represented 0.8% of our deposits. Our brokered CDs at December 31, 2012 have maturities of less than five years and are reflected in the CDs under $100,000 category. At December 31, 2011, we had $163.8 million in brokered CDs and at December 31, 2010, we had $161.3 million in brokered CDs. Our current policy allows for a maximum of $180 million in brokered CDs. The potential higher interest cost and lack of customer loyalty are risks associated with the use of brokered CDs.

Short-term obligations, consisting primarily of FHLB advances and federal funds purchased and repurchase agreements, decreased $212.8 million, or 58.3%, during 2012 when compared to 2011. FHLB advances are collateralized by FHLB stock, nonspecified loans and securities. Short-term obligations are summarized as follows (dollars in thousands):

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Federal funds purchased and repurchase agreements | | | |
| Balance at end of period | $984 | $2,945 | $3,844 |
| Average amount outstanding during the period (1) | 1,770 | 3,137 | 6,699 |
| Maximum amount outstanding during the period (2) | 2,704 | 3,291 | 13,187 |
| Weighted average interest rate during the period (3) | 1.4 % | 2.7 % | 3.1 % |
| Interest rate at end of period | 0.4 % | 2.6 % | 3.3 % |
| | | | |
| FHLB advances | | | |
| Balance at end of period | $150,985 | $361,811 | $189,094 |
| Average amount outstanding during the period (1) | 282,741 | 292,242 | 300,428 |
| Maximum amount outstanding during the period (2) | 440,246 | 466,316 | 401,893 |
| Weighted average interest rate during the period (3) | 2.2 % | 2.2 % | 2.4 % |
| Interest rate at end of period | 3.7 % | 1.6 % | 3.6 % |
| | | | |
| Other obligations | | | |
| Balance at end of period | $219 | $219 | $2,651 |
| Average amount outstanding during the period (1) | 219 | 2,581 | 2,522 |
| Maximum amount outstanding during the period (2) | 219 | 2,963 | 3,135 |
| Weighted average interest rate during the period (3) | 8.0 % | 0.7 % | 0.2 % |
| Interest rate at end of period | 8.0 % | 8.0 % | 0.7 % |

(1) The average amount outstanding during the period was computed by dividing the total daily outstanding principal balances by the number of days in the period.

(2) The maximum amount outstanding at any month-end during the period.

(3) The weighted average interest rate during the period was computed by dividing the actual interest expense by the average balance outstanding during the period.

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Long-term obligations are summarized as follows (in thousands):

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| FHLB Advances (1) | | |
| Varying maturities to 2028 | $369,097 | $260,724 |
| | | |
| Long-term Debt (2) | | |
| Southside Statutory Trust III Due 2033 (3) | 20,619 | 20,619 |
| Southside Statutory Trust IV Due 2037 (4) | 23,196 | 23,196 |
| Southside Statutory Trust V Due 2037 (5) | 12,887 | 12,887 |
| Magnolia Trust Company I Due 2035 (6) | 3,609 | 3,609 |
| Total Long-term Debt | 60,311 | 60,311 |
| Total Long-term Obligations | $429,408 | $321,035 |

(1) At December 31, 2012, the weighted average cost of these advances was 1.6%.

(2) This long-term debt consists of trust preferred securities that qualify under the risk-based capital guidelines as Tier 1 capital, subject to certain limitations.

(3) This debt carries an adjustable rate of 3.251% through March 30, 2013 and adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points.

(4) This debt carries an adjustable rate of 1.61325% through January 29, 2013 and adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points.

(5) This debt carries an adjustable rate of 2.558% through March 14, 2013 and adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points.

(6) This debt carries an adjustable rate of 2.1115% through February 24, 2013 and adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

Long-term FHLB advances increased $108.4 million, or 41.6%, during 2012 to $369.1 million when compared to $260.7 million in 2011. The increase was the result of an increase in long-term FHLB advances purchased during 2012 which more than offset the advances classified as long-term at December 31, 2011 rolling into the short-term FHLB advance category. During 2012, we have been actively calling our brokered CDs and replacing them with long-term FHLB advances which has allowed us to extend the maturities and lower the funding costs.

In addition, as $150 million of the $200 million par in long-term advance commitments from the FHLB expired, long-term advances at rates below the advance commitment rates that expired were taken out. During 2011 and 2010, we entered into the option to fund between one and a half years and two years forward from the advance commitment date, $200 million par in long-term advance commitments from the FHLB at the FHLB rates on the date the option was purchased. During the year ended December 31, 2012, $150 million par of long-term advance commitments expired unexercised. In order to obtain these commitments from the FHLB, we paid fees of $10.95 million. During the third quarter of 2011, the value of the FHLB advance option fees became impaired. They were further impaired during the fourth quarter of 2011 resulting in a total charge of $8.9 million in 2011. During 2012, the FHLB advance option fees were further impaired and completely written down for a total charge of $2.0 million for the year ended December 31, 2012. At December 31, 2012, there was no remaining carrying value recorded in our balance sheet.

Long-term debt was $60.3 million at December 31, 2012 and 2011. Long-term debt consists of $20.6 million of our junior subordinated debentures issued in 2003 and $36.1 million issued in August 2007 in connection with the issuance of trust preferred securities by Southside Statutory Trusts III, IV and V and the assumption in October 2007 of $3.6 million of junior subordinated debentures issued by FWBS to Magnolia Trust Company I.

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CAPITAL RESOURCES

Our total shareholders' equity at December 31, 2012 of $257.8 million decreased 0.4%, or $1.2 million, from December 31, 2011 and represented 8.0% of total assets at December 31, 2012 compared to 7.8% at December 31, 2011.

The decrease in shareholders' equity at December 31, 2012 was the result of a decrease of $11.8 million in accumulated other comprehensive income, $19.1 million in cash dividends paid and the repurchase of $7.4 million of common stock which more than offset the $34.7 million of net income for 2012 and the issuance of $1.9 million in common stock (94,134 shares) through our employee stock and dividend reinvestment plans. The decrease in accumulated other comprehensive income is composed of a decrease of $6.3 million, net of tax, in the unrealized gain on securities, net of reclassification adjustment (see “Note 3 – Comprehensive Income (Loss)”) and a decrease of $5.5 million, net of tax, related to the change in the unfunded status of our defined benefit plans. Our dividend policy requires that any cash dividend payments may not exceed consolidated earnings for that year. Shareholders should not anticipate a continuation of the cash dividend simply because of the existence of a dividend reinvestment program. The payment of dividends will depend upon future earnings, our financial condition, and other related factors including the discretion of the board of directors.

We 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 our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Our 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 us to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier 1 Capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 Capital (as defined) to average assets (as defined). Tier 1 Capital is defined as the sum of shareholders’ equity and qualifying subordinated debt, excluding unrealized gains or losses on debt securities available for sale, unrealized gains on equity securities available for sale and unrealized gains or losses on cash flow hedges, net of deferred income taxes; plus certain mandatorily redeemable capital securities, less nonqualifying intangible assets net of applicable deferred income taxes, and certain nonfinancial equity investments. Total capital is defined as the sum of Tier 1 Capital, a qualifying portion of the allowance for loan losses, and qualifying subordinated debt. Management believes, as of December 31, 2012, that we meet all capital adequacy requirements to which we are subject.

In addition, for a depository institution to be considered "well capitalized" under the regulatory framework for prompt corrective action, its Tier 1 and Total Capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively and its leverage ratio must be at least 5.0%.

| | Actual | | | For Capital Adequacy Purposes | | | To Be Well Capitalized Under Prompt Corrective Action Provisions | | |
|---|---|---|---|---|---|---|---|---|---|
| | Amount | Ratio | | Amount | Ratio | | Amount | Ratio | |
| As of December 31, 2012: | (dollars in thousands) | | | | | | | | |
| Total Capital (to Risk Weighted Assets) | | | | | | | | | |
| Consolidated | $308,133 | 22.42 | % | $109,962 | 8.00 | % | N/A | N/A | |
| Bank Only | $300,196 | 21.86 | % | $109,852 | 8.00 | % | $137,315 | 10.00 | % |
| Tier 1 Capital (to Risk Weighted Assets) | | | | | | | | | |
| Consolidated | $290,873 | 21.16 | % | $54,981 | 4.00 | % | N/A | N/A | |
| Bank Only | $282,936 | 20.60 | % | $54,926 | 4.00 | % | $82,389 | 6.00 | % |
| Tier 1 Capital (to Average Assets) (1) | | | | | | | | | |
| Consolidated | $290,873 | 9.11 | % | $127,698 | 4.00 | % | N/A | N/A | |
| Bank Only | $282,936 | 8.87 | % | $127,531 | 4.00 | % | $159,413 | 5.00 | % |
| As of December 31, 2011: | | | | | | | | | |
| Total Capital (to Risk Weighted Assets) | | | | | | | | | |
| Consolidated | $296,715 | 22.36 | % | $106,152 | 8.00 | % | N/A | N/A | |
| Bank Only | $285,539 | 21.52 | % | $106,159 | 8.00 | % | $132,699 | 10.00 | % |
| Tier 1 Capital (to Risk Weighted Assets) | | | | | | | | | |
| Consolidated | $280,050 | 21.11 | % | $53,076 | 4.00 | % | N/A | N/A | |
| Bank Only | $268,874 | 20.26 | % | $53,080 | 4.00 | % | $79,619 | 6.00 | % |
| Tier 1 Capital (to Average Assets) (1) | | | | | | | | | |
| Consolidated | $280,050 | 8.63 | % | $129,795 | 4.00 | % | N/A | N/A | |
| Bank Only | $268,874 | 8.29 | % | $129,698 | 4.00 | % | $162,122 | 5.00 | % |

(1) Refers to quarterly average assets as calculated by bank regulatory agencies.

The capital requirements applicable to the Company and Southside Bank are subject to change because, over the coming years, the regulatory capital framework is expected to change in important respects as a result of the Dodd-Frank Act and as a result of a separate, international regulatory capital initiative known as "Basel III." Complying with the new Basel III capital requirements will likely affect our operations, and the extent to which we will be affected will be known with more certainty once additional clarity is provided on the underlying details of these new requirements. These new requirements have been endorsed by the U.S. banking regulators, but have not yet been translated by the regulators into official, final regulations for U.S. financial institutions. It is anticipated that the regulators will adopt new regulatory capital requirements similar to those proposed by the BCBS, and, as noted above, it was anticipated that the new requirements would be phased-in for U.S. financial institutions beginning in 2013. However, on November 9, 2012, U.S. regulators announced that the implementation of rules implementing Basel III would be delayed and regulators have not provided a specific timeframe for their implementation of these requirements. Furthermore, it is widely anticipated that the capital requirements for most bank and financial holding companies, as well as for most insured depository institutions, will increase, although the nature and amounts of the

increase have not yet been specified.

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The table below summarizes our key equity ratios for the years ended December 31, 2012, 2011 and 2010:

| | Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 | | 2011 | | 2010 | |
| Return on Average Assets | 1.05 | % | 1.25 | % | 1.30 | % |
| Return on Average Shareholders' Equity | 12.83 | % | 16.20 | % | 17.98 | % |
| Dividend Payout Ratio – Basic | 55.50 | % | 39.82 | % | 37.78 | % |
| Dividend Payout Ratio – Diluted | 55.50 | % | 39.82 | % | 37.78 | % |
| Average Shareholders' Equity to Average Total Assets | 8.17 | % | 7.69 | % | 7.24 | % |

ACCOUNTING PRONOUNCEMENTS

See “Note 1 – Summary of Significant Accounting and Reporting Policies” to our consolidated financial statements included in this report.

EFFECTS OF INFLATION

Our consolidated financial statements, and their related notes, have been prepared in accordance with GAAP that require the measurement of financial position and operating results in terms of historical dollars, without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike many industrial companies, nearly all of our assets and liabilities are monetary. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services. Inflation can affect the amount of money customers have for deposits, as well as ability to repay loans.

MANAGEMENT OF LIQUIDITY

Liquidity management involves our ability to convert assets to cash with a minimum of loss to enable us to meet our obligations to our customers at any time. This means addressing (1) the immediate cash withdrawal requirements of depositors and other funds providers; (2) the funding requirements of all lines and letters of credit; and (3) the short-term credit needs of customers. Liquidity is provided by short-term investments that can be readily liquidated with a minimum risk of loss. Cash, interest earning deposits, federal funds sold and short-term investments with maturities or repricing characteristics of one year or less continue to be a substantial percentage of total assets. At December 31, 2012, these investments were 18.6% of total assets, as compared with 19.0% for December 31, 2011, and 16.8% for December 31, 2010. The decrease to 18.6% at December 31, 2012 is primarily reflective of changes in the investment portfolio. Liquidity is further provided through the matching, by time period, of rate sensitive interest earning assets with rate sensitive interest bearing liabilities. Southside Bank has three lines of credit for the purchase of overnight federal funds at prevailing rates. One $25.0 million and two $15.0 million unsecured lines of credit have been established with Frost Bank, Comerica Bank and TIB -The Independent Bankers Bank, respectively. There were no federal funds purchased at December 31, 2012. Southside Bank has a $5.0 million line of credit with Frost Bank to be used to issue letters of credit. At December 31, 2012, the amount of additional funding Southside Bank could obtain from FHLB using unpledged securities at FHLB was approximately $221.6 million, net of FHLB stock purchases required. Southside Bank obtained no letters of credit from FHLB as collateral for a portion of its public fund deposits.

Interest rate sensitivity management seeks to avoid fluctuating net interest margins and to enhance consistent growth of new interest income through periods of changing interest rates. The ALCO closely monitors various liquidity

ratios, interest rate spreads and margins. The ALCO performs interest rate simulation tests that apply various interest rate scenarios including immediate shocks and market value of portfolio equity (“MVPE”) with interest rates immediately shocked plus and minus 200 basis points to assist in determining our overall interest rate risk and adequacy of the liquidity position. In addition, the ALCO utilizes a simulation model to determine the impact of net interest income of several different interest rate scenarios. By utilizing this technology, we can determine changes that need to be made to the asset and liability mixes to minimize the change in net interest income under these various interest rate scenarios.

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OFF-BALANCE-SHEET ARRANGEMENTS

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, we are a party to certain financial instruments, with off-balance-sheet risk, to meet the financing needs of our customers. These off-balance-sheet instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the financial statements. The contract or notional amounts of these instruments reflect the extent of involvement and exposure to credit loss we have in these particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require payment of fees. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These 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 commitments to customers.

We had outstanding unused commitments to extend credit of $132.8 million and $116.0 million at December 31, 2012 and 2011, respectively. Each commitment has a maturity date or an annual cancellation date and the commitment expires on that date with the exception of credit card and ready reserve commitments, which have no stated maturity date. Unused commitments for credit card and ready reserve at December 31, 2012 and 2011 were $13.0 million and $12.7 million, respectively, and are reflected in the due after one year category. We had outstanding standby letters of credit of $5.6 million and $6.5 million at December 31, 2012 and 2011, respectively.

The scheduled maturities of unused commitments as of December 31, 2012 and 2011 were as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Unused commitments: | | |
| Due in one year or less | $84,756 | $85,737 |
| Due after one year | 48,061 | 30,291 |
| Total | $132,817 | $116,028 |

We apply the same credit policies in making commitments and standby letters of credit as we do for on-balance-sheet instruments. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory, oil, gas and mineral interests, property, plant, and equipment.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The following summarizes our contractual cash obligations and commercial commitments at December 31, 2012, and the effect such obligations are expected to have on liquidity and cash flow in future periods. Payments reflected in the table below do not include interest.

| | Payments Due By Period | | | | |
|---|---|---|---|---|---|
| | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years | Total |
| | (in thousands) | | | | |
| Contractual obligations: | | | | | |
| Long-term debt, including current maturities (1) | $— | $— | $— | $60,311 | $60,311 |
| FHLB advances (2) | 152,175 | 58,594 | 268,463 | 40,850 | 520,082 |
| Operating leases (3) | 1,357 | 1,769 | 851 | 629 | 4,606 |
| Deferred compensation agreements (4) | 484 | 1,051 | 887 | 5,035 | 7,457 |
| Time deposits (5) | 415,980 | 183,329 | 44,037 | 1,271 | 644,617 |
| Securities purchased not paid for | 10,047 | — | — | — | 10,047 |
| Capital lease obligations | — | — | — | — | — |
| Purchase obligations | — | — | — | — | — |
| Total contractual obligations | $580,043 | $244,743 | $314,238 | $108,096 | $1,247,120 |

(1) The total balance of long-term debt was $60.3 million at December 31, 2012. The scheduled maturities and interest rates were as follows:

- Floating rate debt of $20.6 million with a scheduled maturity of 2033, was indexed to three-month LIBOR plus 294 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 3.251% through March 30, 2013.
- Floating rate debt of $23.2 million with a scheduled maturity of 2037, was indexed to three-month LIBOR plus 130 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 1.61325% through January 29, 2013.
- Floating rate debt of $12.9 million with a scheduled maturity of 2037, was indexed to three-month LIBOR plus 225 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 2.558% through March 14, 2013.
- Floating rate debt of $3.6 million with a scheduled maturity of 2035, was indexed to three-month LIBOR plus 180 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 2.1115% through February 24, 2013.

(2) We had fixed rate FHLB advances with maturity dates ranging from 2013 through 2028, with interest rates ranging from 0.9% to 7.6% with a total balance of $520.1 million at December 31, 2012.

(3) We had various operating leases for our office machines that total $578,000 and expire on or before the end of 2017. In addition, we have operating leases totaling $4.0 million on our retail branch locations and loan production offices which have future commitments of up to ten years and additional options, which we control, beyond the commitment period.

(4) We have deferred compensation agreements (the “agreements”) with 18 officers totaling $7.5 million. Payments from the agreements are to commence at the time of retirement. As of December 31, 2012, $1.0 million in payments had been made from such agreements. Of the 18 officers included in the agreements, two were eligible for retirement

at December 31, 2012 and two retired officers are currently receiving benefits. One officer becomes eligible in each of the years 2014 through 2017. The remaining 10 officers are eligible at various dates after five years. The totals reflected under five years assume the retirement of the two eligible officers at December 31, 2012 and the retirement of the eligible officers in years 2014 through 2017. Additional information regarding executive compensation is incorporated into “Item 11. Executive Compensation” of this Annual Report on Form 10-K.

(5) We had $19.5 million of brokered CDs at December 31, 2012 with maturity dates ranging from 2015 through 2017 and coupons ranging from 0.75% to 1.5%.

During 2011 and 2010, we entered into the option to purchase between one and a half years and two years forward from the advance commitment date, $200 million par in long-term advance commitments from the FHLB at the FHLB rates on the date the option was purchased. During the year ended December 31, 2012, $150 million par of long-term advance commitments expired unexercised. In order to obtain these commitments from the FHLB, we paid fees, which at December 31, 2012, were completely written down.

We expect to contribute between $2.0 million and $3.0 million to our defined benefit plan during 2013. We also expect to contribute to our defined benefit plan in future years, however, those amounts are indeterminable at this time.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the banking industry, a major risk exposure is changing interest rates. The primary objective of monitoring our interest rate sensitivity, or risk, is to provide management the tools necessary to manage the balance sheet to minimize adverse changes in net interest income as a result of changes in the direction and level of interest rates. Federal Reserve Board monetary control efforts, the effects of deregulation, the current economic downturn and legislative changes have been significant factors affecting the task of managing interest rate sensitivity positions in recent years.

In an attempt to manage our exposure to changes in interest rates, management closely monitors our exposure to interest rate risk through our ALCO. Our ALCO meets regularly and reviews our interest rate risk position and makes recommendations to our board for adjusting this position. In addition, our board reviews our asset/liability position on a monthly basis. We primarily use two methods for measuring and analyzing interest rate risk: net income simulation analysis and MVPE modeling. We utilize the net income simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of various interest rate scenarios on projected net interest income and net income over the next 12 months. The model was used to measure the impact on net interest income relative to a base case scenario of rates increasing 100 and 200 basis points or decreasing 100 and 200 basis points over the next 12 months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet. The impact of interest rate-related risks such as prepayment, basis and option risk are also considered. Due to the low level of interest rates many of the current interest rates cannot decline 100 or 200 basis points. The model has floors for each of those interest rates and none are assumed to go negative. As of December 31, 2012, the model simulations projected that 100 and 200 basis point immediate increases in interest rates would result in positive variances on net interest income of 0.79% and 0.08%, respectively, relative to the base case over the next 12 months, while an immediate decrease in interest rates of 100 and 200 basis points would result in a negative variance in net interest income of 2.77% and 3.92%, respectively, relative to the base case over the next 12 months. As of December 31, 2011, the model simulations projected that 100 and 200 basis point increases in interest rates would result in negative variances on net interest income of 1.60% and 3.59%, respectively, relative to the base case over 12 months, while decreases in interest rates of 100 and 200 basis points would result in negative variances in net interest income of 2.16% and 1.95%, respectively, relative to the base case over the next 12 months. As part of the overall assumptions, certain assets and liabilities have been given reasonable floors. This type of simulation analysis requires numerous assumptions including but not limited to changes in balance sheet mix, prepayment rates on mortgage-related assets and fixed rate loans, cash flows and repricings of all financial instruments, changes in volumes and pricing, future shapes of the yield curve, relationship of market interest rates to each other (basis risk), credit spread and deposit sensitivity. Assumptions are based on management's best estimates but may not accurately reflect actual results under certain changes in interest rates.

The ALCO monitors various liquidity ratios to ensure a satisfactory liquidity position for us. Management continually evaluates the condition of the economy, the pattern of market interest rates and other economic data to determine the types of investments that should be made and at what maturities. Using this analysis, management from time to time assumes calculated interest sensitivity gap positions to maximize net interest income based upon anticipated movements in the general level of interest rates. Regulatory authorities also monitor our gap position along with other liquidity ratios. In addition, as described above, we utilize a simulation model to determine the impact of net interest income under several different interest rate scenarios. By utilizing this technology, we can determine changes that need to be made to the asset and liability mixes to mitigate the change in net interest income under these various interest rate scenarios.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this item is set forth in Part IV.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), undertook an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act of 1934, as amended) as of December 31, 2012 and, based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of that date.

Changes in Internal Control Over Financial Reporting

No changes were made to our internal control over financial reporting (as defined in Rule 13a - 15(f) under the Exchange Act of 1934, as amended) during the last fiscal quarter of the period covered by this report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, is a process designed by, or under the supervision of, our CEO and CFO and effected by our board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of

Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control-Integrated Framework.

Based on this assessment, management concluded that we maintained effective internal control over financial reporting as of December 31, 2012.

The effectiveness of our internal control over financial reporting as of December 31, 2012 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which appears in this Item under the heading "Attestation Report of Independent Registered Public Accounting Firm."

Attestation Report of Independent Registered Public Accounting Firm

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders of
Southside Bancshares, Inc.

We have audited Southside Bancshares, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Southside Bancshares, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Southside Bancshares, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2012 consolidated financial statements of Southside Bancshares, Inc. and subsidiaries and our report dated March 6, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas
March 6, 2013

ITEM 9B. OTHER INFORMATION

None.

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# PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2013 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

## ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2013 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2013 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2013 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2013 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

1. Financial Statements

The following consolidated financial statements of Southside Bancshares, Inc. and its subsidiaries are filed as part of this report.

- Consolidated Balance Sheets as of December 31, 2012 and 2011.
- Consolidated Statements of Income for the years ended December 31, 2012, 2011 and 2010.
- Consolidated Statements of Comprehensive Income for the years ended December 31, 2012, 2011 and 2010.
- Consolidated Statements of Changes in Equity for the years ended December 31, 2012, 2011 and 2010.
- Consolidated Statements of Cash Flow for the years ended December 31, 2012, 2011 and 2010.
- Notes to Consolidated Financial Statements.

2. Financial Statement Schedules

All schedules are omitted because they are not applicable or not required, or because the required information is included in the consolidated financial statements or notes thereto.

3. Exhibits

The exhibits listed in the Exhibit Index (following the signature pages of this report) are filed with, or incorporated by reference in, this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

SOUTHSIDE BANCSHARES, INC.

BY: /s/ SAM DAWSON
Sam Dawson, Chief Executive Officer
(Principal Executive Officer)

DATE: March 6, 2013

BY: /s/ LEE R. GIBSON
Lee R. Gibson, CPA, Senior Executive Vice President
and Chief Financial Officer
(Principal Financial Officer)

DATE: March 6, 2013

BY: /s/ JULIE N. SHAMBURGER
Julie N. Shamburger, CPA, Executive Vice President
and Chief Accounting Officer
(Principal Accounting Officer)

DATE: March 6, 2013

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

| | Signature | Title | Date |
|---|---|---|---|
| /s/ | B. G. HARTLEY<br>(B. G. Hartley) | Chairman of the Board and Director | March 6, 2013 |
| /s/ | SAM DAWSON<br>(Sam Dawson) | Chief Executive Officer and Director | March 6, 2013 |
| | (Robbie N. Edmonson) | Vice Chairman of the Board and Director | March 6, 2013 |
| /s/ | LAWRENCE ANDERSON<br>(Lawrence Anderson) | Director | March 6, 2013 |
| /s/ | HERBERT C. BUIE<br>(Herbert C. Buie) | Director | March 6, 2013 |
| /s/ | ALTON CADE<br>(Alton Cade) | Director | March 6, 2013 |
| /s/ | PIERRE DE WET<br>(Pierre de Wet) | Director | March 6, 2013 |
| /s/ | BOB GARRETT<br>(Bob Garrett) | Director | March 6, 2013 |
| /s/ | MELVIN B. LOVELADY<br>(Melvin B. Lovelady) | Director | March 6, 2013 |
| /s/ | JOE NORTON<br>(Joe Norton) | Director | March 6, 2013 |
| /s/ | PAUL W. POWELL<br>(Paul W. Powell) | Director | March 6, 2013 |
| /s/ | WILLIAM SHEEHY<br>(William Sheehy) | Director | March 6, 2013 |
| /s/ | PRESTON SMITH<br>(Preston Smith) | Director | March 6, 2013 |
| /s/ | DON THEDFORD<br>(Don Thedford) | Director | March 6, 2013 |

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders of
Southside Bancshares, Inc.

We have audited the accompanying consolidated balance sheet of Southside Bancshares, Inc. and subsidiaries as of December 31, 2012, and the related consolidated statements of income and comprehensive income, changes in equity and cash flows for the year ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southside Bancshares, Inc. and subsidiaries at December 31, 2012, and the consolidated results of their operations and their cash flows for the year ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Southside Bancshares, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 6, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas
March 6, 2013

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Southside Bancshares, Inc:

In our opinion, the consolidated balance sheet as of December 31, 2011 and the related consolidated statements of income, of comprehensive income, of changes in equity, and of cash flows for each of two years in the period ended December 31, 2011 present fairly, in all material respects, the financial position of Southside Bancshares, Inc. and its subsidiaries at December 31, 2011, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Dallas, Texas
March 26, 2012

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $47,312 | $40,989 |
| Interest bearing deposits | 103,318 | 2,249 |
| Total cash and cash equivalents | 150,630 | 43,238 |
| Investment securities: | | |
| Available for sale, at estimated fair value | 617,707 | 282,956 |
| Held to maturity, at amortized cost | 1,009 | 1,496 |
| Mortgage-backed and related securities: | | |
| Available for sale, at estimated fair value | 806,360 | 716,126 |
| Securities carried at fair value through income | — | 647,759 |
| Held to maturity, at amortized cost | 245,538 | 365,631 |
| FHLB stock, at cost | 27,889 | 33,869 |
| Other investments, at cost | 2,064 | 2,064 |
| Loans held for sale | 3,601 | 3,552 |
| Loans: | | |
| Loans | 1,262,977 | 1,087,230 |
| Less: Allowance for loan losses | (20,585) | (18,540) |
| Net loans | 1,242,392 | 1,068,690 |
| Premises and equipment, net | 50,075 | 50,595 |
| Goodwill | 22,034 | 22,034 |
| Other intangible assets, net | 324 | 522 |
| Interest receivable | 18,936 | 19,426 |
| Deferred tax asset | 4,120 | — |
| Other assets | 44,724 | 45,859 |
| TOTAL ASSETS | $3,237,403 | $3,303,817 |
| LIABILITIES AND EQUITY | | |
| Deposits: | | |
| Noninterest bearing | $595,093 | $505,594 |
| Interest bearing | 1,756,804 | 1,816,077 |
| Total deposits | 2,351,897 | 2,321,671 |
| Short-term obligations: | | |
| Federal funds purchased and repurchase agreements | 984 | 2,945 |
| FHLB advances | 150,985 | 361,811 |
| Other obligations | 219 | 219 |
| Total short-term obligations | 152,188 | 364,975 |
| Long-term obligations: | | |
| FHLB advances | 369,097 | 260,724 |
| Long-term debt | 60,311 | 60,311 |
| Total long-term obligations | 429,408 | 321,035 |
| Deferred tax liability | — | 3,458 |
| Unsettled trades to purchase securities | 10,047 | 1,196 |

| | | |
|---|---|---|
| Other liabilities | 36,100 | 32,555 |
| TOTAL LIABILITIES | 2,979,640 | 3,044,890 |
| | | |
| Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 16) | | |
| | | |
| Shareholders' equity: | | |
| Common stock: ($1.25 par, 40,000,000 shares authorized, 19,446,187 shares issued in 2012 and 18,517,101 shares issued in 2011) | 24,308 | 23,146 |
| Paid-in capital | 195,602 | 176,791 |
| Retained earnings | 70,708 | 72,646 |
| Treasury stock (2,379,338 and 2,023,838 shares at cost ) | (35,793 ) | (28,377 ) |
| Accumulated other comprehensive income | 2,938 | 14,721 |
| TOTAL SHAREHOLDERS' EQUITY | 257,763 | 258,927 |
| TOTAL LIABILITIES AND EQUITY | $3,237,403 | $3,303,817 |

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

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Interest income | | | |
| Loans | $69,462 | $66,736 | $69,973 |
| Investment securities – taxable | 519 | 64 | 91 |
| Investment securities – tax-exempt | 13,644 | 12,520 | 10,889 |
| Mortgage-backed and related securities | 32,118 | 51,467 | 50,130 |
| FHLB stock and other investments | 240 | 233 | 259 |
| Other interest earning assets | 37 | 18 | 32 |
| Total interest income | 116,020 | 131,038 | 131,374 |
| Interest expense | | | |
| Deposits | 10,841 | 15,647 | 18,969 |
| Short-term obligations | 6,340 | 6,577 | 7,563 |
| Long-term obligations | 9,714 | 13,407 | 18,775 |
| Total interest expense | 26,895 | 35,631 | 45,307 |
| Net interest income | 89,125 | 95,407 | 86,067 |
| Provision for loan losses | 10,736 | 7,496 | 13,737 |
| Net interest income after provision for loan losses | 78,389 | 87,911 | 72,330 |
| Noninterest income | | | |
| Deposit services | 15,433 | 15,943 | 16,819 |
| Gain on sale of securities available for sale | 17,966 | 11,795 | 25,789 |
| (Loss) gain on sale of securities carried at fair value through income | (498) | 937 | — |
| Total other-than-temporary impairment losses | (21) | — | (39) |
| Portion of loss recognized in other comprehensive income (before taxes) | (160) | — | (36) |
| Net impairment losses recognized in earnings | (181) | — | (75) |
| Fair value gain (loss) – securities | — | 6,693 | (598) |
| FHLB advance option impairment charges | (2,031) | (8,923) | — |
| Gain on sale of loans | 1,119 | 1,230 | 1,751 |
| Trust income | 2,794 | 2,610 | 2,368 |
| Bank owned life insurance income | 1,110 | 1,087 | 1,155 |
| Other | 4,309 | 3,950 | 3,589 |
| Total noninterest income | 40,021 | 35,322 | 50,798 |
| Noninterest expense | | | |
| Salaries and employee benefits | 48,084 | 45,421 | 43,957 |
| Occupancy expense | 7,498 | 7,205 | 6,780 |
| Equipment expense | 2,169 | 2,055 | 1,899 |
| Advertising, travel & entertainment | 2,463 | 2,414 | 2,319 |
| ATM and debit card expense | 1,063 | 987 | 825 |
| Director fees | 1,213 | 914 | 950 |
| Supplies | 747 | 746 | 902 |
| Professional fees | 2,034 | 2,160 | 2,015 |
| Postage | 700 | 725 | 800 |

| | | | |
|---|---|---|---|
| Telephone and communications | 1,665 | 1,325 | 1,443 |
| FDIC insurance | 1,744 | 1,817 | 2,909 |
| Other | 6,727 | 6,579 | 6,515 |
| Total noninterest expense | 76,107 | 72,348 | 71,314 |
| Income before income tax expense | 42,303 | 50,885 | 51,814 |
| Provision (benefit) for income tax expense | | | |
| Current | 8,841 | 11,665 | 11,100 |
| Deferred | (1,233) | (1,271) | 656 |
| Total income taxes | 7,608 | 10,394 | 11,756 |
| Net income | 34,695 | 40,491 | 40,058 |
| Less: Net income attributable to the noncontrolling interest | — | (1,358) | (955) |
| Net income attributable to Southside Bancshares, Inc. | $34,695 | $39,133 | $39,103 |
| | | | |
| Earnings per common share – basic | $2.00 | $2.26 | $2.25 |
| Earnings per common share – diluted | $2.00 | $2.26 | $2.25 |
| Dividends paid per common share | $1.11 | $0.90 | $0.85 |

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

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

| | Years ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Net income | $34,695 | $40,491 | $40,058 |
| Other comprehensive (loss) income: | | | |
| Unrealized holding gains on available for sale securities during the period | 7,880 | 52,506 | 15,021 |
| Noncredit portion of other-than-temporary impairment losses on the AFS securities | 160 | — | 36 |
| Reclassification adjustment for gain on sale of available for sale securities included in net income | (17,966) | (11,795) | (25,789) |
| Reclassification of other-than-temporary impairment charges on available for sale securities included in net income | 181 | — | 75 |
| Amortization of net actuarial loss, included in net periodic benefit cost | 2,022 | 1,466 | 1,296 |
| Amortization of prior service credit included in net periodic benefit cost | (43) | (44) | (44) |
| Change in the net actuarial gain/loss | (10,362) | (9,804) | (6,783) |
| Other comprehensive (loss) income | (18,128) | 32,329 | (16,188) |
| Income tax benefit (expense) related to other items of comprehensive income | 6,345 | (11,315) | 5,666 |
| Other comprehensive (loss) income, net of tax | (11,783) | 21,014 | (10,522) |
| Comprehensive income | $22,912 | $61,505 | $29,536 |

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(in thousands, except share amounts)

| | Common Stock | Paid In Capital | Retained Earnings | Treasury Stock | Accu-mulated-Other Compre-hensive Income (Loss) | Noncon-trolling Interest | Total Equity |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2009 | $20,928 | $146,357 | $53,812 | $(23,545) | $4,229 | $468 | $202,249 |
| Net Income | | | 39,103 | | | 955 | 40,058 |
| Other comprehensive loss | | | | | (10,522) | | (10,522) |
| Issuance of common stock (163,313 shares) | 204 | 1,619 | | | | | 1,823 |
| Purchase of common stock (261,577 shares) | | | | (4,832) | | | (4,832) |
| Tax benefit of incentive stock options | | 331 | | | | | 331 |
| Capital distribution to noncontrolling interest shareholders | | | | | | (310) | (310) |
| Cash dividends paid on common stock ($0.85 per share) | | | (13,223) | | | | (13,223) |
| Stock dividend declared | 943 | 14,570 | (15,513) | | | | — |
| Balance at December 31, 2010 | 22,075 | 162,877 | 64,179 | (28,377) | (6,293) | 1,113 | 215,574 |
| Net Income | | | 39,133 | | | 1,358 | 40,491 |
| Other comprehensive income | | | | | 21,014 | | 21,014 |
| Issuance of common stock (71,925 shares) | 90 | 1,391 | | | | | 1,481 |
| Stock compensation expense | | 261 | | | | | 261 |
| Tax benefit of incentive stock options | | 2 | | | | | 2 |
| Capital distribution to noncontrolling interest shareholders | | | | | | (475) | (475) |
| Purchase of noncontrolling interest | | (2,754) | | | | (1,996) | (4,750) |
| Cash dividends paid on common stock ($0.90 per share) | | | (14,671) | | | | (14,671) |
| Stock dividend declared | 981 | 15,014 | (15,995) | | | | — |
| Balance at December 31, 2011 | 23,146 | 176,791 | 72,646 | (28,377) | 14,721 | — | 258,927 |
| Net Income | | | 34,695 | | | | 34,695 |
| Other comprehensive loss | | | | | (11,783) | | (11,783) |
| Issuance of common stock (94,134 shares) | 118 | 1,756 | | | | | 1,874 |
| Purchase of common stock (355,500 shares) | | | | (7,416) | | | (7,416) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Stock compensation expense | | 511 | | | | | 511 |
| Tax benefits related to stock awards | | 44 | | | | | 44 |
| Net issuance of common stock under employee stock plan | 10 | 75 | (90 ) | | | | (5 ) |
| Cash dividends paid on common stock ($1.11 per share) | | | (19,084 ) | | | | (19,084 ) |
| Stock dividend declared | 1,034 | 16,425 | (17,459 ) | | | | — |
| Balance at December 31, 2012 | $24,308 | $195,602 | $70,708 | $(35,793 ) | $2,938 | $— | $257,763 |

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

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| OPERATING ACTIVITIES: | | | |
| Net income | $34,695 | $40,491 | $40,058 |
| Adjustments to reconcile net income to net cash provided by operations: | | | |
| Depreciation | 3,606 | 3,365 | 3,204 |
| Amortization of premium | 45,926 | 37,117 | 35,245 |
| Accretion of discount and loan fees | (4,746) | (4,336) | (4,502) |
| Provision for loan losses | 10,736 | 7,496 | 13,737 |
| Stock compensation expense | 511 | 261 | — |
| Deferred tax (benefit) expense | (1,233) | (1,254) | 673 |
| Excess tax benefits from stock-based awards | (11) | — | — |
| Loss (gain) on sale of securities carried at fair value through income | 498 | (937) | — |
| Gain on sale of securities available for sale | (17,966) | (11,795) | (25,789) |
| Net other-than-temporary impairment losses | 181 | — | 75 |
| Fair value (gain) loss – securities | — | (6,693) | 598 |
| FHLB advance option impairment charges | 2,031 | 8,923 | — |
| Gain on sale of assets | (1) | (4) | (7) |
| Loss on retirement of assets | — | 90 | — |
| Impairment on other real estate owned | 28 | 264 | 20 |
| (Gain) loss on sale of other real estate owned | (19) | (298) | 153 |
| Net change in: | | | |
| Interest receivable | 490 | (1,393) | 449 |
| Other assets | (271) | (2,254) | (8,289) |
| Interest payable | (886) | (888) | (879) |
| Other liabilities | (3,952) | 2,396 | 1,566 |
| Loans held for sale | (49) | 3,031 | (3,726) |
| Net cash provided by operating activities | 69,568 | 73,582 | 52,586 |
| | | | |
| INVESTING ACTIVITIES: | | | |
| Securities held to maturity: | | | |
| Purchases | — | (11,875) | (258,935) |
| Maturities, calls and principal repayments | 113,086 | 46,396 | 74,915 |
| Securities available for sale: | | | |
| Purchases | (1,807,157) | (629,911) | (1,399,085) |
| Sales | 1,004,315 | 582,362 | 1,325,221 |
| Maturities, calls and principal repayments | 362,887 | 268,514 | 357,164 |
| Securities carried at fair value through income: | | | |
| Purchases | (57,606) | (868,937) | (32,689) |
| Sales | 675,255 | 234,403 | — |
| Maturities, calls and principal repayments | 25,279 | 56,406 | 3,462 |
| Proceeds from redemption of FHLB stock | 18,572 | 18,236 | 6,818 |
| Purchases of FHLB stock and other investments | (12,592) | (17,393) | (2,900) |
| Net increase in loans | (186,814) | (21,898) | (58,985) |
| Purchases of premises and equipment | (3,109) | (3,915) | (6,902) |
| Proceeds from sales of premises and equipment | 24 | 13 | 38 |

| | | | |
|---|---|---|---|
| Proceeds from sales of other real estate owned | 567 | 1,431 | 1,648 |
| Proceeds from sales of repossessed assets | 4,453 | 4,820 | 4,949 |
| Net cash provided by (used in) investing activities | 137,160 | (341,348) | 14,719 |

(continued)

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| FINANCING ACTIVITIES: | | | |
| Net increase in demand and savings accounts | 267,513 | 150,439 | 190,323 |
| Net (decrease) increase in certificates of deposit | (237,848) | 40,842 | 87,268 |
| Net decrease in federal funds purchased and repurchase agreements | (1,961) | (899) | (9,481) |
| Proceeds from FHLB advances | 16,010,884 | 13,270,293 | 8,949,688 |
| Repayment of FHLB advances | (16,113,337) | (13,210,331) | (9,241,985) |
| Net capital distributions to noncontrolling interest in consolidated entities | — | (475) | (310) |
| Purchase of noncontrolling interest | — | (4,750) | — |
| Excess tax benefits from stock-based awards | 11 | — | — |
| Tax benefit of incentive stock options | 33 | 2 | 331 |
| Net issuance of common stock under employee stock plan | (5) | — | — |
| Purchase of common stock | (7,416) | — | (4,832) |
| Proceeds from the issuance of common stock | 1,874 | 1,481 | 1,823 |
| Cash dividends paid | (19,084) | (14,671) | (13,223) |
| Net cash (used in) provided by financing activities | (99,336) | 231,931 | (40,398) |
| | | | |
| Net increase (decrease) in cash and cash equivalents | 107,392 | (35,835) | 26,907 |
| Cash and cash equivalents at beginning of year | 43,238 | 79,073 | 52,166 |
| Cash and cash equivalents at end of year | $150,630 | $43,238 | $79,073 |
| | | | |
| SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION: | | | |
| Interest paid | $27,781 | $36,519 | $46,186 |
| Income taxes paid | $11,200 | $9,000 | $10,650 |
| | | | |
| SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | | |
| Loans transferred to other repossessed assets and real estate through foreclosure | $5,659 | $6,232 | $6,990 |
| Adjustment to pension liability | $8,383 | $8,382 | $5,531 |
| 5% stock dividend | $17,459 | $15,995 | $15,513 |
| Unsettled trades to purchase securities | $(10,047) | $(1,196) | $(145) |
| Unsettled issuances of brokered CDs | $— | $— | $4,960 |

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

The significant accounting and reporting policies of Southside Bancshares, Inc. (the "Company"), and its wholly-owned subsidiaries, Southside Delaware Financial Corporation, Southside Bank (“Southside Bank”), and our nonbank subsidiaries, are summarized below.

Organization and Basis of Presentation. The consolidated financial statements include the accounts of Southside Bancshares, Inc., Southside Bank, SFG Finance, LLC (formerly Southside Financial Group) and the nonbank subsidiaries. On July 15, 2011, Southside Bank acquired the remaining 50% interest in SFG increasing our ownership to 100%. The purchase price was $4.8 million and resulted in a decrease to shareholders’ equity of approximately $2.8 million and the elimination of the noncontrolling interest. SFG is consolidated in our financial statements and this purchase will not limit or change our ability to allocate capital. In addition, during the second quarter of 2011 Southside Securities, Inc., which is a wholly-owned subsidiary of Southside Bancshares, Inc., began doing business as a broker-dealer. Effective February 14, 2012, Southside Bank became a direct wholly-owned subsidiary of Southside Bancshares, Inc. as a result of the merger of Southside Delaware Financial Corporation with and into Southside Bancshares, Inc.

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

We offer a full range of financial services to commercial, industrial, financial and individual customers. All significant intercompany accounts and transactions are eliminated in consolidation. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires the use of management’s estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

We determine if we have a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity (“VIE”) under accounting principles generally accepted in the United States. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity’s activities. We consolidate voting interest entities in which we have all, or at least a majority of, the voting interest. As defined in applicable accounting standards, VIEs are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE is present when an enterprise has both the power to direct the activities of the VIE that most significantly impact the VIEs economic performance and an obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE.

Cash Equivalents. Cash equivalents, for purposes of reporting cash flow, include cash, amounts due from banks and federal funds sold that have an initial maturity of less than 90 days. We maintain deposits with other institutions in amounts that exceed federal deposit insurance coverage. Management regularly evaluates the credit risk associated with the counterparties to these transactions and believes that we are not exposed to any significant credit risks on cash and cash equivalents.

We are no longer required to maintain cash reserve balances with the Federal Reserve Bank. The required reserve balance with the Federal Reserve Bank was $250,000 as of December 31, 2011.

Basic and Diluted Earnings per Common Share. Basic earnings per common share is based on net income divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of stock options granted using the treasury stock method. A reconciliation of the weighted-average shares used in calculating basic earnings per common share and the weighted average common shares used in calculating diluted earnings per common share for the reported periods is provided in "Note 2 – Earnings Per Share."

Comprehensive Income. Comprehensive income includes all changes in shareholders' equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of comprehensive income include the after tax effect of changes in the fair value of securities available for sale, changes in the funded status of defined benefit retirement plans and the noncredit portion of other-than-temporary impairment. Comprehensive income is reported in the accompanying consolidated statements of changes in shareholders' equity and in "Note 3 – Comprehensive Income (Loss)."

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Loans. All loans are stated at principal outstanding net of unearned discount and other deferred expenses or fees. Interest income on loans is recognized using the level yield method. Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. A loan is considered impaired, based on current information and events, if it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Substantially all of our impaired loans are collateral-dependent, and as such, are measured for impairment based on the fair value of the collateral.

Loans Held For Sale. Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

Loan Fees. We treat loan fees, net of direct costs, as an adjustment to the yield of the related loan over its term.

Allowance for Loan Losses. An allowance for loan losses is provided through charges to income in the form of a provision for loan losses. Loans which management believes are uncollectible are charged against this account with subsequent recoveries, if any, credited to the account. The amount of the allowance for loan losses is determined by management's evaluation of the quality and inherent risks in the loan portfolio, economic conditions and other factors which warrant current recognition.

Nonaccrual Loans. A loan is placed on nonaccrual when principal or interest is contractually past due 90 days or more unless, in the determination of management, the principal and interest on the loan are well collateralized and in the process of collection. In addition, a loan is placed on nonaccrual when, in the opinion of management, the future collectability of interest and principal is in serious doubt. When classified as nonaccrual, accrued interest receivable on the loan is reversed and the future accrual of interest is suspended. Payments of contractual interest are recognized as income only to the extent that full recovery of the principal balance of the loan is reasonably certain.

Other Real Estate Owned. Other Real Estate Owned (“OREO”) includes real estate acquired in full or partial settlement of loan obligations. OREO is initially carried at the fair value of the collateral net of estimated selling costs. Prior to foreclosure, the recorded amount of the loan is written down, if necessary, to the appraised fair value of the real estate to be acquired, less selling costs, by charging the allowance for loan losses. Any subsequent reduction in fair value net of estimated selling costs is charged to noninterest expense. Costs of maintaining and operating foreclosed properties are expensed as incurred and included in other expense in our income statement. Expenditures to complete or improve foreclosed properties are capitalized only if expected to be recovered; otherwise, they are expensed.

Securities. We use the specific identification method to determine the basis for computing realized gain or loss. We account for debt and equity securities as follows:

Held to Maturity (“HTM”). Debt securities that management has the positive intent and ability to hold until maturity are classified as HTM and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the level interest yield method over the estimated remaining term of the underlying security.

Available for Sale (“AFS”). Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as AFS. These assets are carried at

fair value. Fair value is determined using published quotes as of the close of business. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services.

Securities Carried at Fair Value through Income. Debt securities purchased at significant premiums that contain an embedded derivative where the embedded derivative is not readily identifiable and measurable and as such cannot be bifurcated, are classified as securities carried at fair value through income. Fair value is determined using quoted market prices. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services. Changes in fair value are reported through the income statement as fair value gain (loss) – securities.

Unrealized gains and losses on AFS securities are excluded from earnings and reported net of tax in Accumulated Other Comprehensive Income until realized. Declines in the fair value of securities below their cost are reflected in earnings as realized losses to the extent the impairment is deemed to be other-than-temporary credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income unless there is no ability or intent to hold to recovery.



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Purchase premiums and discounts are recognized in interest income using the effective interest rate method over the terms of the securities. Declines in the fair value of HTM and AFS securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Securities with limited marketability, such as stock in the Federal Home Loan Bank ("FHLB"), are carried at cost and assessed for other-than-temporary impairment.

Premises and Equipment. Bank premises and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed on a straight line basis over the estimated useful lives of the related assets. Useful lives are estimated to be 15 to 40 years for premises and 3 to 10 years for equipment. Leasehold improvements are generally depreciated over the lesser of the term of the respective leases or the estimated useful lives of the improvements. Maintenance and repairs are charged to income as incurred while major improvements and replacements are capitalized.

Goodwill and Other Intangibles. Intangible assets consist primarily of core deposits and customer relationships. Intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life. Goodwill and intangible assets that have indefinite useful lives are subject to at least an annual impairment test and more frequently if a triggering event occurs. If any such impairment is determined, a write-down is recorded.

We measured our goodwill for impairment at December 31, 2012. At December 31, 2012, the fair value of the reporting unit was greater than the carrying value of the reporting unit. As a result, we did not record any goodwill impairment for the year ended December 31, 2012 and we had no cumulative goodwill impairment.

For the years ended December 31, 2012, 2011 and 2010, amortization expense related to our core deposit intangible was $198,000, $255,000 and $319,000, respectively.

Repurchase Agreements. We sell certain securities under agreements to repurchase. The agreements are treated as collateralized financing transactions and the obligations to repurchase securities sold are reflected as a liability in the accompanying consolidated balance sheets. The dollar amount of the securities underlying the agreements remains in the asset account. We determine the type of securities to pledge. Generally we pledge U.S. agency mortgage-backed securities.

Advertising Costs. Advertising costs are expensed as incurred.

Income Taxes. We file a consolidated federal income tax return. Income tax expense represents the taxes expected to be paid or returned for current year taxes adjusted for the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of changes in tax rates is recognized in income in the period the change occurs.

Use of Estimates. In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the

balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, assumptions used in the defined benefit plan and the fair values of financial instruments. The status of contingencies are particularly subject to change and significant assumptions used in periodic evaluation of securities for other-than-temporary impairment.

FHLB Advance Option Fees. Option fees paid to the FHLB giving us the option to enter into long-term advance commitments at specified interest rates in the future are capitalized and reviewed for impairment. Once the option is exercised, the FHLB advance option fee is amortized over the term of the advance as interest expense.

Fair Value of Financial Instruments. Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment. In cases where quoted market prices are not available, fair values are based on estimates using present value or other estimation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.



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Fair Value Option. We elect the fair value option for mortgage-backed securities purchased at a significant premium.

Share Based Awards. Share-based compensation transactions are recognized as compensation cost in the income statement based on their fair values on the date of the grant.

Loss Contingencies. Loss contingencies, including claims and legal actions arising in the ordinary course of business are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Trust Assets. Assets of our trust department, other than cash on deposit at Southside Bank, are not included in the accompanying financial statements because they are not our assets.

Segment Information. We have determined that our business is conducted in one reportable segment.

Accounting Pronouncements:

ASU No. 2011-03, "Transfers and Servicing (Topic 860) – Reconsideration of Effective Control for Repurchase Agreements." ASU 2011-03 is intended to improve financial reporting of repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. We adopted ASU 2011-03 on January 1, 2012 and it did not have a significant impact on our consolidated financial statements.

ASU 2011-04, "Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." ASU 2011-04 amends Topic 820, "Fair Value Measurements and Disclosures," to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. We adopted ASU 2011-04 on January 1, 2012 and it did not have a significant impact on our consolidated financial statements. See "Note 12 - Fair Value Measurement."

ASU 2011-05, "Comprehensive Income (Topic 220) – Presentation of Comprehensive Income." ASU 2011-05 amends Topic 220, "Comprehensive Income," to require that all nonowner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Certain provisions related to the presentation of reclassification adjustments have been deferred by ASU 2011-12 "Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." We adopted ASU 2011-05 on January 1, 2012 and it did not have a significant impact on our consolidated financial statements. See "Consolidated Statements of Comprehensive Income" directly following our Consolidated Statements of Income in our consolidated financial statements.

ASU 2011-08, "Intangibles - Goodwill and Other (Topic 350) – Testing Goodwill for Impairment." ASU 2011-08 amends Topic 350, "Intangibles – Goodwill and Other," to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. We adopted ASU 2011-08 on January 1, 2012, and it did not have a significant impact on our consolidated financial statements.

ASU 2011-11, "Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities." ASU 2011-11 amends Topic 210, "Balance Sheet," to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. We adopted ASU 2011-11 on January 1, 2013, and it is

not expected to have a significant impact on our consolidated financial statements.

ASU 2012-02, “Intangibles-Goodwill and Other (Topic 320) – Testing Indefinite-Lived Intangible Assets for Impairment No. 2012-02." ASU 2012-02 allows an entity to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. Under these amendments, an entity would not be required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on qualitative assessment, that it is not more likely than not, the indefinite-lived intangible asset is impaired. We adopted ASU 2012-02 September 15, 2012 and it did not have a significant impact on our consolidated financial statements.

ASU 2013-02, “Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” ASU 2013-02 requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component. We adopted ASU 2013-02 on January 1, 2013, and it is not expected to have a significant impact on our consolidated financial statements.



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2. EARNINGS PER SHARE

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Basic and Diluted Earnings: | | | |
| Net Income – Southside Bancshares, Inc. | $34,695 | $39,133 | $39,103 |
| Basic weighted-average shares outstanding: | 17,325 | 17,272 | 17,350 |
| Add: Stock options | 12 | 8 | 29 |
| Diluted weighted-average shares outstanding | 17,337 | 17,280 | 17,379 |
| Basic Earnings Per Share: | | | |
| Net Income – Southside Bancshares, Inc. | $2.00 | $2.26 | $2.25 |
| Diluted Earnings Per Share: | | | |
| Net Income – Southside Bancshares, Inc. | $2.00 | $2.26 | $2.25 |

During the third quarter of 2012, our board of directors approved equity grants in the form of stock options and restricted stock units. These equity grants were made pursuant to the shareholder-approved Southside Bancshares, Inc. 2009 Incentive Plan.

For both the years ended December 31, 2012 and 2011, there were approximately 12,000 anti-dilutive options. For the year ended December 31, 2010 there were no antidilutive options.

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3. COMPREHENSIVE INCOME (LOSS)

The components of other comprehensive (loss) income are as follows (in thousands):

| | Year Ended December 31, 2012 | | |
|---|---|---|---|
| | Before-Tax Amount | Tax (Expense) Benefit | Net-of-Tax Amount |
| Unrealized losses on securities: | | | |
| Unrealized holding gains arising during period | $7,880 | $(2,758) | $5,122 |
| Noncredit portion of other-than-temporary impairment losses on the AFS securities | 160 | (56) | 104 |
| Less: reclassification adjustment for gain on sale of AFS securities included in net income | 17,966 | (6,288) | 11,678 |
| Less: reclassification of other-than-temporary impairment charges of AFS securities included in net income | (181) | 63 | (118) |
| Net unrealized losses on securities | (9,745) | 3,411 | (6,334) |
| Change in pension plans | (8,383) | 2,934 | (5,449) |
| Other comprehensive loss | $(18,128) | $6,345 | $(11,783) |

| | Year ended December 31, 2011 | | |
|---|---|---|---|
| | Before-Tax Amount | Tax (Expense) Benefit | Net-of-Tax Amount |
| Unrealized gains on securities: | | | |
| Unrealized holding gains arising during period | $52,506 | $(18,377) | $34,129 |
| Less: reclassification adjustment for gain on sale of AFS securities included in net income | 11,795 | (4,128) | 7,667 |
| Net unrealized gains on securities | 40,711 | (14,249) | 26,462 |
| Change in pension plans | (8,382) | 2,934 | (5,448) |
| Other comprehensive income | $32,329 | $(11,315) | $21,014 |

| | Year ended December 31, 2010 | | |
|---|---|---|---|
| | Before-Tax Amount | Tax (Expense) Benefit | Net-of-Tax Amount |
| Unrealized losses on securities: | | | |
| Unrealized holding gains arising during period | $15,021 | $(5,257) | $9,764 |
| Noncredit portion of other-than-temporary impairment losses on the AFS securities | 36 | (13) | 23 |
| Less: reclassification adjustment for gain on sale of AFS securities included in net income | 25,789 | (9,026) | 16,763 |
| Less: reclassification of other-than-temporary impairment charges on AFS securities included in net income | (75) | 26 | (49) |
| Net unrealized losses on securities | (10,657) | 3,730 | (6,927) |
| Change in pension plans | (5,531) | 1,936 | (3,595) |
| Other comprehensive loss | $(16,188) | $5,666 | $(10,522) |

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The components of accumulated other comprehensive income, net of tax, as of December 31, 2012 and 2011, are reflected in the table below (in thousands):

| | Years Ended December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Unrealized gains on AFS securities | $29,360 | $35,694 |
| Net unfunded liability for defined benefit plans | (26,422) | (20,973) |
| Total | $2,938 | $14,721 |

4. SECURITIES

The amortized cost and estimated fair value of investment and mortgage-backed securities as of December 31, 2012 and 2011, are reflected in the tables below (in thousands):

| | December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Amortized | Gross Unrealized | Gross Unrealized Losses | | Estimated |
| AVAILABLE FOR SALE: | Cost | Gains | OTTI | Other | Fair Value |
| Investment Securities: | | | | | |
| U.S. Government Agency Debentures | $61,461 | $— | $— | $598 | $60,863 |
| State and Political Subdivisions | 515,116 | 30,888 | — | 316 | 545,688 |
| Other Stocks and Bonds | 12,807 | 104 | 1,754 | 1 | 11,156 |
| Mortgage-backed Securities: | | | | | |
| U.S. Government Agencies | 86,182 | 3,636 | — | 15 | 89,803 |
| Government-Sponsored Enterprises | 703,174 | 14,367 | — | 984 | 716,557 |
| Total | $1,378,740 | $48,995 | $1,754 | $1,914 | $1,424,067 |

| | December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Amortized | Gross Unrealized | Gross Unrealized Losses | | Estimated |
| HELD TO MATURITY: | Cost | Gains | OTTI | Other | Fair Value |
| Investment Securities: | | | | | |
| State and Political Subdivisions | $1,009 | $128 | $— | $— | $1,137 |
| Mortgage-backed Securities: | | | | | |
| U.S. Government Agencies | 20,135 | 1,191 | — | 47 | 21,279 |
| Government-Sponsored Enterprises | 225,403 | 7,579 | — | — | 232,982 |
| Total | $246,547 | $8,898 | $— | $47 | $255,398 |

| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Amortized | Gross Unrealized | Gross Unrealized Losses | | Estimated |
| AVAILABLE FOR SALE: | Cost | Gains | OTTI | Other | Fair Value |
| Investment Securities: | | | | | |
| State and Political Subdivisions | $251,281 | $31,221 | $— | $45 | $282,457 |
| Other Stocks and Bonds | 2,925 | — | 2,426 | — | 499 |
| Mortgage-backed Securities: | | | | | |
| U.S. Government Agencies | 99,974 | 7,158 | — | 80 | 107,052 |
| Government-Sponsored Enterprises | 589,687 | 20,127 | — | 740 | 609,074 |

| | | | | | |
|---|---|---|---|---|---|
| Total | $943,867 | $58,506 | $2,426 | $865 | $999,082 |

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| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Amortized | Gross Unrealized | Gross Unrealized Losses | | Estimated |
| HELD TO MATURITY: | Cost | Gains | OTTI | Other | Fair Value |
| Investment Securities: | | | | | |
| State and Political Subdivisions | $1,010 | $196 | $— | $— | $1,206 |
| Other Stocks and Bonds | 486 | 15 | — | — | 501 |
| Mortgage-backed Securities: | | | | | |
| U.S. Government Agencies | 22,999 | 1,159 | — | 43 | 24,115 |
| Government-Sponsored Enterprises | 342,632 | 14,848 | — | 11 | 357,469 |
| Total | $367,127 | $16,218 | $— | $54 | $383,291 |

Year-end securities carried at fair value through income were as follows (in thousands):

| | At December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Mortgage-backed Securities: | | | |
| U.S. Government Agencies | $— | $30,413 | $5,392 |
| Government-Sponsored Enterprises | — | 617,346 | 66,784 |
| Total | $— | $647,759 | $72,176 |

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Net gain on sales transactions | $(498) | $937 | $— |
| Net mark-to-market gains (losses) | — | 6,693 | (598) |
| Net gain on securities carried at fair value through income | $(498) | $7,630 | $(598) |

The following table represents the unrealized loss on securities for the years ended December 31, 2012 and 2011 (in thousands):

| | Less Than 12 Months | | More Than 12 Months | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| As of December 31, 2012: | | | | | | |
| Available for Sale | | | | | | |
| U.S. Government Agency Debentures | $60,863 | $598 | $— | $— | $60,863 | $598 |
| State and Political Subdivisions | 49,548 | 316 | — | — | 49,548 | 316 |
| Other Stocks and Bonds | 4,856 | 1 | 990 | 1,754 | 5,846 | 1,755 |
| Mortgage-backed Securities | 260,909 | 967 | 3,122 | 32 | 264,031 | 999 |
| Total | $376,176 | $1,882 | $4,112 | $1,786 | $380,288 | $3,668 |
| Held to Maturity | | | | | | |
| Mortgage-backed Securities | $3,251 | $47 | $— | $— | $3,251 | $47 |
| Total | $3,251 | $47 | $— | $— | $3,251 | $47 |
| As of December 31, 2011: | | | | | | |
| Available for Sale | | | | | | |
| State and Political Subdivisions | $1,668 | $42 | $307 | $3 | $1,975 | $45 |
| Other Stocks and Bonds | — | — | 499 | 2,426 | 499 | 2,426 |
| Mortgage-backed Securities | 148,171 | 754 | 5,322 | 66 | 153,493 | 820 |
| Total | $149,839 | $796 | $6,128 | $2,495 | $155,967 | $3,291 |
| Held to Maturity | | | | | | |
| Mortgage-backed Securities | $8,918 | $54 | $— | $— | $8,918 | $54 |
| Total | $8,918 | $54 | $— | $— | $8,918 | $54 |

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

The turmoil in the capital markets had a significant impact on our estimate of fair value for certain of our securities. We believe the fair values are reflective of illiquidity and credit impairment. At December 31, 2012, we have in AFS Other Stocks and Bonds, $2.7 million amortized cost basis in pooled trust preferred securities ("TRUPs"). Those securities are structured products with cash flows dependent upon securities issued by U.S. financial institutions, including banks and insurance companies. Our estimate of fair value at December 31, 2012 for the TRUPs is approximately $990,000 and reflects the market illiquidity. With the exception of the TRUPs, to the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment and mortgage-backed securities portfolio at December 31, 2012 with an other-than-temporary impairment.

Given the facts and circumstances associated with the TRUPs we performed detailed cash flow modeling for each TRUP using an industry-accepted cash flow model. Prior to loading the required assumptions into the model we reviewed the financial condition of each of the underlying issuing banks within the TRUP collateral pool that had not deferred or defaulted as of December 31, 2012. Management's best estimate of a deferral assumption was assigned to each issuing bank based on the category in which it fell. Our analysis of the underlying cash flows contemplated various default, deferral and recovery scenarios to arrive at our best estimate of cash flows. Based on that detailed analysis, we have concluded that the other-than-temporary impairment, which captures the credit component, was estimated at $3.3 million and $3.1 million at December 31, 2012 and 2011, respectively. The noncredit charge to other comprehensive income was estimated at $1.8 million at December 31, 2012 and $2.4 million at December 31, 2011. The carrying amount of the TRUPs was written down with $181,000 recognized in earnings for the year ended December 31, 2012. There was no write-down recognized in earnings during 2011and $75,000 of write-down was recognized in earnings during 2010. The cash flow model assumptions represent management's best estimate and consider a variety of qualitative factors, which include, among others, the credit rating downgrades, the severity and duration of the mark-to-market loss, and the structural nuances of each TRUP. Management believes that the detailed review of the collateral and cash flow modeling support the conclusion that the TRUPs had an other-than-temporary impairment at December 31, 2012. We will continue to update our assumptions and the resulting analysis each reporting period to reflect changing market conditions. Additionally, we do not currently intend to sell the TRUPs and it is not more likely than not that we will be required to sell the TRUPs before the anticipated recovery of their amortized cost basis.

The table below provides more detail on the TRUPs at December 31, 2012 (in thousands):

| TRUP | Par | Credit Loss | Amortized Cost | Fair Value | Tranche | Credit Rating |
|---|---|---|---|---|---|---|
| 1 | $2,000 | $1,256 | $744 | $134 | C1 | Ca |
| 2 | 2,000 | 550 | 1,450 | 474 | B1 | C |
| 3 | 2,000 | 1,450 | 550 | 382 | B2 | C |
| | $6,000 | $3,256 | $2,744 | $990 | | |

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Balance, beginning of period | $3,075 | $3,075 | $3,000 |
| Additions for credit losses recognized on debt securities that had no previous impairment losses | — | — | — |
| Additions for credit losses recognized on debt securities that had previously incurred impairment losses | 181 | — | 75 |
| Balance, end of period | $3,256 | $3,075 | $3,075 |

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| U.S. Treasury | $— | $2 | $8 |
| U.S. Government Agency Debentures | 372 | — | — |
| State and Political Subdivisions | 13,697 | 12,548 | 10,926 |
| Other Stocks and Bonds | 94 | 34 | 46 |
| Mortgage-backed Securities | 32,118 | 51,467 | 50,130 |
| Total interest income on securities | $46,281 | $64,051 | $61,110 |

There were no securities transferred from AFS to HTM during 2012 and 2011. There were no sales from the HTM portfolio during the years ended December 31, 2012, 2011 or 2010. There were $246.5 million and $367.1 million of securities classified as HTM at December 31, 2012 and 2011, respectively.

Of the $18.0 million in net securities gains from the AFS portfolio for the year ended December 31, 2012, there were $18.5 million in realized gains and approximately $572,000 in realized losses. Of the $11.8 million in net securities gains from the AFS portfolio for the year ended December 31, 2011, there were $11.9 million in realized gains and $121,000 in realized losses. Of the $25.8 million in net securities gains from the AFS portfolio for the year ended December 31, 2010, there were $28.3 million in realized gains and $2.5 million in realized losses.

The amortized cost and fair value of securities at December 31, 2012, are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are presented in total by category due to the fact that mortgage-backed securities typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

| | December 31, 2012 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Available for sale securities: | (in thousands) | |
| Investment Securities | | |
| Due in one year or less | $4,459 | $4,473 |
| Due after one year through five years | 21,780 | 22,128 |
| Due after five years through ten years | 148,750 | 152,422 |
| Due after ten years | 414,395 | 438,684 |
| | 589,384 | 617,707 |
| Mortgage-backed securities | 789,356 | 806,360 |
| Total | $1,378,740 | $1,424,067 |

| | December 31, 2012 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Held to maturity securities: | (in thousands) | |
| Investment Securities | | |
| Due in one year or less | $— | $— |
| Due after one year through five years | — | — |
| Due after five years through ten years | — | — |
| Due after ten years | 1,009 | 1,137 |
| | 1,009 | 1,137 |
| Mortgage-backed securities | 245,538 | 254,261 |
| Total | $246,547 | $255,398 |

Investment and mortgage-backed securities with book values of $945.7 million and $1.04 billion were pledged as of December 31, 2012 and 2011, respectively, to collateralize FHLB advances, repurchase agreements, public funds and trust deposits or for other purposes as required by law.

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

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5. LOANS AND ALLOWANCE FOR PROBABLE LOAN LOSSES

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

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | (in thousands) | |
| Real Estate Loans: | | |
| Construction | $113,744 | $111,361 |
| 1-4 Family residential | 368,845 | 247,479 |
| Other | 236,760 | 206,519 |
| Commercial loans | 160,058 | 143,552 |
| Municipal loans | 220,947 | 207,261 |
| Loans to individuals | 162,623 | 171,058 |
| Total loans | 1,262,977 | 1,087,230 |
| Less: Allowance for loan losses | 20,585 | 18,540 |
| Net loans | $1,242,392 | $1,068,690 |

Loans to Affiliated Parties

In the normal course of business, we make loans to certain of our own executive officers and directors and their related interests. As of December 31, 2012 and 2011, these loans totaled $4.3 million and $4.1 million, respectively. These loans represented 1.7% and 1.6% of shareholders' equity as of December 31, 2012 and 2011, respectively. Such loans are made in the normal course of business at normal credit terms, including interest rate and collateral requirements and do not represent more than normal credit risks contained in the rest of the loan portfolio for loans of similar types.

Allowance for Loan Losses

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

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

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

Industry and our own experience indicates that a portion of our loans will become delinquent and a portion of the loans will require partial or full charge-off. Regardless of the underwriting criteria utilized, losses may be experienced as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit of the borrower and the ability of the borrower to make payments on the loan. Our determination of the appropriateness of the allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which would have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, the views of the bank regulators (who have the authority to require additional allowances in accordance with GAAP), and geographic and industry loan concentration.

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

New pools purchased are reserved at their estimated annual loss. Thereafter, the reserve is adjusted based on the actual performance versus projected performance. Additionally, we use data mining measures to track migration within risk tranches. Reserves are adjusted quarterly to match the migration metrics.

Credit Quality Indicators

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

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

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

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

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

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

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

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- Loss (Rating 9) – Loans classified as Loss are currently in the process of being charged off and are fully reserved. They are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

Loans not meeting risk ratings five through nine are reserved for as a group of similar type pass rated credits and included in the general portion of the allowance for loan losses.

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

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

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

| | Year Ended December 31, 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Real Estate | | | | | | | |
| | Construction | 1-4 Family Residential | Other | Commercial Loans | Municipal Loans | Loans to Individuals | Unallocated | Total |
| Balance at beginning of period | $2,620 | $1,957 | $3,051 | $2,877 | $619 | $6,244 | $1,172 | $18,540 |
| Provision (reversal) for loan losses | (345) | 1,655 | (608) | 371 | 14 | 9,590 | 59 | 10,736 |
| Loans charged off | (41) | (239) | (159) | (402) | — | (10,188) | — | (11,029) |
| Recoveries of loans charged off | 121 | 172 | 6 | 312 | — | 1,727 | — | 2,338 |
| Balance at end of period | $2,355 | $3,545 | $2,290 | $3,158 | $633 | $7,373 | $1,231 | $20,585 |

| | Year ended December 31, 2011 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Real Estate | | | | | | | |
| | Construction | 1-4 Family Residential | Other | Commercial Loans | Municipal Loans | Loans to Individuals | Unallocated | Total |
| Balance at beginning of period | $2,585 | $1,988 | $3,354 | $3,746 | $607 | $7,978 | $453 | $20,711 |
| Provision (reversal) for loan losses | 20 | 546 | (307) | (64) | 12 | 6,570 | 719 | 7,496 |
| Loans charged off | (46) | (675) | (271) | (1,254) | — | (10,231) | — | (12,477) |
| Recoveries of loans charged off | 61 | 98 | 275 | 449 | — | 1,927 | — | 2,810 |
| Balance at end of period | $2,620 | $1,957 | $3,051 | $2,877 | $619 | $6,244 | $1,172 | $18,540 |

| | Year ended December 31, 2010 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Real Estate | | | | | | | |
| | Construction | 1-4 Family Residential | Other | Commercial Loans | Municipal Loans | Loans to Individuals | Unallocated | Total |
| Balance at beginning of period | $3,080 | $1,460 | $3,175 | $3,184 | $400 | $7,321 | $1,276 | $19,896 |
| Provision (reversal) for loan losses | 213 | 803 | 756 | 2,311 | 207 | 10,270 | (823) | 13,737 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Loans charged off | (873 ) | (288 ) | (577 ) | (2,603 ) | — | (12,072 ) | — | (16,413 ) |
| Recoveries of loans charged off | 165 | 13 | — | 854 | — | 2,459 | — | 3,491 |
| Balance at end of period | $2,585 | $1,988 | $3,354 | $3,746 | $607 | $7,978 | $453 | $20,711 |

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

| | As of December 31, 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Real Estate | | | | | | | |
| | Construction | 1-4 Family Residential | Other | Commercial Loans | Municipal Loans | Loans to Individuals | Unallocated | Total |
| Ending balance – individually evaluated for impairment | $592 | $500 | $387 | $1,015 | $89 | $308 | $— | $2,891 |
| Ending balance – collectively evaluated for impairment | 1,763 | 3,045 | 1,903 | 2,143 | 544 | 7,065 | 1,231 | 17,694 |
| Balance at end of period | $2,355 | $3,545 | $2,290 | $3,158 | $633 | $7,373 | $1,231 | $20,585 |

| | As of December 31, 2011 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Real Estate | | | | | | | |
| | Construction | 1-4 Family Residential | Other | Commercial Loans | Municipal Loans | Loans to Individuals | Unallocated | Total |
| Ending balance – individually evaluated for impairment | $888 | $788 | $511 | $1,108 | $110 | $347 | $— | $3,752 |
| Ending balance – collectively evaluated for impairment | 1,732 | 1,169 | 2,540 | 1,769 | 509 | 5,897 | 1,172 | 14,788 |
| Balance at end of period | $2,620 | $1,957 | $3,051 | $2,877 | $619 | $6,244 | $1,172 | $18,540 |

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Reserve For Unfunded Loan Commitments: | | | |
| Balance at beginning of period | $26 | $30 | $5 |
| Provision (reversal) for losses on unfunded loan commitments | (21) | (4) | 25 |
| Balance at end of period | $5 | $26 | $30 |

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

| December 31, 2012 | Real Estate Construction | 1-4 Family Residential | Other | Commercial Loans | Municipal Loans | Individuals | Total |
|---|---|---|---|---|---|---|---|
| Loans individually evaluated for impairment | $7,653 | $8,563 | $10,366 | $6,284 | $559 | $1,165 | $34,590 |
| Loans collectively evaluated for impairment | 106,091 | 360,282 | 226,394 | 153,774 | 220,388 | 161,458 | 1,228,387 |
| Total ending loans balance | $113,744 | $368,845 | $236,760 | $160,058 | $220,947 | $162,623 | $1,262,977 |

| December 31, 2011 | Real Estate Construction | 1-4 Family Residential | Other | Commercial Loans | Municipal Loans | Loans to Individuals | Total |
|---|---|---|---|---|---|---|---|
| Loans individually evaluated for impairment | $6,274 | $12,453 | $9,394 | $5,986 | $651 | $1,320 | $36,078 |
| Loans collectively evaluated for impairment | 105,087 | 235,026 | 197,125 | 137,566 | 206,610 | 169,738 | 1,051,152 |
| Total ending loans balance | $111,361 | $247,479 | $206,519 | $143,552 | $207,261 | $171,058 | $1,087,230 |

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

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

| December 31, 2011 | Pass | Pass Watch | Special Mention | Substandard | Doubtful | Loss | Total |
|---|---|---|---|---|---|---|---|
| Real Estate Loans: | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Construction | $105,087 | $785 | $20 | $5,285 | $184 | $— | $111,361 |
| 1-4 Family residential | 235,026 | 1,763 | 5,299 | 4,345 | 1,046 | — | 247,479 |
| Other | 197,126 | 2,911 | 2,877 | 3,475 | 130 | — | 206,519 |
| Commercial loans | 137,565 | 908 | 242 | 4,772 | 55 | 10 | 143,552 |
| Municipal loans | 206,610 | 231 | — | 420 | — | — | 207,261 |
| Loans to individuals | 169,738 | 81 | — | 976 | 236 | 27 | 171,058 |
| Total | $1,051,152 | $6,679 | $8,438 | $19,273 | $1,651 | $37 | $1,087,230 |

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

| | At December 31, 2012 | At December 31, 2011 |
|---|---|---|
| Nonaccrual loans | $10,314 | $10,299 |
| Accruing loans past due more than 90 days | 15 | 5 |
| Restructured loans | 2,998 | 2,109 |
| Other real estate owned | 686 | 453 |
| Repossessed assets | 704 | 322 |
| Total Nonperforming Assets | $14,717 | $13,188 |

Nonaccrual and Past Due Loans

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

All loans not classified as pass loans are individually evaluated for impairment. Loans are considered impaired if, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is generally based on the present value of the expected future cash flows discounted at the historical effective interest rate stipulated in the loan agreement, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral. In measuring the fair value of the collateral, in addition to relying on third party appraisals, we use assumptions such as discount rates, and methodologies, such as comparison to the recent selling price of similar assets, consistent with those that would be utilized by unrelated third parties performing a valuation. Loans that are evaluated and determined not to meet the definition of an impaired loan are reserved for at the general reserve rate for its appropriate class.

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

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

| | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Nonaccrual | Accruing Loans Past Due More Than 90 Days | Nonaccrual | Accruing Loans Past Due More Than 90 Days |
| Real Estate Loans: | | | | |

| | | | | |
|---|---|---|---|---|
| Construction | $2,416 | $— | $3,894 | $— |
| 1-4 Family residential | 2,001 | — | 2,362 | — |
| Other | 1,357 | — | 781 | — |
| Commercial loans | 1,812 | — | 1,353 | — |
| Loans to individuals | 2,728 | 15 | 1,909 | 5 |
| Total | $10,314 | $15 | $10,299 | $5 |

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

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days Past Due | Total Past Due | Current Loans | Total |
| Real Estate Loans: | | | | | | |
| Construction | $1,589 | $— | $2,416 | $4,005 | $109,739 | $113,744 |
| 1-4 Family residential | 4,450 | 977 | 2,001 | 7,428 | 361,417 | 368,845 |
| Other | 1,639 | 273 | 1,357 | 3,269 | 233,491 | 236,760 |
| Commercial loans | 769 | 175 | 1,812 | 2,756 | 157,302 | 160,058 |
| Municipal loans | 709 | — | — | 709 | 220,238 | 220,947 |
| Loans to individuals | 5,908 | 1,191 | 2,743 | 9,842 | 152,781 | 162,623 |
| Total | $15,064 | $2,616 | $10,329 | $28,009 | $1,234,968 | $1,262,977 |

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days Past Due | Total Past Due | Current Loans | Total |
| Real Estate Loans: | | | | | | |
| Construction | $185 | $146 | $3,894 | $4,225 | $107,136 | $111,361 |
| 1-4 Family residential | 4,289 | 1,051 | 2,362 | 7,702 | 239,777 | 247,479 |
| Other | 1,129 | 296 | 781 | 2,206 | 204,313 | 206,519 |
| Commercial loans | 1,353 | 129 | 1,353 | 2,835 | 140,717 | 143,552 |
| Municipal loans | — | — | — | — | 207,261 | 207,261 |
| Loans to individuals | 4,614 | 960 | 1,914 | 7,488 | 163,570 | 171,058 |
| Total | $11,570 | $2,582 | $10,304 | $24,456 | $1,062,774 | $1,087,230 |

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

| | December 31, 2012 | | |
|---|---|---|---|
| | Average Recorded Investment | Interest Income Recognized | Accruing Interest at Original Contracted Rate |
| Real Estate Loans: | | | |
| Construction | $3,222 | $2 | $241 |
| 1-4 Family residential | 2,873 | 38 | 128 |
| Other | 1,734 | 69 | 178 |
| Commercial loans | 2,234 | 32 | 128 |
| Loans to individuals | 3,170 | 431 | 673 |
| Total | $13,233 | $572 | $1,348 |

| | December 31, 2011 | | |
|---|---|---|---|
| | Average Recorded Investment | Interest Income Recognized | Accruing Interest at Original Contracted Rate |
| Real Estate Loans: | | | |
| Construction | $4,054 | $18 | $292 |
| 1-4 Family residential | 2,362 | 112 | 153 |
| Other | 1,744 | 50 | 130 |
| Commercial loans | 1,748 | 2 | 65 |
| Loans to individuals | 4,508 | 761 | 1,191 |
| Total | $14,416 | $943 | $1,831 |

| | December 31, 2010 | | |
|---|---|---|---|
| | Average Recorded Investment | Interest Income Recognized | Accruing Interest at Original Contracted Rate |
| Real Estate Loans: | | | |
| Construction | $6,013 | $4 | $356 |
| 1-4 Family residential | 1,250 | 49 | 139 |
| Other | 1,445 | 16 | 117 |
| Commercial loans | 1,950 | 8 | 48 |
| Loans to individuals | 7,904 | 980 | 1,547 |
| Total | $18,562 | $1,057 | $2,207 |

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

| December 31, 2012 | Unpaid Contractual Principal Balance | Recorded Investment With No Allowance | Recorded Investment With Allowance | Total Recorded Investment | Loan Losses Allocated |
|---|---|---|---|---|---|
| Real Estate Loans: | | | | | |
| Construction | $3,716 | $— | $2,465 | $2,465 | $200 |
| 1-4 Family residential | 2,907 | — | 2,799 | 2,799 | 222 |
| Other | 3,133 | — | 2,613 | 2,613 | 243 |
| Commercial loans | 2,215 | — | 2,043 | 2,043 | 630 |
| Loans to individuals | 3,626 | 1 | 3,359 | 3,360 | 1,428 |
| Total | $15,597 | $1 | $13,279 | $13,280 | $2,723 |

| December 31, 2011 | Unpaid Contractual Principal Balance | Recorded Investment With No Allowance | Recorded Investment With Allowance | Total Recorded Investment | Loan Losses Allocated |
|---|---|---|---|---|---|
| Real Estate Loans: | | | | | |
| Construction | $4,909 | $— | $3,895 | $3,895 | $597 |
| 1-4 Family residential | 2,449 | — | 2,362 | 2,362 | 320 |
| Other | 1,930 | — | 1,508 | 1,508 | 380 |
| Commercial loans | 1,570 | — | 1,493 | 1,493 | 485 |
| Loans to individuals | 3,389 | 4 | 3,108 | 3,112 | 857 |
| Total | $14,247 | $4 | $12,366 | $12,370 | $2,639 |

At any time a potential loss is recognized in the collection of principal, proper reserves should be allocated. Loans are charged off when deemed uncollectible. Loans are charged down as soon as collection by liquidation is evident to the liquidation value of the collateral net of liquidation costs, if any, and placed in nonaccrual status.

Troubled Debt Restructurings

The restructuring of a loan is considered a troubled debt restructuring ("TDR") if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. We reassessed all loan modifications occurring since January 1, 2011 for identification as TDRs.

The following tables set forth the Recorded Investment in Loans Modified for the period presented (dollars in thousands):

| | Year Ended December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Extend Amortization Period | Interest Rate Reductions | Principal Forgiveness | Combination (1) | Total Modifications | Number of Contracts |
| Real Estate Loans: | | | | | | |
| Construction | $— | $— | $— | $— | $— | — |
| 1-4 Family residential | 644 | 32 | — | 428 | 1,104 | 13 |
| Other | 510 | 204 | — | 349 | 1,063 | 9 |
| Commercial loans | 372 | — | — | 516 | 888 | 12 |
| Loans to individuals | 27 | 7 | — | 98 | 132 | 26 |
| Total | $1,553 | $243 | $— | $1,391 | $3,187 | 60 |

| | Year ended December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Extend Amortization Period | Interest Rate Reductions | Principal Forgiveness | Combination (1) | Total Modifications | Number of Contracts |
| Real Estate Loans: | | | | | | |
| Construction | $— | $54 | $33 | $— | $87 | 2 |
| 1-4 Family residential | 107 | 213 | — | — | 320 | 4 |
| Other | 728 | — | — | — | 728 | 1 |
| Commercial loans | 89 | 52 | — | — | 141 | 2 |
| Loans to individuals | 39 | 39 | 4 | 7 | 89 | 12 |
| Total | $963 | $358 | $37 | $7 | $1,365 | 21 |

(1) These modifications include more than one of the following-extension of the amortization period, lowering interest rate and principal forgiveness.

The majority of loans restructured as TDRs during the year ended December 31, 2012 were modified to extend the maturity. Interest continues to be charged on principal balances outstanding during the term extended. Therefore, the financial effects of the recorded investment of loans restructured as TDRs during the years ended December 31, 2012 and December 31, 2011 were insignificant. The loans identified as TDRs were previously reported as impaired loans prior to restructuring and therefore the modification did not impact our determination of the allowance for loan losses. On an ongoing basis, the performance of the restructured loans is monitored for subsequent payment default. Payment default for TDRs is recognized when the borrower is 90 days or more past due. For the year ended December 31, 2012, one loan classified as “Real Estate - Other” modified as an extension of terms totaling $85,000 was in payment default. This default did not significantly impact the determination of the allowance for loan loss. For the year ended December 31, 2011, there were no defaults on any loans that were modified as TDRs.

At December 31, 2012 and December 31, 2011, there were no commitments to lend additional funds to borrowers whose terms have been modified in TDRs.

6. PREMISES AND EQUIPMENT

| | December 31, 2012 (in thousands) | December 31, 2011 |
|---|---|---|
| Premises | $63,011 | $61,221 |
| Furniture and equipment | 25,710 | 24,874 |
| | 88,721 | 86,095 |
| Less: accumulated depreciation | 38,646 | 35,500 |
| Total | $50,075 | $50,595 |

During the years ended December 31, 2012 and 2011, assets with accumulated depreciation of $460,000 and $239,000, respectively, were written off.

Depreciation expense was $3.6 million, $3.4 million and $3.2 million for the years ended December 31, 2012, 2011 and 2010, respectively.

7. OTHER REAL ESTATE OWNED

For the years ended December 31, 2012 and 2011, the total of OREO was $686,000 and $453,000, respectively.  OREO is reflected in other assets in our consolidated balance sheet.

For the year ended December 31, 2012 there were losses on impairment or sale of OREO of $9,000 compared to a gain on the sale of OREO of $34,000 for the year ended December 31, 2011. For the year ended December 31, 2010, losses on impairment or sale of OREO were $173,000.

For the years ended December 31, 2012, 2011 and 2010, OREO operating expense exceeded income by $126,000, $29,000 and $157,000, respectively.

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8. DEPOSITS

Year-end deposits were as follows (in thousands):

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Noninterest bearing demand deposits: | | |
| Commercial and individual | $559,121 | $493,744 |
| Public funds | 35,972 | 11,850 |
| Total noninterest bearing demand deposits | 595,093 | 505,594 |
| Interest bearing deposits: | | |
| Private accounts: | | |
| Savings deposits | 103,834 | 91,196 |
| Money market demand deposits | 141,038 | 129,709 |
| Platinum money market deposits | 268,995 | 270,635 |
| Premier business checking | 6,874 | 4,425 |
| NOW demand deposits | 189,837 | 174,487 |
| Certificates and other time deposits of $100,000 or more | 206,469 | 228,117 |
| Certificates and other time deposits under $100,000 | 162,372 | 328,250 |
| Total private accounts | 1,079,419 | 1,226,819 |
| Public accounts: | | |
| Savings deposits | 5 | 7 |
| Money market demand deposits | 662 | 381 |
| Platinum money market deposits | 335,059 | 180,475 |
| Premier business checking | 37 | 47 |
| NOW demand deposits | 65,846 | 82,811 |
| Certificates and other time deposits of $100,000 or more | 275,241 | 324,802 |
| Certificates and other time deposits under $100,000 | 535 | 735 |
| Total public accounts | 677,385 | 589,258 |
| Total interest bearing deposits | 1,756,804 | 1,816,077 |
| Total deposits | $2,351,897 | $2,321,671 |

For the years ended December 31, 2012, 2011 and 2010, interest expense on time deposits of $100,000 or more was $4.3 million, $5.5 million and $5.4 million, respectively.

At December 31, 2012, the scheduled maturities of certificates and other time deposits, including public funds, are as follows (in thousands):

| | |
|---|---|
| 2013 | $415,980 |
| 2014 | 133,438 |
| 2015 | 49,891 |
| 2016 | 25,994 |
| 2017 | 18,043 |
| 2018 and thereafter | 1,271 |
| | $644,617 |

At December 31, 2012, we had $19.5 million in long-term brokered certificates of deposit ("CDs") that represented 0.8% of our deposits. These brokered CDs mature within five years and are reflected in the CDs under $100,000 category. At December 31, 2011, we had $163.8 million in brokered CDs. We utilized long-term brokered CDs because the brokered CDs better matched overall ALCO objectives at the time of issuance by protecting us with fixed

rates should interest rates increase, while providing us options to call the funding should interest rates decrease. Our current policy allows for a maximum of $180 million in brokered CDs.

The aggregate amount of demand deposit overdrafts that have been reclassified as loans were $1.0 million and $1.1 million at December 31, 2012 and 2011, respectively.

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9. SHORT-TERM BORROWINGS

Information related to short-term borrowings is provided in the table below:

| | Years Ended December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (dollars in thousands) | |
| Federal funds purchased and repurchase agreements | | |
| Balance at end of period | $984 | $2,945 |
| Average amount outstanding during the period (1) | 1,770 | 3,137 |
| Maximum amount outstanding during the period (2) | 2,704 | 3,291 |
| Weighted average interest rate during the period (3) | 1.4 % | 2.7 % |
| Interest rate at end of period | 0.4 % | 2.6 % |
| FHLB advances | | |
| Balance at end of period | $150,985 | $361,811 |
| Average amount outstanding during the period (1) | 282,741 | 292,242 |
| Maximum amount outstanding during the period (2) | 440,246 | 466,316 |
| Weighted average interest rate during the period (3) | 2.2 % | 2.2 % |
| Interest rate at end of period | 3.7 % | 1.6 % |
| Other obligations | | |
| Balance at end of period | $219 | $219 |
| Average amount outstanding during the period (1) | 219 | 2,581 |
| Maximum amount outstanding during the period (2) | 219 | 2,963 |
| Weighted average interest rate during the period (3) | 8.0 % | 0.7 % |
| Interest rate at end of period | 8.0 % | 8.0 % |

(1) The average amount outstanding during the period was computed by dividing the total daily outstanding principal balances by the number of days in the period.
(2) The maximum amount outstanding at any month-end during the period.
(3) The weighted average interest rate during the period was computed by dividing the actual interest expense by the average balance outstanding during the period.

Southside Bank has three lines of credit for the purchase of overnight federal funds at prevailing rates. One $25.0 million and two $15.0 million unsecured lines of credit have been established with Frost Bank, Comerica Bank and TIB – The Independent Bankers Bank, respectively. Southside Bank has a $5.0 million line of credit with Frost Bank to be used to issue letters of credit. At December 31, 2012, the amount of additional funding Southside Bank could obtain from FHLB using unpledged securities at FHLB was approximately $221.6 million, net of FHLB stock purchases required. There were no federal funds purchased at December 31, 2012 or 2011. Southside Bank obtained no letters of credit from FHLB as collateral for a portion of its public fund deposits.

Securities sold under agreements to repurchase are secured by borrowings and are stated at the amount of cash received in connection with the transaction. Securities sold under agreements to repurchase totaled $984,000 in demand deposits at December 31, 2012. These agreements have maturities of less than one year. There were $1.7 million in demand deposits and $1.2 million in CDs sold under agreements to repurchase at December 31, 2011.

10. LONG-TERM OBLIGATIONS

| | Years Ended December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (dollars in thousands) | |
| FHLB advances | | |
| Balance at end of period | $369,097 | $260,724 |
| Weighted average interest rate during the period (1) | 2.0 % | 3.5 % |
| Interest rate at end of period | 1.6 % | 3.3 % |
| | | |
| Long-term debt (2) | | |
| Balance at end of period | $60,311 | $60,311 |
| Weighted average interest rate during the period (1) | 5.1 % | 5.4 % |
| Interest rate at end of period | 2.4 % | 5.4 % |

Maturities of fixed rate long-term obligations based on scheduled repayments at December 31, 2012 are as follows (in thousands):

| | Years Ended December 31, | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2017 | Thereafter | Total |
| FHLB advances | $1,190 | $20,086 | $38,508 | $38,029 | $230,434 | $40,850 | $369,097 |
| Long-term debt | — | — | — | — | — | 60,311 | 60,311 |
| Total long-term obligations | $1,190 | $20,086 | $38,508 | $38,029 | $230,434 | $101,161 | $429,408 |

FHLB advances represent borrowings with fixed interest rates ranging from 0.9% to 7.6% and with maturities of one to sixteen years. FHLB advances are collateralized by FHLB stock, nonspecified real estate loans and mortgage-backed securities.

| | Years Ended December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (in thousands) | |
| Long-term Debt | | |
| Southside Statutory Trust III Due 2033 (3) | $20,619 | $20,619 |
| Southside Statutory Trust IV Due 2037 (4) | 23,196 | 23,196 |
| Southside Statutory Trust V Due 2037 (5) | 12,887 | 12,887 |
| Magnolia Trust Company I Due 2035 (6) | 3,609 | 3,609 |
| Total Long-term Debt | $60,311 | $60,311 |

(1) The weighted average interest rate during the period was computed by dividing the actual interest expense by the average balance outstanding during the period.

(2) This long-term debt consists of trust preferred securities that qualify under the risk-based capital guidelines as Tier 1 capital, subject to certain limitations.

(3) This debt carries an adjustable rate of 3.251% through March 30, 2013 and adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points.

(4) This debt carries an adjustable rate of 1.61325% through January 29, 2013 and adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points.

(5)

This debt carries an adjustable rate of 2.558% through March 14, 2013 and adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points.

(6) This debt carries an adjustable rate of 2.1115% through February 24, 2013 and adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

During 2010 and 2011, we entered into the option to fund between one and a half and two years forward from the advance commitment date $200 million par in long-term advance commitments from the FHLB at the rates on the date the option was purchased. During the year ended December 31, 2012, $150 million par of long-term advance commitments expired unexercised. During the years ended December 31, 2012 and 2011, we recorded impairment charges of $2.0 million and $8.9 million, respectively, in our income statement. At December 31, 2012, the remaining FHLB advance option fees recorded on our balance sheet were fully impaired.

Below is a table detailing the optional advance commitment terms (dollars in thousands):

| Advance Commitment | Option Expiration Date | Advance Commitment Term at Exercise Date | Advance Commitment Rate | Option Fee Paid | Impairment | Fair Value Option Fee |
|---|---|---|---|---|---|---|
| $20,000 | 03/18/13 | 60 months | 2.510% | $1,528 | $1,528 | $— |
| 15,000 | 03/18/13 | 36 months | 1.622% | 828 | 828 | — |
| 15,000 | 03/18/13 | 48 months | 2.086% | 1,017 | 1,017 | — |
| $50,000 | | | | $3,373 | $3,373 | $— |

11. EMPLOYEE BENEFITS

Southside Bank has deferred compensation agreements with 18 of its executive officers, which generally provides for payment of an aggregate amount of $7.5 million over a maximum period of 15 years after retirement or death. Of the 18 executives included in the agreements, two were eligible for retirement at December 31, 2012 and two retired executives are currently receiving benefits. Deferred compensation expense was $481,000, $361,000 and $256,000 for the years ended December 31, 2012, 2011 and 2010, respectively. For the years ended December 31, 2012 and 2011, the deferred compensation plan liability totaled $3.9 million and $4.3 million, respectively.

We provide accident and health insurance for substantially all employees through a self-funded insurance program. The cost of health care benefits was $4.1 million, $3.5 million and $3.7 million for the years ended December 31, 2012, 2011 and 2010, respectively. Our healthcare plan was amended to provide health insurance coverage for any retiree having 50 years of service with the Company. In addition, the eligible retiree must have Medicare coverage, including part A, part B and part D. Premiums paid will be billed at the Consolidated Omnibus Budget Reconciliation Act (“COBRA”) rates. There were no retirees participating in the health insurance plan as of December 31, 2012 and 2011.

We have an Employee Stock Ownership Plan (the “ESOP”) which covers substantially all employees. Contributions to the ESOP are at the sole discretion of the board of directors. There was $250,000 contributed to the ESOP for each of the years ended December 31, 2012, 2011 and 2010. At December 31, 2012 and 2011, 385,492 and 345,054 shares of common stock were owned by the ESOP, respectively. The number of shares has been adjusted as a result of stock dividends. These shares are treated as externally held shares for dividend and earnings per share calculations.

We have an officer’s long-term disability income policy which provides coverage in the event they become disabled as defined under its terms. Individuals are automatically covered under the policy if they (a) have been elected as an officer, (b) have been an employee of Southside Bank for three years and (c) receive earnings of $50,000 or more on an annual basis. The policy provides, among other things, that should a covered individual become totally disabled he would receive two-thirds of his current salary, not to exceed $15,000 per month. The benefits paid out of the policy are limited by the benefits paid to the individual under the terms of our other Company-sponsored benefit plans.

We entered into split dollar agreements with eight of our executive officers. The agreements provide we will be the beneficiary of bank owned life insurance ("BOLI") insuring the executives' lives. The agreements provide the executives the right to designate the beneficiaries of the death benefits guaranteed in each agreement. The agreements originally provided for death benefits of an initial aggregate amount of $4.5 million. The individual amounts are increased annually on the anniversary date of the agreement by inflation adjustment factors ranging from 3% to 5%. As of December 31, 2012, the expected death benefits total $5.7 million. The agreements also state that after the executive's retirement, we shall also pay an annual gross-up bonus to the executive in an amount sufficient to enable the executive to pay federal income tax on both the economic benefit and on the gross-up bonus. The expense required to record the post retirement liability associated with the split dollar post retirement bonuses was

$17,000, $10,000 and $41,000 for the years ended December 31, 2012, 2011 and 2010, respectively. For the years ended December 31, 2012 and 2011, the split dollar liability totaled $1.6 million and $1.4 million, respectively.

We have a defined benefit pension plan ("the Plan") pursuant to which participants are entitled to benefits based on final average monthly compensation and years of credited service determined in accordance with plan provisions.

Entrance into the Plan by new employees was frozen effective December 31, 2005. Employees hired after December 31, 2005 are not eligible to participate in the plan. All participants in the Plan are fully vested. Benefits are payable monthly commencing on the later of age 65 or the participant's date of retirement. Eligible participants may retire at reduced benefit levels after reaching age 55. We contribute amounts to the pension fund sufficient to satisfy funding requirements of the Employee Retirement Income Security Act.

Plan assets, which consist primarily of marketable equity and debt instruments, are valued using market quotations. Plan obligations and the annual pension expense are determined by independent actuaries and through the use of a number of assumptions. Key assumptions in measuring the plan obligations include the discount rate, the rate of salary increases and the estimated future return on plan assets.

In determining the discount rate, we utilized a cash flow matching analysis to determine a range of appropriate discount rates for the defined benefit pension plan and restoration plans. In developing the cash flow matching analysis, we had our actuaries construct a portfolio of high quality noncallable bonds to match as closely as possible the timing of future benefit payments of the plans at December 31, 2012. We utilized a bond selection-settlement approach that selects a portfolio of bonds from a universe of high quality corporate bonds rated Aa by at least half of the rating agencies available. Based on the results of this cash flow matching analysis, we were able to determine an appropriate discount rate.

Salary increase assumptions are based upon historical experience and anticipated future management actions. The expected long-term rate of return assumption reflects the average return expected based on the investment strategies and asset allocation of the assets invested to provide for the Plan's liabilities. We considered broad equity and bond indices, long-term return projections, and actual long-term historical Plan performance when evaluating the expected long-term rate of return assumption. At December 31, 2012, the weighted-average actuarial assumptions used to determine the benefit obligation of the Plan were: a discount rate of 4.08%; a long-term rate of return on Plan assets of 7.25%; and assumed salary increases of 4.50%. Material changes in pension benefit costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the number of Plan participants, changes in the level of benefits provided, changes in the discount rates, changes in the expected long-term rate of return, changes in the level of contributions to the Plan and other factors.

Plan assets included 193,165 shares of our stock at December 31, 2012 and 2011. Our stock included in Plan assets was purchased at fair value. The number of shares has been adjusted as a result of stock dividends. During 2012, our underfunded status increased to $14.8 million at December 31, 2012 from an underfunded status of $7.8 million at December 31, 2011, primarily as a result of the decrease in the discount rate to 4.08% at December 31, 2012 from 4.84% at December 31, 2011.

We have a nonfunded supplemental retirement plan (the "Restoration Plan") for our employees whose benefits under the principal retirement plan are reduced because of compensation deferral elections or limitations under federal tax laws.



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We use a measurement date of December 31 for our plans.

| | 2012 Defined Benefit Pension Plan (in thousands) | Restoration Plan | 2011 Defined Benefit Pension Plan | Restoration Plan | 2010 Defined Benefit Pension Plan | Restoration Plan |
|---|---|---|---|---|---|---|
| Change in Projected Benefit Obligation: | | | | | | |
| Benefit obligation at end of prior year | $64,062 | $8,309 | $53,471 | $7,174 | $45,290 | $4,789 |
| Service cost | 1,736 | 160 | 1,536 | 174 | 1,363 | 154 |
| Interest cost | 3,068 | 390 | 2,980 | 395 | 2,832 | 384 |
| Actuarial loss | 10,866 | 1,022 | 7,741 | 646 | 5,538 | 1,927 |
| Benefits paid | (1,617) | (80) | (1,554) | (80) | (1,469) | (80) |
| Expenses paid | (113) | — | (112) | — | (83) | — |
| Benefit obligation at end of year | 78,002 | 9,801 | 64,062 | 8,309 | 53,471 | 7,174 |
| Change in Plan Assets: | | | | | | |
| Fair value of plan assets at end of prior year | 56,252 | — | 53,452 | — | 47,669 | — |
| Actual return | 5,643 | — | 2,466 | — | 4,335 | — |
| Employer contributions | 3,000 | 80 | 2,000 | 80 | 3,000 | 80 |
| Benefits paid | (1,617) | (80) | (1,554) | (80) | (1,469) | (80) |
| Expenses paid | (113) | — | (112) | — | (83) | — |
| Fair value of plan assets at end of year | 63,165 | — | 56,252 | — | 53,452 | — |
| Funded status at end of year | (14,837) | (9,801) | (7,810) | (8,309) | (19) | (7,174) |
| Accrued liability recognized | $(14,837) | $(9,801) | $(7,810) | $(8,309) | $(19) | $(7,174) |
| Accumulated benefit obligation at end of year | $62,117 | $7,540 | $51,071 | $6,088 | $42,043 | $4,586 |

Amounts related to our defined benefit pension and restoration plans recognized as a component of other comprehensive income (loss) were as follows (in thousands):

| | 2012 Defined Benefit Pension Plan | Restoration Plan | 2011 Defined Benefit Pension Plan | Restoration Plan | 2010 Defined Benefit Pension Plan | Restoration Plan |
|---|---|---|---|---|---|---|
| Recognition of net loss | $1,704 | $318 | $1,163 | $303 | $1,006 | $290 |
| Recognition of prior service credit | (42) | (1) | (42) | (2) | (42) | (2) |
| Net gain (loss) occurring during the year | (9,340) | (1,022) | (9,158) | (646) | (4,856) | (1,927) |
| | (7,678) | (705) | (8,037) | (345) | (3,892) | (1,639) |
| Deferred tax benefit | 2,687 | 247 | 2,813 | 121 | 1,362 | 574 |
| Other comprehensive income (loss), net of tax | $(4,991) | $(458) | $(5,224) | $(224) | $(2,530) | $(1,065) |

Net amounts recognized in net periodic benefit cost and other comprehensive loss as of December 31, 2012 and 2011 were as follows (in thousands):

| | 2012 Defined Benefit Pension Plan | Restoration Plan | 2011 Defined Benefit Pension Plan | Restoration Plan |
|---|---|---|---|---|
| Net loss | $1,704 | $318 | $1,163 | $303 |
| Prior service credit | (42) | (1) | (42) | (2) |
| | 1,662 | 317 | 1,121 | 301 |
| Deferred tax benefit | (582) | (111) | (392) | (105) |
| Accumulated other comprehensive loss, net of tax | $1,080 | $206 | $729 | $196 |

Amounts recognized as a component of accumulated other comprehensive loss as of December 31, 2012 and 2011 were as follows (in thousands):

| | 2012 Defined Benefit Pension Plan | Restoration Plan | 2011 Defined Benefit Pension Plan | Restoration Plan |
|---|---|---|---|---|
| Net loss | $(36,374) | $(4,658) | $(28,738) | $(3,954) |
| Prior service credit | 380 | 2 | 422 | 3 |
| | (35,994) | (4,656) | (28,316) | (3,951) |
| Deferred tax benefit | 12,598 | 1,630 | 9,911 | 1,383 |
| Accumulated other comprehensive loss, net of tax | $(23,396) | $(3,026) | $(18,405) | $(2,568) |

At December 31, 2012 and 2011, the assumptions used to determine the benefit obligation were as follows:

| | 2012 Defined Benefit Pension Plan | Restoration Plan | 2011 Defined Benefit Pension Plan | Restoration Plan |
|---|---|---|---|---|
| Discount rate | 4.08% | 4.08% | 4.84% | 4.84% |
| Compensation increase rate | 4.50% | 4.50% | 4.50% | 4.50% |

Net periodic pension cost and postretirement benefit cost for the years ended December 31, 2012, 2011 and 2010 included the following components (in thousands):

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Defined Benefit Pension Plan | | | |
| Service cost | $1,736 | $1,536 | $1,363 |
| Interest cost | 3,068 | 2,980 | 2,832 |
| Expected return on assets | (4,117) | (3,883) | (3,652) |
| Net loss amortization | 1,704 | 1,163 | 1,006 |
| Prior service credit amortization | (42) | (42) | (42) |
| Net periodic benefit cost | $2,349 | $1,754 | $1,507 |
| Restoration Plan | | | |
| Service cost | $160 | $174 | $154 |
| Interest cost | 390 | 395 | 384 |
| Net loss amortization | 318 | 303 | 290 |
| Prior service credit amortization | (1) | (2) | (2) |
| Net periodic benefit cost | $867 | $870 | $826 |

For the years ended December 31, 2012, 2011, and 2010, the assumptions used to determine net periodic pension cost and postretirement benefit cost were as follows:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Defined Benefit Pension Plan | | | |
| Discount rate | 4.84% | 5.63% | 6.10% |
| Expected long-term rate of return on plan assets | 7.25% | 7.25% | 7.50% |
| Compensation increase rate | 4.50% | 4.50% | 4.50% |
| Restoration Plan | | | |
| Discount rate | 4.84% | 5.63% | 6.10% |
| Compensation increase rate | 4.50% | 4.50% | 4.50% |

The amounts in accumulated other comprehensive income (loss) that are expected to be recognized as components of net periodic benefit cost during 2013 are as follows (in thousands):

| | Defined Benefit Pension Plan | Restoration Plan |
|---|---|---|
| Net loss | $2,137 | $393 |
| Prior service credit | (42) | (1) |
| | 2,095 | 392 |
| Deferred tax benefit | (733) | (137) |
| Accumulated other comprehensive loss, net of tax | $1,362 | $255 |

The major categories of assets in our Plan as of year-end are presented in the following table. Assets are segregated by the level of the valuation inputs within the fair value hierarchy established by ASC Topic 820 "Fair Value Measurements and Disclosures," utilized to measure fair value (see "Note 12 – Fair Value Measurement"). Our Restoration Plan is unfunded.

| | 2012 | 2011 |
|---|---|---|
| | (in thousands) | |
| Level 1: | | |
| Cash | $2,251 | $2,149 |
| Equity Securities: | | |
| U.S. large cap (1) | 34,573 | 30,093 |
| U.S. mid cap (1) | 756 | 1,914 |
| U.S. small cap (2) | 4,158 | 3,985 |
| International developed (3) | 460 | 387 |
| International emerging (4) | 396 | 329 |
| Level 2: | | |
| Cash equivalents | 10,813 | 6,474 |
| Fixed Income Securities: | | |
| Corporate bonds (5) | 934 | 943 |
| U.S. government agencies (5) | 4,561 | 6,252 |
| Municipal bonds (5) | 3,076 | 2,189 |
| U.S. agency mortgage-backed securities (6) | 1,187 | 1,537 |
| Total fair value of plan assets | $63,165 | $56,252 |

(1) This category is comprised of individual securities that are actively managed.
(2) This category is comprised primarily of Southside Bancshares stock that is owned in the Plan.
(3) This category is comprised of a broadly 'passive' mutual fund.
(4) This category is comprised of a broadly diversified 'passive' mutual fund.
(5) This category is comprised of individual investment grade securities that are generally held to maturity.
(6) This category is comprised of individual securities that are generally not held to maturity.

We did not have any plan assets with Level 3 input fair value measurements at December 31, 2012 or 2011. There were no transfers between Level 1 and Level 2 during the year ended December 31, 2012.

Our overall investment strategy is to realize long-term growth of the plan within acceptable risk parameters, while funding benefit payments from dividend and interest income, to the extent possible. The target allocations for plan assets are 65% equities, 33% fixed income and 2% cash equivalents. Equity securities are diversified among U.S. and international (both developed and emerging), large, mid and small caps, and value and growth securities. The investment objective of equity funds is long-term capital appreciation with current income. Fixed income securities include U.S. Treasuries, agencies, CDs, corporate bonds, and mortgage-backed securities. The investment objective of fixed income funds is to maximize investment return while preserving investment principal. Mutual funds, primarily because of the superior diversification they provide, are used to provide specific international developed and emerging market exposure.

As of December 31, 2012, expected future benefit payments related to our defined benefit pension plan and restoration plan were as follows (in thousands):

| | Defined Benefit Pension Plan | Restoration Plan |
|---|---|---|
| 2013 | $2,112 | $250 |

| | | |
|---|---|---|
| 2014 | 2,308 | 294 |
| 2015 | 2,600 | 323 |
| 2016 | 2,801 | 367 |
| 2017 | 3,075 | 539 |
| 2018 through 2022 | 19,502 | 3,446 |
| | $32,398 | $5,219 |

We expect to contribute between $2.0 million and $3.0 million to our defined benefit pension plan and $80,000 to our postretirement benefit plan in 2013.

401(k) Plan

We have a 401(k) defined contribution plan (the “401(k) Plan”) covering substantially all employees, who have completed one year of service and are age 21 or older. A participant may elect to defer a percentage of their compensation subject to certain limits based on federal tax laws. For the years ended December 31, 2012, 2011 and 2010, expense attributable to the 401(k) Plan amounted to $247,000, $194,000 and $119,000, respectively.

Share-based Incentive Plans

2009 Incentive Plan

On April 16, 2009, our shareholders approved the Southside Bancshares, Inc. 2009 Incentive Plan (the “2009 Incentive Plan”), which is a stock-based incentive compensation plan. A total of 1,215,507 shares of our common stock were reserved and available for issuance pursuant to awards granted under the 2009 Incentive Plan. Under the 2009 Incentive Plan, we were authorized to grant nonqualified stock options (“NQSOs”), restricted stock units (“RSUs”) or any combination thereof to certain officers. During the years ended December 31, 2012 and 2011, we granted RSUs and NQSOs pursuant to the 2009 Incentive Plan but none were granted during 2010.

As of December 31, 2012, there were 340,391 unvested awards outstanding. For the year ended December 31, 2012, there was $511,000 of share-based compensation expense related to the 2009 Incentive Plan. For the year ended December 31, 2012, there was $179,000 of income tax benefit related to the stock compensation expense. As of December 31, 2011, there were 214,438 unvested awards outstanding. As of December 31, 2010, there were no unvested awards outstanding. There was share-based compensation expense and income tax benefit for the year ended December 31, 2011 of $261,000 and $91,000, respectively. There was no share-based compensation expense or income tax benefit for the year ended December 31, 2010.

As of December 31, 2012 and December 31, 2011, there was $2.2 million and $1.4 million of unrecognized compensation cost related to the 2009 Incentive Plan, respectively. The remaining cost at December 31, 2012 is expected to be recognized over a weighted-average period of 2.90 years. There was no unrecognized compensation expense related to the 2009 Incentive Plan as of December 31, 2010.

The NQSOs have contractual terms of 10 years and vest in equal annual installments over either a three- or four-year period.

The fair value of each RSU is the ending stock price on the date of grant. The RSUs vest in equal annual installments over either a three- or four-year period.

Each award is evidenced by an award agreement that specifies the option price, if applicable, the duration of the award, the number of shares to which the award pertains, and such other provisions as the Board determines.

Shares issued in connection with stock compensation awards are issued from authorized shares and not from treasury shares. During 2012, 19,572 shares issued in connection with stock compensation awards were issued from available authorized shares. During 2011 and 2010, 880 and 107,846 shares, respectively, issued in connection with stock compensation awards were issued from available authorized shares.

The estimated weighted-average grant-date fair value per option and the underlying Black-Scholes option-pricing model assumptions are summarized in the following table:

Years Ended December 31,

| | 2012 | 2011 |
|---|---|---|
| Weighted-average grant date fair value per option | $5.83 | $5.59 |
| Weighted-average assumptions: | | |
| Risk-free interest rates | 1.03% | 2.30% |
| Expected dividend yield | 3.82% | 3.54% |
| Expected volatility factors of the market price of Southside Bancshares common stock | 41.96% | 41.71% |
| Expected option life (in years) | 6.9 | 6.8 |

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A combined summary of activity in our share-based plans as of December 31, 2012 is presented below:

| | | Restricted Stock Units Outstanding | | Stock Options Outstanding | | |
|---|---|---|---|---|---|---|
| | Shares Available for Grant | Number of Shares | Weighted-Average Grant-Date Fair Value | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Grant-Date Fair Value |
| Balance, January 1, 2012 | 1,001,069 | 35,070 | $18.28 | 189,857 | $17.82 | $5.45 |
| Granted | (213,793) | 28,667 | 20.94 | 185,126 | 20.94 | 5.83 |
| Stock options exercised | — | — | — | (11,657) | 10.73 | 3.28 |
| Stock awards vested | — | (7,759) | 18.28 | — | — | — |
| Forfeited | 38,582 | (8,218) | 18.28 | (30,364) | 18.28 | 5.59 |
| Canceled/expired | — | — | — | — | — | — |
| Balance, December 31, 2012 | 825,858 | 47,760 | $19.88 | 332,962 | $19.76 | $5.73 |

Other information regarding options outstanding and exercisable as of December 31, 2012 is as follows:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life in Years | Number of Shares | Weighted-Average Exercise Price |
| $18.28 - 20.94 | 332,962 | $19.76 | 9.08 | 40,331 | $18.28 |
| Total | 332,962 | $19.76 | 9.08 | 40,331 | $18.28 |

The total intrinsic value (i.e., the amount by which the fair value of the underlying common stock exceeds the exercise price of a stock option on exercise date) of outstanding stock options and exercisable stock options was $433,000 and $112,000 at December 31, 2012, respectively.

The total intrinsic value of stock options exercised during the years ended December 31, 2012, 2011 and 2010 was $115,000, $7,000 and $1.5 million, respectively.

Cash received from stock option exercises for the years ended December 31, 2012, 2011 and 2010 was $125,000, $9,000 and $419,000, respectively. The tax benefit realized for the deductions related to stock awards was $44,000, $2,000 and $331,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

12. FAIR VALUE MEASUREMENT

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

Valuation techniques including the market approach, the income approach and/or the cost approach are utilized to determine fair value. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Valuation policies and procedures are determined by our investment department and reported to our Asset/Liability Committee ("ALCO") for review. An entity must consider all aspects of nonperforming risk, including the entity's own credit standing when measuring fair value of a liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. A fair value hierarchy for valuation inputs gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

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

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Securities Available for Sale – U.S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, we obtain fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

Securities Carried at Fair Value through Income – U.S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these

securities, we obtain fair value measurements from an independent pricing service.  The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond’s terms and conditions, among other things.

We review the prices quarterly supplied by the independent pricing service for reasonableness and to ensure such prices are aligned with traditional pricing matrices.  In addition, we obtain an understanding of their underlying pricing methodologies and their Statement on Standards for Attestation Engagements-Reporting on Controls of a Service Organization (“SSAE 16”).  We validate prices supplied by the independent pricing service by comparison to prices obtained from, in most cases, three additional third party sources.  For securities where prices are outside a reasonable range, we further review those securities to determine what a reasonable price estimate is for that security, given available data.

Certain financial assets are measured at fair value in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of fair value accounting or write-downs of individual assets.  Transfers between levels of the fair value

hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with our monthly and/or quarterly valuation process. There were no transfers between Level 1 and Level 2 during the year ended December 31, 2012.

Loans Held for Sale – These loans are reported at the lower of cost or fair value. Fair value is determined based on expected proceeds, which are based on sales contracts and commitments and are considered Level 2 inputs. At December 31, 2012 and 2011, based on our estimates of fair value, no valuation allowance was recognized.

Foreclosed Assets – Foreclosed assets are initially carried at fair value less costs to sell. The fair value measurements of foreclosed assets can include Level 2 measurement inputs such as real estate appraisals and comparable real estate sales information, in conjunction with Level 3 measurement inputs such as cash flow projections, qualitative adjustments, sales cost estimates, etc. As a result, the categorization of foreclosed assets is Level 3 of the fair value hierarchy. In connection with the measurement and initial recognition of certain foreclosed assets, we may recognize charge-offs through the allowance for loan losses.

Impaired Loans – Certain impaired loans may be reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on customized discounting criteria or appraisals. At December 31, 2012 and 2011, the impact of loans with specific reserves based on the fair value of the collateral was reflected in our allowance for loan losses.

Certain nonfinancial assets and nonfinancial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain nonfinancial assets measured at fair value on a nonrecurring basis include nonfinancial assets and nonfinancial liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other nonfinancial long-lived assets (such as real estate owned) that are measured at fair value in the event of an impairment.

The following tables summarize assets measured at fair value on a recurring and nonrecurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

| | At or For the Year Ended December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | | Fair Value Measurements at the End of the Reporting Period Using | | | |
| | Carrying Amount | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Gains (Losses) |
| Recurring fair value measurements | | | | | |
| Investment Securities: | | | | | |
| U.S. Government Agency Debentures | $60,863 | $— | $60,863 | $— | $— |
| State and Political Subdivisions | 545,688 | — | 545,688 | — | — |
| Other Stocks and Bonds | 11,156 | — | 10,166 | 990 | (181) |
| Mortgage-backed Securities: | | | | | |
| U.S. Government Agencies | 89,803 | — | 89,803 | — | — |
| Government-Sponsored Enterprises | 716,557 | — | 716,557 | — | — |
| Total recurring fair value measurements | $1,424,067 | $— | $1,423,077 | $990 | $(181) |

| | | | | | |
|---|---|---|---|---|---|
| Nonrecurring fair value measurements | | | | | |
| Foreclosed assets (1) | $1,390 | $— | $— | $1,390 | $(752 ) |
| Impaired loans (2) | 10,557 | — | — | 10,557 | (81 ) |
| Total nonrecurring fair value measurements | $11,947 | $— | $— | $11,947 | $(833 ) |

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| | At or For the Year Ended December 31, 2011 | | | |
|---|---|---|---|---|
| | | Fair Value Measurements at the End of the Reporting Period Using | | |
| | Carrying Amount | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Recurring fair value measurements | | | | |
| Securities Available for Sale | | | | |
| Investment Securities: | | | | |
| State and Political Subdivisions | $282,457 | $— | $282,457 | $— |
| Other Stocks and Bonds | 499 | — | — | 499 |
| Mortgage-backed Securities: | | | | |
| U.S. Government Agencies | 107,052 | — | 107,052 | — |
| Government-Sponsored Enterprises | 609,074 | — | 609,074 | — |
| Total available for sale securities | $999,082 | $— | $998,583 | $499 |
| Securities carried at fair value through income | | | | |
| Mortgage-backed Securities: | | | | |
| U.S. Government Agencies | $30,413 | $— | $30,413 | $— |
| Government-Sponsored Enterprises | 617,346 | — | 617,346 | — |
| Total securities carried at fair value through income | $647,759 | $— | $647,759 | $— |
| Total recurring fair value measurements | $1,646,841 | $— | $1,646,342 | $499 |
| | | | | |
| Nonrecurring fair value measurements | | | | |
| Foreclosed assets (1) | $775 | $— | $— | $775 |
| Impaired loans (2) | 9,731 | — | — | 9,731 |
| Total nonrecurring fair value measurements | $10,506 | $— | $— | $10,506 |

(1) Losses represent related losses on foreclosed properties that were written down subsequent to their initial classification as foreclosed properties.

(2) Loans represent collateral dependent impaired loans with a specific valuation allowance. Losses on these loans represent charge-offs which are netted against the allowance for loan losses.

The following tables present additional information about financial assets and liabilities measured at fair value on a recurring basis and for which we have utilized Level 3 inputs to determine fair value (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Other Stocks and Bonds | | |
| Balance at Beginning of Period | $499 | $189 |
| Total gains or losses (realized/unrealized): | | |
| Included in earnings | (181) | — |
| Included in other comprehensive income | 672 | 310 |
| Purchases | — | — |
| Issuances | — | — |
| Settlements | — | — |
| Transfers in and/or out of Level 3 | — | — |
| Balance at End of Period | $990 | $499 |
| The amount of total gains or losses for the periods included in earnings attributable to the change in unrealized gains or losses relating to assets still held at reporting date | $(181) | $— |

The following tables present income statement classification of realized and unrealized gains and losses due to changes in fair value recorded in earnings for the periods presented for recurring Level 3 assets, as shown in the previous tables (in thousands):

| | Year Ended December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Net Securities Gains (Losses) | | Other Noninterest Income (Loss) | | Total | |
| Securities Available for Sale | Realized | Unrealized | Realized | Unrealized | Realized | Unrealized |
| Investment securities: | | | | | | |
| Other stocks and bonds | $— | $— | $(181) | $— | $(181) | $— |

The following table presents quantitative information related to the significant unobservable inputs utilized in our Level 3 recurring fair value measurements as of December 31, 2012. No liabilities were recorded as Level 3 at December 31, 2012 (in thousands):

| Securities Available for Sale | As of December 31, 2012 | | | |
|---|---|---|---|---|
| Investment securities: | Fair Value | Valuation Techniques | Unobservable Input | Range of Inputs |
| Other stocks and bonds | $990 | Discounted Cash Flows | Constant prepayment rate | 1% - 2% |
| | | | Discount Rate | Libor + 14% - 15% |
| | | | Loss Severity | 25% - 100% |

The significant unobservable inputs used in the fair value measurement of our trust preferred securities (“TRUPS”) included the credit rating downgrades, the severity and duration of the mark-to-market loss, and the structural nuances of each TRUP. Our analysis of the underlying cash flows contemplated various default, deferral and recovery scenarios to arrive at our best estimate of cash flows. Significant increases (decreases) in any of those inputs would result in a significant lower (higher) fair value.

Level 3 assets recorded at fair value on a nonrecurring basis at December 31, 2012 included loans for which a specific allowance was established based on the fair value of collateral and other real estate for which fair value of the properties was less than the cost basis. For both asset classes, the unobservable inputs were the additional adjustments applied by management to the appraised values to reflect such factors as non-current appraisals and revisions to estimated time to sell. These adjustments are determined based on qualitative judgments made by management on a case-by-case basis and are not quantifiable inputs, although they are used in the determination of fair value.

We reported at fair value through income certain of our mortgage-backed securities with embedded derivatives and purchased at a significant premium, which we defined as greater than 111.111% as opposed to bifurcating the embedded derivative and valuing it on a stand-alone basis, as these embedded derivatives are not readily identifiable and measurable and as such cannot be bifurcated. At December 31, 2012, we had no securities carried at fair value through income. During the first quarter of 2012, we sold all of our securities carried at fair value through income. The sale of these securities resulted in a loss on sale of securities carried at fair value through income of $498,000. At December 31, 2011, we had $647.8 million classified as securities carried at fair value through income. The change in fair value recorded in income was an increase of $6.7 million for the year ended December 31, 2011.

Assets and liabilities accounted for under the fair value election are initially measured at fair value with subsequent changes in fair value recognized in earnings. Such changes in the fair value of assets for which we elected the fair value option are included in current period earnings with classification in the income statement line item reflected in the following table (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Changes in fair value included in net income: | | | |
| Mortgage-backed Securities: | | | |
| U.S. Government Agencies | $— | $629 | $60 |
| Government-Sponsored Enterprises | — | 6,064 | (658) |
| Total | $— | $6,693 | $(598) |

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Disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet is required, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other estimation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Such techniques and assumptions, as they apply to individual categories of our financial instruments, are as follows:

Cash and cash equivalents – The carrying amounts for cash and cash equivalents is a reasonable estimate of those assets' fair value.

Investment and mortgage-backed and related securities – Fair values for these securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services.

FHLB stock and other investments – The carrying amount of FHLB stock is a reasonable estimate of those assets’ fair value.

Loans receivable – For adjustable rate loans that reprice frequently and with no significant change in credit risk, the carrying amounts are a reasonable estimate of those assets' fair value. The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Nonperforming loans are estimated using discounted cash flow analyses or the underlying value of the collateral where applicable.

Deposit liabilities – The fair value of demand deposits, savings accounts, and certain money market deposits is the amount on demand at the reporting date, that is, the carrying value. Fair values for fixed rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities.

Federal funds purchased and repurchase agreements – Federal funds purchased and repurchase agreements generally have an original term to maturity of one day and thus are considered short-term borrowings. Consequently, their carrying value is a reasonable estimate of fair value.

FHLB advances – The fair value of these advances is estimated by discounting the future cash flows using rates at which advances would be made to borrowers with similar credit ratings and for the same remaining maturities.

Long-term debt – The carrying amount for the long-term debt is estimated by discounting future cash flows using estimated rates at which long-term debt would be made to borrowers with similar credit ratings and for the remaining maturities.

The following tables present our financial assets, financial liabilities, and unrecognized financial instruments at both their respective carrying amounts and fair value (in thousands):

| | | Estimated Fair Value | | | |
|---|---|---|---|---|---|
| December 31, 2012 | Carrying Amount | Total | Level 1 | Level 2 | Level 3 |
| Financial assets: | | | | | |
| Cash and cash equivalents | $150,630 | $150,630 | $150,630 | $— | $— |
| Investment securities: | | | | | |
| Held to maturity, at amortized cost | 1,009 | 1,137 | — | 1,137 | — |
| Mortgage-backed and related securities: | | | | | |
| Held to maturity, at amortized cost | 245,538 | 254,261 | — | 254,261 | — |
| FHLB stock and other investments, at cost | 29,953 | 29,953 | — | 29,953 | — |
| Loans, net of allowance for loan losses | 1,242,392 | 1,235,511 | — | — | 1,235,511 |
| Loans held for sale | 3,601 | 3,601 | — | 3,601 | — |
| Financial liabilities: | | | | | |
| Retail deposits | $2,351,897 | $2,353,613 | $— | $2,353,613 | $— |
| Federal funds purchased and repurchase agreements | 984 | 984 | — | 984 | — |
| FHLB advances | 520,082 | 520,488 | — | 520,488 | — |
| Long-term debt | 60,311 | 49,507 | — | 49,507 | — |

| | | Estimated Fair Value | | | |
|---|---|---|---|---|---|
| December 31, 2011 | Carrying Amount | Total | Level 1 | Level 2 | Level 3 |
| Financial assets: | | | | | |
| Cash and cash equivalents | $43,238 | $43,238 | $43,238 | $— | $— |
| Investment securities: | | | | | |
| Held to maturity, at amortized cost | 1,496 | 1,707 | — | 1,707 | — |
| Mortgage-backed and related securities: | | | | | |
| Held to maturity, at amortized cost | 365,631 | 381,584 | — | 381,584 | — |
| FHLB stock and other investments, at cost | 35,933 | 35,933 | — | 35,933 | — |
| Loans, net of allowance for loan losses | 1,068,690 | 1,073,298 | — | — | 1,073,298 |
| Loans held for sale | 3,552 | 3,552 | — | 3,552 | — |
| Financial liabilities: | | | | | |
| Retail deposits | $2,321,671 | $2,329,243 | $— | $2,329,243 | $— |
| Federal funds purchased and repurchase agreements | 2,945 | 2,945 | — | 2,945 | — |
| FHLB advances | 622,535 | 636,129 | — | 636,129 | — |
| Long-term debt | 60,311 | 45,132 | — | 45,132 | — |

As discussed earlier, the fair value estimate of financial instruments for which quoted market prices are unavailable is dependent upon the assumptions used. Consequently, those estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Accordingly, the aggregate fair value amounts presented in the above fair value table do not necessarily represent their underlying value.

The estimated fair value of our commitments to extend credit, credit card arrangements and letters of credit, estimated using Level 3 inputs, was not material at December 31, 2012 or 2011.

13. SHAREHOLDERS' EQUITY

Cash dividends declared and paid were $1.11, $0.90 and $0.85 per share for the years ended December 31, 2012, 2011 and 2010, respectively.  Future dividends will depend on our earnings, financial condition and other factors which the board of directors considers to be relevant.  Our dividend policy requires that any cash dividend payments made may not exceed consolidated earnings for that year.

We 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 our financial statements.  Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices.  Our capital amounts and classification are also subject to qualitative judgments by the regulators regarding components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier 1 Capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 Capital (as defined) to average assets (as defined).  At December 31, 2012, we exceeded all regulatory minimum capital requirements.

In addition, for a depository institution to be considered “well capitalized” under the regulatory framework for prompt corrective action, its Tier 1 and Total Capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively and its leverage ratio must be at least 5.0%.

As of December 31, 2012, the most recent notification from the FDIC categorized us as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized we must maintain minimum Total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed our category.

| | Actual | | | For Capital Adequacy Purposes | | | To Be Well Capitalized Under Prompt Corrective Actions Provisions | | |
|---|---|---|---|---|---|---|---|---|---|
| | Amount | Ratio | | Amount | Ratio | | Amount | Ratio | |
| As of December 31, 2012: | (dollars in thousands) | | | | | | | | |
| Total Capital (to Risk Weighted Assets) | | | | | | | | | |
| Consolidated | $308,133 | 22.42 | % | $109,962 | 8.00 | % | N/A | N/A | |
| Bank Only | $300,196 | 21.86 | % | $109,852 | 8.00 | % | $137,315 | 10.00 | % |
| Tier 1 Capital (to Risk Weighted Assets) | | | | | | | | | |
| Consolidated | $290,873 | 21.16 | % | $54,981 | 4.00 | % | N/A | N/A | |
| Bank Only | $282,936 | 20.60 | % | $54,926 | 4.00 | % | $82,389 | 6.00 | % |
| Tier 1 Capital (to Average Assets) (1) | | | | | | | | | |
| Consolidated | $290,873 | 9.11 | % | $127,698 | 4.00 | % | N/A | N/A | |
| Bank Only | $282,936 | 8.87 | % | $127,531 | 4.00 | % | $159,413 | 5.00 | % |
| As of December 31, 2011: | | | | | | | | | |
| Total Capital (to Risk Weighted Assets) | | | | | | | | | |
| Consolidated | $296,715 | 22.36 | % | $106,152 | 8.00 | % | N/A | N/A | |
| Bank Only | $285,539 | 21.52 | % | $106,159 | 8.00 | % | $132,699 | 10.00 | % |
| Tier 1 Capital (to Risk Weighted Assets) | | | | | | | | | |
| Consolidated | $280,050 | 21.11 | % | $53,076 | 4.00 | % | N/A | N/A | |
| Bank Only | $268,874 | 20.26 | % | $53,080 | 4.00 | % | $79,619 | 6.00 | % |
| Tier 1 Capital (to Average Assets) (1) | | | | | | | | | |
| Consolidated | $280,050 | 8.63 | % | $129,795 | 4.00 | % | N/A | N/A | |
| Bank Only | $268,874 | 8.29 | % | $129,698 | 4.00 | % | $162,122 | 5.00 | % |

(1) Refers to quarterly average assets as calculated by bank regulatory agencies.

Our payment of dividends is limited under regulation. The amount that can be paid in any calendar year without prior approval of our regulatory agencies cannot exceed the lesser of net profits (as defined) for that year plus the net profits for the preceding two calendar years, or retained earnings.

14. DIVIDEND REINVESTMENT AND COMMON STOCK REPURCHASE PLAN

We have a Dividend Reinvestment Plan funded by stock authorized but not yet issued. Proceeds from the sale of the common stock will be used for general corporate purposes and could be directed to our subsidiaries. For the year ended December 31, 2012, 82,555 shares were sold under this plan at an average price of $21.17 per share, reflective of other trades at the time of each sale. For the year ended December 31, 2011, 71,127 shares were sold under this plan at an average price of $20.69 per share, reflective of other trades at the time of each sale.

We have a Common Stock Repurchase Plan. Under the repurchase plan, our board of directors establishes, on a quarterly basis, total dollar limitations and price per share for stock to be repurchased. Our board reviews this plan in conjunction with our capital needs and those of Southside Bank and may, at their discretion, modify or discontinue the plan. During 2012 , the board-approved additional funding to repurchase stock in the amount of $10.0 million from which 355,500 shares of common stock were purchased at a cost of $7.4 million. During 2011, there were no shares of common stock purchased under this plan.

Subsequent to December 31, 2012 through February 15, 2013, we purchased 90,300 shares of common stock at an average price of $21.03.

15. INCOME TAXES

The provision for income taxes included in the accompanying statements of income consist of the following (in thousands):

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Current tax provision | $8,841 | $11,665 | $11,100 |
| Deferred tax provision (benefit) | (1,233 ) | (1,271 ) | 656 |
| Provision for tax expense charged to operations | $7,608 | $10,394 | $11,756 |

The components of the net deferred tax asset (liability) as of December 31, 2012 and 2011 are summarized below (in thousands):

| | Assets | Liabilities |
|---|---|---|
| Write-downs on OREO | $61 | $ |
| Allowance for loan losses | 7,206 | |
| Retirement and other benefit plans | | (3,936 ) |
| Unrealized gains on securities available for sale | | (15,810 ) |
| Premises and equipment | | (994 ) |
| FHLB stock dividends | | (11 ) |
| Other-than-temporary impairment losses | 2,320 | |
| Unfunded status of defined benefit plan | 14,228 | |
| State business tax credit | 674 | |
| Stock-based compensation | 219 | |
| Other | 163 | |
| Gross deferred tax assets (liabilities) | 24,871 | (20,751 ) |
| Net deferred tax asset at December 31, 2012 | $4,120 | |
| | | |
| Write-downs on OREO | $57 | $ |
| Allowance for loan losses | 6,490 | |
| Retirement and other benefit plans | | (3,910 ) |
| Unrealized gains on securities available for sale | | (19,221 ) |
| Premises and equipment | | (1,170 ) |
| FHLB stock dividends | | (9 ) |
| Fair value gain (loss) – securities | | (2,133 ) |
| Other-than-temporary impairment losses | 4,199 | |
| Unfunded status of defined benefit plan | 11,294 | |
| State business tax credit | 692 | |
| Stock-based compensation | 91 | |
| Other | 162 | |
| Gross deferred tax assets (liabilities) | 22,985 | (26,443 ) |
| Net deferred tax liability at December 31, 2011 | $(3,458 ) | |

A reconciliation of tax at statutory rates and total tax expense is as follows (dollars in thousands):

| Years Ended December 31, | | | | | |
|---|---|---|---|---|---|
| 2012 | | 2011 | | 2010 | |
| Amount | Percent of Pre-Tax Income | Amount | Percent of Pre-Tax Income | Amount | Percent of Pre-Tax Income |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Statutory Tax Expense | $14,806 | | 35.0 | % | $17,810 | | 35.0 | % | $18,134 | | 35.0 | % |
| Increase (Decrease) in Taxes from: | | | | | | | | | | | | |
| Tax Exempt Interest | (7,601 | ) | (17.9 | )% | (7,182 | ) | (14.1 | )% | (6,323 | ) | (12.2 | )% |
| State Business Tax | 140 | | 0.3 | % | 82 | | 0.1 | % | 91 | | 0.2 | % |
| Other Net | 263 | | 0.6 | % | (316 | ) | (0.6 | )% | (146 | ) | (0.3 | )% |
| Provision for Tax Expense Charged to Operations | $7,608 | | 18.0 | % | $10,394 | | 20.4 | % | $11,756 | | 22.7 | % |

We file income tax returns in the U.S. federal jurisdiction and in certain states. We are no longer subject to U.S. federal income tax examinations by tax authorities for years before 2009.

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16. OFF-BALANCE-SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, we are a party to certain financial instruments, with off-balance-sheet risk, to meet the financing needs of our customers. These off-balance-sheet instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the financial statements. The contract or notional amounts of these instruments reflect the extent of involvement and exposure to credit loss that we have in these particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require payment of fees. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These 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 commitments to customers.

We had outstanding unused commitments to extend credit of $132.8 million and $116.0 million at December 31, 2012 and 2011, respectively. Each commitment has a maturity date and the commitment expires on that date with the exception of credit card and ready reserve commitments, which have no stated maturity date. Unused commitments for credit card and ready reserve at December 31, 2012 and 2011 were $13.0 million and $12.7 million, respectively, and are reflected in the due after one year category. We had outstanding standby letters of credit of $5.6 million and $6.5 million at December 31, 2012 and 2011, respectively.

The scheduled maturities of unused commitments as of December 31, 2012 and 2011 were as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Unused commitments: | | |
| Due in one year or less | $84,756 | $85,737 |
| Due after one year | 48,061 | 30,291 |
| Total | $132,817 | $116,028 |

We apply the same credit policies in making commitments and standby letters of credit as we do for on-balance-sheet instruments. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory, oil, gas and mineral interests, property, plant, and equipment.

Lease Commitments. We lease certain branch facilities and office equipment under operating leases. Rent expense for branch facilities was $1.2 million for the year ended December 31, 2012, and $1.1 million for both of the years ended December 31, 2011 and 2010, respectively. Rent expense for leased equipment was $267,000, $259,000, and $228,000 for the years ended December 31, 2012, 2011, and 2010, respectively.

Future minimum rental commitments due under non-cancelable operating leases at December 31, 2012 were as follows (in thousands):

| | |
|---|---|
| 2013 | $1,357 |
| 2014 | 983 |

| | |
|---|---|
| 2015 | 786 |
| 2016 | 576 |
| 2017 | 275 |
| Thereafter | 629 |
| | $4,606 |

It is expected that certain leases will be renewed, or equipment replaced with new leased equipment, as these leases expire.

Securities. In the normal course of business we buy and sell securities. There were $10.0 million and $1.2 million of unsettled trades to purchase securities at December 31, 2012 and December 31, 2011, respectively. There were no unsettled trades to sell securities as of December 31, 2012 and December 31, 2011.

Deposits. There were no unsettled issuances of brokered CDs at December 31, 2012 or December 31, 2011.

Litigation. We are involved with various litigation in the normal course of business. Management, after consulting with our legal counsel, believes that any liability resulting from litigation will not have a material effect on our financial position, results of operations or liquidity.

17. SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Although we have a diversified loan portfolio, a significant portion of our loans are collateralized by real estate. Repayment of these loans is in part dependent upon the economic conditions in the market area. Part of the risk associated with real estate loans has been mitigated since 51.3% of this group represents loans collateralized by residential dwellings that are primarily owner-occupied. Losses on this type of loan have historically been less than those on speculative properties. Many of the remaining real estate loans are collateralized primarily with owner-occupied commercial real estate. The oil and gas industry remains a significant component of the East Texas economy and as such the health of the oil and gas industry has an effect on our business.

At December 31, 2012, approximately 38% of our total loans were to customers in Tyler, Texas. We did not have a concentration in any other city that exceeded 10% of our total loans at December 31, 2012.

A significant portion of our loan portfolio is dependent on the medical community. Medical loan types include commercial loans and commercial real estate loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations. The medical community represents a concentration of risk in our Commercial loan and Commercial Real Estate loan portfolio. See “Item 1. Business – Market Area.” We believe that risk in the medical community is mitigated because it is spread among multiple practice types and multiple specialties. Should the government change the amount it pays the medical community through the various government health insurance programs or if new government regulation impacts the profitability of the medical community, the medical community could be adversely impacted which in turn could result in higher default rates by borrowers in the medical industry.

The mortgage-backed securities we hold consist exclusively of U.S. agency pass-through securities which are either directly or indirectly backed by the full faith and credit of the United States Government or guaranteed by GSEs. The GNMA mortgage-backed securities are backed by the full faith and credit of the United States Government and the Fannie Mae and Freddie Mac U.S. agency GSE guaranteed mortgage-backed securities are not backed by the full faith and credit of the United States government.

18. PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information for Southside Bancshares, Inc. (parent company only) was as follows (in thousands, except share amounts):

| CONDENSED BALANCE SHEETS | December 31, 2012 | December 31, 2011 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $4,534 | $9,348 |
| Investment in bank subsidiaries at equity in underlying net assets | 306,054 | 304,025 |
| Investment in nonbank subsidiaries at equity in underlying net assets | 3,050 | 2,649 |
| Other assets | 4,553 | 3,564 |
| TOTAL ASSETS | $318,191 | $319,586 |
| LIABILITIES | | |
| Long-term debt | $60,311 | $60,311 |
| Other liabilities | 117 | 348 |
| TOTAL LIABILITIES | 60,428 | 60,659 |
| SHAREHOLDERS' EQUITY | | |
| Common stock ($1.25 par, 40,000,000 shares authorized, 19,446,187 shares issued in 2012 and 18,517,101 shares issued in 2011) | 24,308 | 23,146 |
| Paid-in capital | 195,602 | 176,791 |
| Retained earnings | 70,708 | 72,646 |
| Treasury stock (2,379,338 and 2,023,838 shares at cost) | (35,793) | (28,377) |
| Accumulated other comprehensive income | 2,938 | 14,721 |
| TOTAL SHAREHOLDERS' EQUITY | 257,763 | 258,927 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $318,191 | $319,586 |

CONDENSED STATEMENTS OF INCOME

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| INCOME | (in thousands) | | |
| Dividends from subsidiary | $25,000 | $17,000 | $28,000 |
| Interest income | 93 | 98 | 98 |
| TOTAL INCOME | 25,093 | 17,098 | 28,098 |
| EXPENSE | | | |
| Interest expense | 3,085 | 3,266 | 3,275 |
| Other | 2,429 | 2,164 | 1,775 |
| TOTAL EXPENSE | 5,514 | 5,430 | 5,050 |
| Income before income tax expense | 19,579 | 11,668 | 23,048 |
| Income tax benefit | 1,897 | 1,866 | 1,733 |
| Income before equity in undistributed earnings of subsidiaries | 21,476 | 13,534 | 24,781 |
| Equity in undistributed earnings of subsidiaries | 13,219 | 25,599 | 14,322 |
| NET INCOME | $34,695 | $39,133 | $39,103 |

CONDENSED STATEMENTS OF CASH FLOW

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (in thousands) | | |
| OPERATING ACTIVITIES: | | | |
| Net Income | $34,695 | $39,133 | $39,103 |
| Adjustments to reconcile net income to net cash provided by operations: | | | |
| Equity in undistributed earnings of subsidiaries | (13,219) | (25,599) | (14,322) |
| (Increase) decrease in other assets | (989) | (187) | 1,022 |
| Decrease in other liabilities | (231) | (22) | (243) |
| Net cash provided by operating activities | 20,256 | 13,325 | 25,560 |
| INVESTING ACTIVITIES: | | | |
| Investment in subsidiaries | (441) | 713 | (1,701) |
| Net cash (used in) provided by investing activities | (441) | 713 | (1,701) |
| FINANCING ACTIVITIES: | | | |
| Purchase of common stock | (7,416) | — | (4,832) |
| Proceeds from issuance of common stock | 1,874 | 1,481 | 1,823 |
| Dividends paid | (19,084) | (14,671) | (13,223) |
| Payments for other financing activities | (3) | — | — |
| Net cash used in financing activities | (24,629) | (13,190) | (16,232) |
| Net (decrease) increase in cash and cash equivalents | (4,814) | 848 | 7,627 |
| Cash and cash equivalents at beginning of year | 9,348 | 8,500 | 873 |
| Cash and cash equivalents at end of year | $4,534 | $9,348 | $8,500 |

19. QUARTERLY FINANCIAL INFORMATION OF REGISTRANT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
(in thousands, except share amounts)

| | 2012<br>Fourth Quarter | Third Quarter | Second Quarter | First Quarter |
|---|---|---|---|---|
| Interest income | $26,398 | $28,464 | $29,442 | $31,716 |
| Interest expense | 5,822 | 6,456 | 6,897 | 7,720 |
| Net interest income | 20,576 | 22,008 | 22,545 | 23,996 |
| Provision for loan losses | 2,245 | 3,265 | 2,174 | 3,052 |
| Gain on sale of securities available for sale | 4,395 | 4,302 | 3,297 | 5,972 |
| Gain on sale of securities carried at fair value through income | — | — | (13) | (485) |
| FHLB advance option impairment charges | — | (195) | (1,364) | (472) |
| Noninterest income excluding net securities gains (losses) and FHLB advance option impairment | 6,259 | 6,391 | 6,142 | 5,792 |
| Noninterest expense | 19,413 | 19,076 | 19,096 | 18,522 |
| Income before income tax expense | 9,572 | 10,165 | 9,337 | 13,229 |
| Provision for income tax expense | 1,352 | 1,558 | 1,608 | 3,090 |
| Net income attributable to Southside Bancshares, Inc. | 8,220 | 8,607 | 7,729 | 10,139 |
| Earnings per common share | | | | |
| Basic | $0.47 | $0.50 | $0.45 | $0.58 |
| Diluted | $0.47 | $0.50 | $0.45 | $0.58 |

| | 2011<br>Fourth Quarter | Third Quarter | Second Quarter | First Quarter |
|---|---|---|---|---|
| Interest income | $32,756 | $32,653 | $33,724 | $31,905 |
| Interest expense | 8,191 | 8,637 | 9,157 | 9,646 |
| Net interest income | 24,565 | 24,016 | 24,567 | 22,259 |
| Provision for loan losses | 2,044 | 1,454 | 1,860 | 2,138 |
| Gain on sale of securities available for sale | 2,715 | 3,609 | 3,920 | 1,551 |
| Gain on sale of securities carried at fair value through income | 345 | 254 | 84 | 254 |
| Fair value gain (loss)-securities | (664) | 3,274 | 2,456 | 1,627 |
| FHLB advance option impairment charges | (1,104) | (7,819) | — | — |
| Noninterest income excluding net securities gains (losses) and FHLB advance option impairment | 6,024 | 6,417 | 6,175 | 6,204 |
| Noninterest expense | 17,804 | 17,696 | 18,116 | 18,732 |
| Income before income tax expense | 12,033 | 10,601 | 17,226 | 11,025 |
| Provision for income tax expense | 2,470 | 2,038 | 4,100 | 1,786 |
| Net income | 9,563 | 8,563 | 13,126 | 9,239 |
| Less: Net income attributable to the noncontrolling interest | — | — | (493) | (865) |
| Net income attributable to Southside Bancshares, Inc. | 9,563 | 8,563 | 12,633 | 8,374 |

| | | | | |
|---|---|---|---|---|
| Earnings per common share | | | | |
| Basic | $0.55 | $0.50 | $0.73 | $0.49 |
| Diluted | $0.55 | $0.50 | $0.73 | $0.49 |

INDEX TO EXHIBITS

Exhibit No.

| | | |
|---|---|---|
| 3 (a) | – | Amended and Restated Articles of Incorporation of Southside Bancshares, Inc. effective April 17, 2009 (filed as Exhibit 3(a) to the Registrant's Form 8-K, filed April 20, 2009, and incorporated herein by reference). |
| 3 (b)(i) | – | Amended and Restated Bylaws of Southside Bancshares, Inc. effective August 9, 2012 (filed as Exhibit 3(b) to the Registrant's Form 8-K, filed August 10, 2012, and incorporated herein by reference). |
| 4 | – | Management agrees to furnish to the Securities and Exchange Commission, upon request, a copy of any other agreements or instruments of Southside Bancshares, Inc. and its subsidiaries defining the rights of holders of any long-term debt whose authorization does not exceed 10% of total assets. |
| ** 10 (a)(i) | – | Deferred Compensation Plan for B. G. Hartley effective February 13, 1984, as amended June 28, 1990, December 15, 1994, November 20, 1995, December 21,1999 and June 29, 2001 (filed as Exhibit 10(a)(i) to the Registrant's Form 10-Q for the quarter ended June 30, 2001, and incorporated herein by reference). |
| ** 10 (a)(ii) | – | Deferred Compensation Plan for Robbie N. Edmonson effective February 13, 1984, as amended June 28, 1990 and March 16, 1995 (filed as Exhibit 10(a)(ii) to the Registrant's Form 10-K for the year ended December 31, 1995, and incorporated herein by reference). |
| ** 10 (b) | – | Officers Long-term Disability Income Plan effective June 25, 1990 (filed as Exhibit 10(b) to the Registrant's Form 10-K for the year ended June 30, 1990, and incorporated herein by reference). |
| ** 10 (c) | – | Retirement Plan Restoration Plan for the subsidiaries of SoBank, Inc. (now named Southside Bancshares, Inc.) (filed as Exhibit 10(c) to the Registrant's Form 10-K for the year ended December 31, 1992, and incorporated herein by reference). |
| ** 10 (d) | – | Form of Deferred Compensation Agreements dated June 30, 1994 with each of Sam Dawson, Lee Gibson and Jeryl Story, as amended October 15, 1997 (filed as Exhibit 10(f) to the Registrant's Form 10-K for the year ended December 31, 1997, and incorporated herein by reference). |
| ** 10 (e) | – | Split dollar compensation plan dated October 13, 2004 with Jeryl Wayne Story (filed as exhibit 10(h) to the Registrant's Form 8-K, filed October 19, 2004, and incorporated herein by reference). |
| ** 10 (f) | – | Split dollar compensation plan dated September 7, 2004 with Lee R. Gibson, III (filed as exhibit 10(i) to the Registrant's Form 8-K, filed October 19, 2004, and incorporated herein by reference). |

| | | | |
|---|---|---|---|
| ** | 10 (g) | – | Split dollar compensation plan dated August 27, 2004 with B. G. Hartley (filed as exhibit 10 (j) to the Registrant's Form 8-K, filed October 19, 2004, and incorporated herein by reference). |
| ** | 10 (h) | – | Split dollar compensation plan dated August 31, 2004 with Charles E. Dawson (filed as exhibit 10(k) to the Registrant's Form 8-K, filed October 19, 2004, and incorporated herein by reference). |
| ** | 10 (i) | – | Employment Agreement dated October 22, 2007, by and between Southside Bank and Lee R. Gibson (filed as exhibit 10 (l) to the Registrant's Form 8-K, filed October 26, 2007, and incorporated herein by reference). |
| ** | 10 (j) | – | Employment Agreement dated October 22, 2007, by and between Southside Bank and Sam Dawson (filed as exhibit 10 (m) to the Registrant's Form 8-K, filed October 26, 2007, and incorporated herein by reference). |
| 10 (k) | | – | Master Software License Maintenance and Services Agreement dated February 4, 2008, by and between Southside Bank and Jack Henry & Associates, Inc. (filed as Item 1.01 to the Registrant's Form 8-K, filed February 8, 2008, and incorporated herein by reference). |
| ** | 10 (l) | – | Retirement Agreement dated November 7, 2008, by and between Southside Bank, Southside Bancshares, Inc. and B. G. Hartley (filed as exhibit 10 (o) to the Registrant's Form 10-Q, filed November 7, 2008, and incorporated herein by reference). |

| | | | |
|---|---|---|---|
| ** | 10 (m) | – | Southside Bancshares, Inc. 2009 Incentive Plan (filed as Exhibit 99.1 to the Registrant's Form 8-K, filed April 20, 2009, and incorporated herein by reference). |
| ** | 10 (n) | – | Form of Southside Bancshares, Inc. Nonstatutory Stock Option Award Certificate for purchase of Options pursuant to the Southside Bancshares, Inc. 2009 Incentive Plan (filed as Exhibit 10.1 to the Registrant's Form 10-Q filed August 8, 2011, and incorporated herein by reference). |
| ** | 10 (o) | – | Form of Southside Bancshares, Inc. Restricted Stock Unit Award Certificate for grant of Units pursuant to the Southside Bancshares, Inc. 2009 Incentive Plan (filed as Exhibit 10.2 to the Registrant's Form 10-Q filed August 8, 2011, and incorporated herein by reference). |
| | 10 (p) | – | Agreement and Plan of Merger dated May 17, 2007, as amended, by and among Southside Bancshares, Inc., Southside Merger Sub, Inc. and Fort Worth Bancshares, Inc. (filed as Exhibit 10(a) to the Registrant's Form 10-Q for the quarter ended September 30, 2007, and incorporated herein by reference). |
| * | 21 | – | Subsidiaries of the Registrant. |
| * | 23.1 | – | Consent of Independent Registered Public Accounting Firm |
| * | 23.2 | – | Consent of Independent Registered Public Accounting Firm |
| * | 31.1 | – | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| * | 31.2 | – | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| * | 32 | – | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| *** | 101.INS | – | XBRL Instance Document. |
| *** | 101.SCH | – | XBRL Taxonomy Extension Schema Document. |
| *** | 101.CAL | – | XBRL Taxonomy Extension Calculation Linkbase Document. |
| *** | 101.LAB | – | XBRL Taxonomy Extension Label Linkbase Document. |
| *** | 101.PRE | – | XBRL Taxonomy Extension Presentation Linkbase Document. |
| *** | 101.DEF | – | XBRL Taxonomy Extension Definition Linkbase Document. |

*Filed herewith.

**Compensation plan, benefit plan or employment contract or arrangement.

***Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.