MIDSOUTH BANCORP INC
Form 10-K
March 18, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
Commission File number 1-11826

MIDSOUTH BANCORP, INC.
(Exact name of registrant as specified in its charter)

Louisiana	72-1020809
(State of Incorporation)	(I.R.S. EIN Number)

102 Versailles Boulevard, Lafayette, Louisiana 70501
(Address of principal executive offices)
Registrant's telephone number, including area code: (337) 237-8343
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.10 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: none
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.
Yes No þ
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
Yes þ No
Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a nonaccelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company," in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer þ	Nonaccelerated filer	Smaller reporting company þ	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.)
Yes No þ
The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of the registrant at June 29, 2018 was approximately $220,299,932 based upon the closing market price per share of the registrant’s common

stock as reported on

The New York Stock Exchange, Inc. as of such date. As of February 28, 2019, there were 16,714,171 outstanding shares of MidSouth Bancorp, Inc. common stock par value $0.10 per share.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the registrant's Proxy Statement for its 2019 Annual Meeting of Shareholders are incorporated into Part III hereof by reference.

MIDSOUTH BANCORP, INC.
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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements included in this Report and the documents incorporated by reference herein, other than statements of historical fact, are forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the regulations thereunder), which are intended to be covered by the safe harbors created thereby. Forward-looking statements include, but are not limited to certain statements under the captions “Business,” “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “will,” “would,” “could,” “should,” “guidan “continue,” “project,” “forecast,” “confident,” and similar expressions are typically used to identify forward-looking statements. These statements are based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Any forward-looking statements are not guarantees of our future performance and are subject to risks and uncertainties and may be affected by various factors that may cause actual results, developments and business decisions to differ materially from those in the forward-looking statements. Some of the factors that may cause actual results, developments and business decisions to differ materially from those contemplated by such forward-looking statements include the factors discussed under the caption “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Report and the following:

- changes in interest rates and market prices that could affect the net interest margin, asset valuation, and expense levels;
- changes in local economic and business conditions in the markets we serve, including, without limitation, changes related to the oil and gas industries that could adversely affect customers and their ability to repay borrowings under agreed upon terms, adversely affect the value of the underlying collateral related to their borrowings, and reduce demand for loans;
- increases in competitive pressure in the banking and financial services industries;
- increased competition for deposits and loans which could affect compositions, rates and terms;
- changes in the levels of prepayments received on loans and investment securities that adversely affect the yield and value of the earning assets;
- our ability to successfully implement and manage our strategic initiatives;
- costs and expenses associated with our strategic initiatives and regulatory remediation efforts and possible changes in the size and components of the expected costs and charges associated with our strategic initiatives and regulatory remediation efforts;
- our ability to realize the anticipated benefits and cost savings from our strategic initiatives within the anticipated time frame, if at all;
- the ability of the Company to comply with the terms of the formal agreement and the consent order with the Office of the Comptroller of the Currency;
- risk of noncompliance with and further enforcement actions regarding the Bank Secrecy Act and other anti-money laundering statues and regulations;
- credit losses due to loan concentration, particularly our energy lending and commercial real estate portfolios;
- a deviation in actual experience from the underlying assumptions used to determine and establish our allowance for loan and lease losses (“ALLL”), which could result in greater than expected loan losses;
- the adequacy of the level of our ALLL and the amount of loan loss provisions required in future periods including the impact of implementation of the new CECL (current expected credit loss) methodology;
- future examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, impose additional enforcement actions or conditions on our operations, require additional regulatory remediation efforts or require us to increase our allowance for loan losses or write-down assets;

- changes in the availability of funds resulting from reduced liquidity or increased costs;
- the timing and impact of future acquisitions or divestitures, the success or failure of integrating acquired operations, and the ability to capitalize on growth opportunities upon entering new markets;
- the ability to acquire, operate, and maintain effective and efficient operating systems;
- the identified material weaknesses in our internal control over financial reporting;
- increased asset levels and changes in the composition of assets that would impact capital levels and regulatory capital ratios;
- loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;

- legislative and regulatory changes, including the impact of regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and other changes in banking, securities and tax laws and regulations and their application by our regulators, changes in the scope and cost of FDIC insurance and other coverage;
- regulations and restrictions resulting from our participation in government-sponsored programs such as the U.S. Treasury's Small Business Lending Fund, including potential retroactive changes in such programs;
- changes in accounting principles, policies, and guidelines applicable to financial holding companies and banking;
- increases in cybersecurity risk, including potential business disruptions or financial losses;
- acts of war, terrorism, cyber intrusion, weather, or other catastrophic events beyond our control; and
- the ability to manage the risks involved in the foregoing.

We can give no assurance that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition. We disclaim any intent or obligation to publicly update or revise any forward-looking statements, regardless of whether new information becomes available, future developments occur or otherwise.

Part I

ITEM 1. BUSINESS

Overview

The Company was incorporated in 1984 as a Louisiana corporation and is a registered bank holding company headquartered in Lafayette, Louisiana. Its operations have been conducted primarily through its wholly owned bank subsidiary MidSouth Bank, N.A. The Bank, a national banking association, was chartered and commenced operations in 1985. As of December 31, 2018, the Bank operated through a network of 42 offices located in Louisiana and Texas.

Unless otherwise indicated or unless the context requires otherwise, all references in this report to "the Company," "we," "us," "our," or similar references, mean MidSouth Bancorp, Inc. and our subsidiaries, including our banking subsidiary, MidSouth Bank, N.A., on a consolidated basis. References to "MidSouth Bank" or the "Bank" mean our wholly owned banking subsidiary, MidSouth Bank, N.A.

Products and Services

The Bank is community oriented and focuses primarily on offering commercial and consumer loan and deposit services to small and middle market businesses, their owners and employees, and other individuals in our markets. Our community banking philosophy emphasizes personalized service and building broad customer relationships. Deposit products and services offered by the Bank include interest-bearing and noninterest-bearing checking accounts, investment accounts, cash management services, and electronic banking services, including remote deposit capture services, internet banking, and debit and credit cards. Most of the Bank's deposit accounts are FDIC-insured up to the maximum allowed, and the Bank customers have access to a world-wide ATM network of more than 55,000 surcharge-free ATMs.

Loans offered by the Bank include commercial and industrial loans, commercial real estate loans (both owner-occupied and non-owner occupied), other loans secured by real estate and consumer loans.

We are committed to an exceptional level of customer care. We maintain our own in-house call center so that customers enjoy live interaction with employees of the Bank rather than an automated telephone system. Additionally, we provide our employees with the training and technological tools to improve customer care. We also conduct focus groups within the communities we serve and strive to create a two-way dialog to ensure that we are offering the banking products and services that our customers and communities need.

Markets

We operate in Louisiana and central and east Texas along the Interstate 10, Interstate 49, Highway 90, Interstate 45, Interstate 20 and Interstate 35 corridors. As of December 31, 2018, our market area in Louisiana included 32 offices and is bound by Lafourche Parish to the south, East Baton Rouge Parish to the east, Caddo Parish to the north and Calcasieu Parish to the west. Our market areas in Texas include 10 offices located in Beaumont, College Station, Conroe, Dallas, Greenville, Houston, Mesquite, Rockwall, and Tyler. For additional information regarding our properties, see Item 2 – Properties of this Report.

Oil and gas is the key industry within our markets. However, medical, technology and research companies continue to develop within these markets thereby diversifying the economy. Additionally, numerous major universities located within our market areas, including Louisiana State University, University of Houston, Rice University, Texas A&M

University and University of Louisiana at Lafayette, provide a substantial number of jobs and help to contribute to the educated work force within our markets.

Competition

We face strong competition in our market areas from both traditional and nontraditional financial services providers, such as commercial banks; savings banks; credit unions; finance companies; mortgage, leasing, and insurance companies; money market mutual funds; brokerage houses; and branches that provide credit facilities. Several of the financial services competitors in our market areas are substantially larger and have far greater resources; however, we have effectively competed by building long-term customer relationships. Customer loyalty has been built through our continued focus on quality customer care enhanced by technology and effective delivery systems.

Other factors, including economic, legislative, and technological changes, also impact our competitive environment. Management continually evaluates competitive challenges in the financial services industry and develops appropriate responses consistent with our overall market strategy.

Employees

As of December 31, 2018, the Bank employed approximately 474 full-time equivalent employees. The Company had no employees who are not also employees of the Bank. Through the Bank, employees receive customary employee benefits, which include an employee stock ownership plan; a 401(K) plan; and life, health and disability insurance plans. Our directors, officers, and employees are important to the success of the Company and play a key role in business development by actively participating in the communities served by the Company. The Company's employees are not represented by a union or covered by a collective bargaining agreement. Management believes that its employee relations are good.

Available Information

More information on the Company and the Bank is available on the Bank's website at www.midsouthbank.com. The Company is not incorporating by reference into this Report the information contained on its website; therefore, the content of the website is not a part of this Report. Copies of this Report and other reports filed or furnished by the Company pursuant to Section 13(a) or 15(d) of the Exchange Act, including exhibits, are available free of charge on the Company's website under the "Investor Relations" link as soon as reasonably practicable after they have been filed or furnished electronically to the Securities and Exchange Commission ("SEC"). Copies of these filings may also be obtained free of charge on the SEC's website at www.sec.gov.

Supervision and Regulation

Under Federal Reserve policy, we are expected to act as a source of financial strength for, and to commit resources to support, the Bank. This support may be required at times when, absent such Federal Reserve policy, we may not be inclined to provide such support. In addition, any capital loans by a bank holding company to any of its banking subsidiaries are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by a bank holding company to a federal bank regulatory agency to maintain the capital of a banking subsidiary will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Regulatory Matters

On December 27, 2017, the Company was informed in writing by the Federal Reserve Bank of Atlanta ("FRB Atlanta") that the FRB Atlanta has determined that the Company is in "troubled condition" for purposes of Section 225.71 of Regulation Y. Based on the troubled condition determination, the Company (1) must notify the FRB Atlanta prior to adding or replacing a member of its board of directors or employing, or changing the responsibilities of, any senior executive officer, and (2) may not, except under certain circumstances, enter into any agreements to make severance

or indemnification payments or make any such payments to “institution-affiliated parties” as defined in the regulations.

On June 8, 2017, the Bank was informed by the Office of the Comptroller of the Currency (“OCC”) that the OCC has determined that the Bank is in “troubled condition” for purposes of 12 C.F.R. 5.51, Changes in Directors and Senior Executive Officers, which implements the provisions of Section 914 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. 1831i, and, as a result, the Bank is subject to specified restrictions on its operations. The OCC’s determination was based on deficiencies identified in its examination of the Bank, including but not limited to deficiencies in asset quality, credit administration and strategic planning. Based on the troubled condition determination, the Bank is now subject to the following restrictions on its operations: (1) the Bank must seek approval from the OCC prior to adding or replacing a member of its board of directors, or employing, or changing the responsibilities of any senior executive officer, and (2) the Bank may not, except

under certain circumstances, enter into any agreements to make severance or indemnification payments or make any such payments to "institution-affiliated parties" as defined in the regulations.

On July 19, 2017, the Bank entered into a formal written agreement with the OCC that provides, among other things, that the Bank: (i) create a committee to monitor the Bank's compliance with the Agreement and make quarterly reports to the Board of Directors and the OCC; (ii) adopt and implement a three-year strategic plan for the Bank consistent with regulatory guidance and to be reviewed and updated on at least an annual basis by the Board of Directors; (iii) protect its interests in its criticized assets (those assets classified as "doubtful," "substandard," or "special mention" by internal or external loan review or examination), and adopt and implement a written program designed to eliminate the basis of criticism of criticized assets equal to or exceeding $250,000, which shall be reviewed and, as necessary, revised, on a quarterly basis; (iv) may not extend additional credit to any borrower with an aggregate outstanding loan balance of $250,000 that is a criticized asset unless approved and deemed by the Bank's Board of Directors to be necessary to promote the best interests of the Bank and will not compromise the Bank's written program with respect to such loans; (v) develop and implement a written program to improve the Bank's loan portfolio management and provide the Board of Directors with written reports on the Bank's loan portfolio to enhance problem loan identification; (vi) review and, as necessary, revise the Bank's loan review program to ensure the timely identification and categorization of problem credits consistent with regulatory guidance; (vii) adopt and implement certain enhancements to its policies and procedures relating to its ALLL and the methodology related thereto; and (viii) revise its internal audit program to ensure Bank adherence to an independent and comprehensive internal audit program.

On October 25, 2018, the Bank entered into a Stipulation to the Issuance of a Consent Order with the OCC, consenting to the issuance of a consent order (the "Consent Order") relating to weaknesses in the Bank's Bank Secrecy Act and Anti-Money Laundering (collectively "BSA") compliance program. In consenting to the issuance of the Consent Order, the Bank did not admit or deny any charges of unsafe or unsound banking practices related to the BSA compliance program.

Under the terms of the Consent Order the Bank and/or its Board of Directors is required to take certain actions which include, but are not limited to: (1) creation of a subcommittee of the Board of Directors of the Bank to monitor and coordinate the Bank's adherence to the provisions of the Consent Order; (2) appointment of a qualified BSA Officer; (3) assessment of the Bank's personnel and training needs to ensure that an adequate number of qualified staff have been retained for the Bank's BSA Department; (4) ensure the Bank's adherence to a written program of policies and procedures to provide for BSA compliance and the appropriate identification and monitoring of transactions that pose greater than normal risk for BSA compliance; (5) development and implementation of a customer due diligence program to enhance customer due diligence and risk assessment processes; (6) revision of the Bank's program for monitoring and reporting suspicious activity; and (7) implementation of a comprehensive training program for employees and directors to ensure their awareness of their responsibility for compliance with (a) the requirements of the BSA and the Office of Foreign Assets Control, (b) the Bank's relevant policies, procedures, and processes, and (c) relevant examples of red flags for money laundering, terrorist financing, and suspicious activity.

The Consent Order does not require the Bank to pay any civil money penalty or require additional capital. The Consent Order will remain in effect and be enforceable until it is modified, terminated, suspended or set aside by the OCC. Issuance of the Consent Order does not preclude further government action with respect to the Bank's BSA program, including the imposition of fines, sanctions, additional expenses and compliance cost, and/or restrictions on the activities of the Bank.

Regulatory Reform

The financial crisis of 2008, including the downturn of global economic, financial and money markets and the threat of collapse of numerous financial institutions, and other recent events have led to the adoption of numerous new laws and regulations that apply to, and focus on, financial institutions. The most significant of these new laws is the

Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which was adopted on July 21, 2010 and, in part, is intended to implement significant structural reforms to the financial services industry.

In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the “EGRRCPA”) was enacted to reduce the regulatory burden on certain banking organizations, including community banks, by modifying or eliminating certain federal regulatory requirements. While the EGRRCPA maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than $10 billion as well as for larger banks with assets above $50 billion. In addition, the EGRRCPA included regulatory relief for community banks regarding regulatory examination cycles, call reports, application of the Volcker Rule (proprietary trading prohibitions), mortgage disclosures, qualified mortgages, and risk weights for certain high-risk commercial real estate loans. However, federal banking regulators retain broad discretion to impose additional regulatory requirements on banking organizations based on safety and soundness and U.S. financial system stability considerations.

The Company and the Bank continue to experience ongoing regulatory reform. These regulatory changes could have a significant effect on how the Company and the Bank conduct business. The specific implications of the Dodd-Frank Act, the EGRRCPA, and other potential regulatory reforms cannot yet be fully predicted and will depend to a large extent on the specific regulations that are to be adopted in the future. Certain aspects of the Dodd-Frank Act and the EGRRCPA are discussed in more detail below.

Bank Holding Companies

Historically, the activities of bank holding companies were limited to the business of banking and activities closely related or incidental to banking. Bank holding companies were generally prohibited from acquiring control of any company that was not a bank and from engaging in any business other than the business of banking or managing and controlling banks. The Gramm-Leach-Bliley Act, which took effect on March 12, 2000, dismantled many Depression-era restrictions against affiliation between banking, securities and insurance firms by permitting bank holding companies to engage in a broader range of financial activities, so long as certain safeguards are observed. Specifically, bank holding companies may elect to become “financial holding companies” that may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental to a financial activity.

We elected to become a financial holding company in November 2012. However, related to the regulatory issues discussed above under “Regulatory Matters,” we decertified as a financial holding company in November 2017. We remain a bank holding company under the Federal Bank Holding Company Act.

Dodd-Frank Act

In July 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act implemented far-reaching changes across the financial regulatory landscape, including changes that have affected all bank holding companies and banks, including us and the Bank, including the following provisions:

- Insurance of Deposit Accounts. The Dodd-Frank Act changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital. The Dodd-Frank Act also made permanent the $250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000.
- Payment of Interest on Demand Deposits. The Dodd-Frank Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.
- Creation of the Consumer Financial Protection Bureau. The Dodd-Frank Act centralized significant aspects of consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the “CFPB”), which is discussed in more detail below.
- Debit Card Interchange Fees. The Dodd-Frank Act amended the Electronic Fund Transfer Act to, among other things, require that debit card interchange fees be reasonable and proportional to the actual cost incurred by the issuer with respect to the transaction. In June 2011, the Federal Reserve Board adopted regulations setting the maximum permissible interchange fee as the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction, with an additional adjustment of up to one cent per transaction if the issuer implements additional fraud-prevention standards. Although issuers that have assets of less than $10 billion are exempt from the Federal Reserve Board’s regulations that set maximum interchange fees, these regulations could significantly impact the interchange fees that financial institutions with less than $10 billion in assets, such as the Bank, are able to collect.

In addition, the Dodd-Frank Act implements other far-reaching changes to the financial regulatory landscape, including provisions that:

- restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of national banks from availing themselves of such preemption;
- impose comprehensive regulation of the over-the-counter derivatives market, subject to significant rulemaking processes, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself;
- require depository institutions with total consolidated assets of more than $10 billion to conduct regular stress tests and require large, publicly traded bank holding companies to create a risk committee responsible for the oversight of enterprise risk management;
- require loan originators to retain 5% of any loan sold or securitized, unless it is a “qualified residential mortgage,” subject to certain exceptions;

- prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the Volcker Rule); and
- implement corporate governance revisions that apply to all public companies, not just financial institutions.

While much of the Dodd-Frank Act has been implemented in the form of final rules from the banking agencies, the full extent of the impact such requirements will have on our operations continues to be unclear. In addition, the current administration in the U.S. has added further uncertainty as to the implementation, scope and timing of additional rules implementing the Dodd-Frank Act, and it is possible that existing rules may be modified or repealed. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain aspects of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to us and our investors, even if only in the short-term.

Capital Requirements

We are subject to various regulatory capital requirements administered by the Federal Reserve and the OCC. Failure to meet minimum capital requirements could result in certain mandatory and possible 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 (described below), 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 policies. Our capital amounts and classification are also subject to judgments by the regulators regarding qualitative components, risk weightings, and other factors. For further detail on capital and capital ratios, see the discussion under Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Basel III Capital Framework

The federal bank regulatory agencies have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and standards for calculating risk-weighted assets and risk-based capital measurements (collectively, the “Basel III Final Rules”). For purposes of these capital rules, (i) common equity Tier 1 capital (“CET1”) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stock and trust preferred securities; and (iii) Tier 2 capital consists principally of Tier 1 capital plus qualifying subordinated debt and preferred stock, and limited amounts of an institution's allowance for loan losses. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the Basel III Final Rules. The Basel III Final Rules also establish risk weightings that are applied to many classes of assets held by community banks, including, importantly, applying higher risk weightings to certain commercial real estate loans. The Company and the Bank are subject to the Basel III capital ratios.

The Basel III Final Rules were effective on January 1, 2015. The Basel III Final Rules' capital conservation buffer (as described below) became fully phased in effective January 1, 2019. As a result, banks are required to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% CET1 ratio, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio, effectively resulting in a minimum Tier 1 capital ratio of 8.5%), (iii) a minimum ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital

conservation buffer (which is added to the 8.0% total capital ratio, effectively resulting in a minimum total capital ratio of 10.5%) and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

The Basel III Final Rules provide deductions from and adjustments to regulatory capital measures, and primarily to CET1, including deductions and adjustments that were not applied to reduce CET1 under historical regulatory capital rules. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities must be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. These deductions from and adjustments to regulatory capital are fully phased in as of January 1, 2019.

The Basel III Final Rules also implemented a “countercyclical capital buffer,” generally designed to absorb losses during periods of economic stress and to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. This buffer is a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% (potentially resulting in total buffers of between 2.5% and 5%).

The Basel III Final Rules also implemented a “countercyclical capital buffer,” generally designed to absorb losses during periods of economic stress and to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. This buffer is a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% (potentially resulting in total buffers of between 2.5% and 5%).

In addition, the OCC has established higher individual minimum capital ratios for the Bank. Specifically, the Bank must maintain a Tier 1 leverage ratio of at least 8%, and a total risk-based capital ratio of at least 12%.

At December 31, 2018, our CET1 to risk-weighted assets ratio was 12.20%, our Tier 1 Capital to risk-weighted assets ratio was 17.79% our Total Capital to risk-weighted assets ratio was 19.04% and our Leverage Ratio was 11.45%. Since our total consolidated assets are below $15 billion, our $21.5 million aggregate principal amount of trust preferred securities issued prior to May 19, 2011, are included in our Tier 1 and Total Capital calculations.

Community Bank Leverage Ratio

As a result of the EGRRCPA, the federal banking agencies were required to develop a Community Bank Leverage Ratio (the ratio of a bank’s tangible equity capital to average total consolidated assets) for banking organizations with assets of less than $10 billion, such as the Bank. On November 21, 2018, the federal banking agencies invited public comment on their proposal to establish the Community Bank Leverage Ratio framework. Under the proposal, a community banking organization would be eligible to elect the Community Bank Leverage Ratio framework if it has less than $10 billion in total consolidated assets, limited amounts of certain assets and off-balance sheet exposures, and a Community Bank Leverage Ratio greater than 9 percent. A qualifying community banking organization that has chosen the proposed framework would be automatically considered in compliance with the Basel III capital requirements and would be exempt from the complex Basel III risk-based capital calculations. Such a community banking organization would be considered to have met the capital ratio requirements to be “well capitalized” for the federal banking agencies’ Prompt Corrective Action rules provided it has a Community Bank Leverage Ratio greater than 9 percent. Because the proposal has not been finalized and a final rule has not been issued, it is difficult at this time to predict when or how this new capital ratio will ultimately be applied to community banking organizations or to predict the specific impacts of the final rule.

The Volcker Rule

The Dodd-Frank Act required the federal bank regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the “Volcker Rule." On December 10, 2013, the Federal Reserve and other federal agencies issued final rules to implement the Volcker Rule. In relevant part, these final rules would have prohibited banking entities from owning collateralized debt obligations (CDOs) backed by trust preferred securities ("TruPS"), effective July 21, 2015. However, subsequent to these final rules the U.S. financial regulatory agencies issued an interim rule to exempt CDOs backed by TruPS from the Volker Rule and the final rule, provided that (a) the CDO was established prior to May 19, 2010, (b) the banking entity reasonably believes that the CDO’s offering proceeds were used to invest primarily in TruPS issued by banks with less than $15 billion in assets, and (iii) the banking entity acquired the CDO investment on or before December 10, 2013. At December 31, 2018, we did not have any CDOs backed by TruPS.

The EGRRCPA exempted all banks with less than $10 billion in assets (including their holding companies and affiliates) from the Volcker Rule, provided that the institution has total trading assets and liabilities of five percent or

less of total assets, subject to certain limited exceptions. In December 2018, the federal banking agencies invited public comment on a proposal to exclude community banks from the application of the Volcker Rule. The Company believes that its financial condition and its operations are not and will not be significantly affected by the Volcker Rule or amendments thereto, including regulations adopted pursuant to the EGRRCPA.

The Durbin Amendment

The Dodd-Frank Act included provisions which restrict interchange fees to those which are “reasonable and proportionate” for certain debit card issuers, and limit the ability of networks and issuers to restrict debit card transaction routing. This statutory provision is known as the “Durbin Amendment.” The Federal Reserve issued final rules implementing the Durbin Amendment on June 29, 2011. In the final rules, interchange fees for debit card transactions were capped at $0.21 plus five basis points in

order to be eligible for a safe harbor such that the fee is conclusively determined to be reasonable and proportionate. Another related rule also permits an additional $0.01 per transaction "fraud prevention adjustment" to the interchange fee if certain Federal Reserve standards are implemented, including an annual review of fraud prevention policies and procedures. With respect to network exclusivity and merchant routing restrictions, it is now required that all debit cards participate in at least two unaffiliated networks so that the transactions initiated using those debit cards will have at least two independent routing channels. While the interchange fee restrictions contained in the Durbin Amendment, and the rules promulgated thereunder, only apply to debit card issuers with $10 billion or more in total consolidated assets, these regulations could significantly affect the interchange fees that financial institutions with less than $10 billion in assets, including the Bank, are able to collect.

Prompt Corrective Action
The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") established a system of prompt corrective action to resolve the problems of undercapitalized institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and are required to take certain mandatory supervisory actions, and are authorized to take other discretionary actions, with respect to institutions in the three undercapitalized categories. The severity of the action will depend upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have set the relevant capital level for each category.

An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal regulatory agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to certain limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5.0% of an undercapitalized subsidiary's assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. In addition, the appropriate federal regulatory agency may treat an undercapitalized institution in the same manner as it treats a significantly undercapitalized institution if it determines that those actions are necessary.

At December 31, 2018, the Bank had the requisite capital level to qualify as "well capitalized" under the regulatory framework for prompt corrective action.

Insurance of Accounts and FDIC Insurance Assessments
The Bank's deposits are insured by the Deposit Insurance Fund (the "DIF") of the FDIC up to the standard maximum insurance amount for each deposit insurance ownership category. Since January 1, 2013, the basic limit on FDIC deposit insurance coverage has been $250,000 per depositor. Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

The DIF is funded by assessments on banks and other depository institutions. As required by the Dodd-Frank Act, in February 2011, the FDIC approved a final rule that changed the assessment base for DIF assessments from domestic deposits to average consolidated total assets minus average tangible equity (defined as Tier 1 capital). In addition, as also required by the Dodd-Frank Act, the FDIC has adopted a new large-bank pricing assessment scheme, set a current target "designated reserve ratio" (described in more detail below) of 2% for the DIF, and established a lower assessment

rate schedule when the reserve ratio reaches 1.15% and, in lieu of dividends, provides for a lower assessment rate schedule when the reserve ratio reaches 2% and 2.5%.

An institution's assessment rate depends upon the institution's assigned risk category, which is based on supervisory evaluations, regulatory capital levels and certain other factors. Initial base assessment rates ranged from 2.5 to 45 basis points. The FDIC may make the following further adjustments to an institution's initial base assessment rates: decreases for long-term unsecured debt, including most senior unsecured debt and subordinated debt; increases for holding long-term unsecured debt or subordinated debt issued by other insured depository institutions; and increases for broker deposits in excess of 10% of domestic deposits for insurances not well rated and well capitalized. As of December 31, 2018, our risk category required a quarterly payment of approximately 8.87 basis points per $100 of assessable deposits.

The Dodd-Frank Act transferred to the FDIC increased discretion with regard to managing the required amount of reserves for the DIF, or the "designated reserve ratio." Among other changes, the Dodd-Frank Act (i) raised the minimum designated reserve ratio to 1.35 % and removed the upper limit on the designated reserve ratio, (ii) requires that the reserve ratio reach 1.35 % by September 2020, and (iii) requires the FDIC to offset the effect on institutions with total consolidated assets of less than $10 billion of raising the reserve ratio from 1.15% to 1.35% which requirement was met by rules adopted by the FDIC during 2016. On June 30, 2016, the reserve ratio rose to 1.17%, which triggered three major changes to deposit insurance assessments beginning for the third quarter of 2016: (i) the range of initial assessment rates for all institutions declined from 5 to 35 basis points to 3 to 30 basis points (which are included in the total base assessment rates in the above paragraph); (ii) surcharges equal to an annual rate of 4.5 basis points began for insured depository institutions with total consolidated assets of $10 billion or more; and (iii) the revised assessment method described above was implemented. The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis.

The FDIC has adopted a DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. Banks with less than $10 billion in total consolidated assets will receive credits to offset the portion of their assessments that help to raise the reserve ratio to 1.35%. When the reserve ratio is at or above 1.38%, the FDIC will automatically apply such a bank's credits to reduce its regular DIF assessment up to the entire amount of the assessment. On September 30, 2018, the reserve ratio reached 1.36%.

Allowance for Loan and Lease Losses
The Allowance for Loan and Lease Losses (the "ALLL") represents one of the most significant estimates in the Bank's financial statements and regulatory reports. Because of its significance, the Bank has established a system by which it develops, maintains, and documents a comprehensive, systematic, and consistently applied process for determining the amounts of the ALLL and the provision for loan and lease losses. The Interagency Policy Statement on the ALLL encourages all banks and federal savings institutions to ensure controls are in place to consistently determine the ALLL in accordance with generally accepted accounting principles in the United States, the federal savings association's stated policies and procedures, management's best judgment and relevant supervisory guidance. The Bank's estimate of credit losses reflects consideration of significant factors that affect the collectability of the portfolio as of the evaluation date.

Safety and Soundness Standards
The Federal Deposit Insurance Act, as amended by the FDICIA and the Riegle Community Development and Regulatory Improvement Act of 1994, requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. The federal bank regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards pursuant to FDICIA, as amended. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation and fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the "prompt corrective action" provisions of FDICIA.

See “Prompt Corrective Action” above. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties. The federal regulatory agencies also proposed guidelines for asset quality and earnings standards.

Community Reinvestment Act

Under the Community Reinvestment Act ("CRA"), the Bank has an obligation to help meet the credit needs of the entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA requires the appropriate federal regulator, in connection with its examination of an insured institution, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications, such as applications for a merger or the establishment of a branch. An unsatisfactory rating may be used as the basis for the denial of an application by the federal banking regulator. The Bank received a satisfactory rating in its most recent CRA examination.

Federal Home Loan Bank of Dallas

The Bank is a member of the Federal Home Loan Bank of Dallas ("FHLB-Dallas"), which is one of 12 regional FHLBs that provide funding to their members for making housing loans as well as for affordable housing and community development loans. Each FHLB serves as a reserve, or central bank, for the members within its assigned region. Each FHLB makes loans to members in accordance with policies and procedures established by the Board of Directors of the FHLB. As a member, the Bank must purchase and maintain stock in the FHLB. At December 31, 2018, the Bank owned $3.5 million of FHLB stock.

Restrictions on Transactions with Affiliates

We are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on: the amount of a bank's loans or extensions of credit to affiliates; a bank's investment in affiliates; assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve; the amount of loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and a bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total permitted amount of the above transactions is limited in amount, as to any one affiliate, to 10.0% of a bank's capital and surplus and, as to all affiliates combined, to 20.0% of a bank's capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid the taking of low-quality assets.

We are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The Dodd-Frank Act changed the definition of "covered transaction" in Sections 23A and 23B and limitations on asset purchases from insiders. With respect to the definition of "covered transaction," the Dodd-Frank Act defines that term to include the acceptance of debt obligations issued by an affiliate as collateral for a bank's loan or extension of credit to another person or company. In addition, a "derivative transaction" with an affiliate is now deemed to be a "covered transaction" to the extent that such a transaction causes a bank or its subsidiary to have a credit exposure to the affiliate. The Dodd-Frank Act also provides that the Bank may not "purchase an asset from, or sell an asset to" a Bank insider (or their related interests) unless (1) the transaction is conducted on market terms, and (2) if the proposed transaction represents more than 10% of the capital stock and surplus of the Bank, it has been approved in advance by a majority of the Bank's non-interested directors.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal stockholders and their related interests. These extensions of credit must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and must not involve more than the normal risk of repayment or present other unfavorable features.

Incentive Compensation

The Federal Reserve, the OCC and the FDIC have issued regulatory guidance (the "Incentive Compensation Guidance") intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The Federal Reserve reviews, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." The findings are included in reports of examination, and deficiencies are incorporated into the organization's supervisory ratings. Enforcement actions may be taken against

a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

The Dodd-Frank Act requires the SEC and the federal bank regulatory agencies to establish joint regulations or guidelines that require financial institutions with assets of at least $1 billion to disclose the structure of their incentive compensation practices and prohibit such institutions from maintaining compensation arrangements that encourage inappropriate risk-taking by providing excessive compensation, or that could lead to material financial loss to the financial institution. The SEC and federal bank regulatory agencies re-proposed regulations in 2016 (initially proposed in 2011) and previously issued guidance on sound incentive compensation policies, but have not yet finalized any regulations. If these or other regulations are adopted in a form

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similar to that initially proposed, they will impose limitations on the manner in which we may structure compensation for our executives. These proposed regulations incorporate the three principles discussed in the Incentive Compensation Guidance.

Bank Secrecy Act and Anti-Money Laundering

The Bank is subject to various laws and regulations that attempt to combat money laundering and terrorist financing. The USA Patriot Act impacts financial institutions in particular through its anti-money laundering and financial transparency laws. The USA Patriot Act amended the Bank Secrecy Act and the rules and regulations of the Office of Foreign Assets Control ("OFAC") to establish regulations which, among others, set standards for identifying customers who open an account and promote cooperation with law enforcement agencies and regulators in order to effectively identify parties that may be associated with, or involved in, terrorist activities or money laundering. The Bank Secrecy Act, the USA Patriot Act, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. OFAC, which is a division of the Treasury, is responsible for helping to ensure that United States entities do not engage in transactions with “enemies” of the United States, as defined by various Executive Orders and Acts of Congress. If the Bank finds a name of an “enemy” of the United States on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account or place transferred funds into a blocked account, and report it to OFAC.

Privacy

Financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing personal financial information with nonaffiliated third parties except for third parties that market the institutions’ own products and services.

In August 2018, the CFPB published its final rule to update Regulation P pursuant to the amended Gramm-Leach-Bliley Act. Under this rule, certain qualifying financial institutions are not required to provide annual privacy notices to customers. To qualify, a financial institution must not share nonpublic personal information about customers except as described in certain statutory exceptions which do not trigger a customer’s statutory opt-out right. In addition, the financial institution must not have changed its disclosure policies and practices from those disclosed in its most recent privacy notice. The rule sets forth timing requirements for delivery of annual privacy notices in the event that a financial institution that qualified for the annual notice exemption later changes its policies or practices in such a way that it no longer qualifies for the exemption.

Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to consumers. The Bank has established policies and procedures designed to safeguard its customers’ personal financial information and to ensure compliance with applicable privacy laws. Although these laws and programs impose compliance costs and create privacy obligations and, in some cases, reporting obligations, and compliance with all of the laws, programs, and privacy and reporting obligations may require significant resources of the Company and the Bank, these laws and programs do not materially affect the Bank’s products, services or other business activities.

Consumer Protection

The Dodd-Frank Act created the CFPB, a federal regulatory agency that is responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than $10 billion of assets and, to a lesser extent, smaller institutions. The Dodd-Frank Act gives the CFPB authority to supervise and regulate providers of consumer financial products and services, establishes the CFPB’s power to act against unfair, deceptive or abusive practices, and gives the CFPB rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth-in-Lending Act and the Real Estate Settlement Procedures Act).

As a smaller institution (i.e., with assets of $10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Company by the Federal Reserve and to the Bank by the OCC. However, the CFPB may include its own examiners in regulatory examinations by a smaller institution's prudential regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies, could influence how the Federal Reserve and OCC apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise impact of the CFPB's consumer protection activities cannot be forecasted.

Cybersecurity

The federal banking agencies have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a financial institution's board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal banking agencies expect financial institutions to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution's operations after a cyber attack. If the Company or the Bank fails to meet the expectations set forth in this regulatory guidance, the Company or the Bank could be subject to various regulatory actions and any remediation efforts may require significant resources of the Company or the Bank.

In October 2016, the federal banking agencies issued proposed rules on enhanced cybersecurity risk-management and resilience standards that would apply to very large financial institutions and to services provided by third parties to these institutions. The comment period for these proposed rules has closed and a final rule has not been published. Although the proposed rules would apply only to bank holding companies and banks with $50 billion or more in total consolidated assets, these rules could influence the federal banking agencies' expectations and supervisory requirements for information security standards and cybersecurity programs of smaller financial institutions, such as the Company and the Bank.

Stress Testing

As required by the Dodd-Frank Act, the federal banking agencies have implemented stress testing requirements for certain financial institutions, including bank holding companies and state chartered banks, with more than $10 billion in total consolidated assets. The EGRRCPA subsequently raised the asset thresholds for company-run stress testing and mandatory stress testing conducted by the Federal Reserve Board to $50 billion and $100 billion, respectively. Although these requirements do not apply to institutions such as the Company and the Bank, the federal banking agencies emphasize that all banking organizations, regardless of size, should have the capacity to analyze the potential impact of adverse market conditions or outcomes on the organization's financial condition. Based on existing regulatory guidance, the Company and the Bank will be expected to consider the institution's interest rate risk management, commercial real estate concentrations and other credit-related information, and funding and liquidity management during this analysis of adverse outcomes.

Brokered Deposits

Section 29 of the FDIA and FDIC regulations generally limit the ability of any bank to accept, renew or roll over any brokered deposit unless it is "well capitalized" or, with the FDIC's approval, "adequately capitalized." However, as a result of the EGRRCPA, the FDIC is undertaking a comprehensive review of its regulatory approach to brokered deposits, including reciprocal deposits, and interest rate caps applicable to banks that are less than "well capitalized." At this time, it is difficult to predict the impact, if any, of the FDIC's review of brokered deposit regulations.

Call Reports and Examination Cycle

All institutions, regardless of size, submit a quarterly call report that includes data used by federal banking agencies to monitor the condition, performance, and risk profile of individual institutions and the industry as a whole. The EGRRCPA contained provisions expanding the number of regulated institutions eligible to use streamline call report forms. In November 2018, the federal banking agencies issued a proposal to permit insured depository institutions with total assets of less than $5 billion that do not engage in certain complex or international activities to file the most streamlined version of the quarterly call report, and to reduce data reportable on certain streamlined call report submissions.

In December 2018, consistent with the provisions of the EGRRCPA, the federal banking agencies jointly adopted final rules that permit banks with up to $3 billion in total assets, that received a composite CAMELS rating of “1” or “2,” and that meet certain other criteria (including not having undergone any change in control during the previous 12-month period, and not being subject to a formal enforcement proceeding or order), to qualify for an 18-month on-site examination cycle. Because FRB Atlanta and the OCC have designated the Company and the Bank, respectively, as in “troubled condition,” neither currently qualifies for the EGRRCPA’s shortened examination cycle.

Other Regulations

Interest and other charges collected or contracted for by the Bank are subject to federal laws concerning interest rates. The Bank’s loan operations are also subject to federal laws applicable to credit transactions, such as the:

- Federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed, or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

The deposit operations of the Bank are subject to the following:

- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- the Truth in Savings Act, which requires disclosure of yields and costs of deposits and deposit accounts.

Future Regulation

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Company cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Company. A change in statutes, regulations or regulatory policies applicable to the Company, the Bank, or any of their subsidiaries could have a material effect on their respective businesses.

Effect of Governmental Monetary Policies

Our earnings are affected by the monetary and fiscal policies of the United States government and its agencies, as well as general domestic economic conditions. The Federal Reserve's power to implement national monetary policy has had, and is likely to continue to have, an important impact on the operating results of financial institutions. The Federal Reserve affects the levels of bank loans, investments, and deposits through its control over the issuance of U.S. government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is difficult to predict the nature, timing or impact of future changes in monetary and fiscal policies.

ITEM 1A. RISK FACTORS

An investment in our stock involves a number of risks. Investors should carefully consider the following risks as well as the other information in this Report and the documents incorporated by reference before making an investment decision. The realization of any of the risks described below could have a material adverse effect on the Company and the price of our common stock.

Risks Relating to Our Business

Our industry and business may be adversely affected by conditions in the financial markets and economic conditions generally and in our market areas.

In recent years, we have faced periods of challenging and uncertain economic conditions, including a significant downturn in the oil and gas industry in our market areas. A return of recessionary conditions similar to 2008-2009 and/or a deterioration of national or local economic conditions could adversely affect the financial condition and operating performance of financial institutions. Specifically, declines in real estate values and sales volumes and increased unemployment levels may result in higher than expected loan delinquencies, increases in levels of non-performing and classified assets and a decline in demand for products and services offered by financial institutions. While general economic conditions in the markets in which we operate, as well as in the U.S. and worldwide, continued to improve during 2018, there can be no assurance that this improvement will continue. Uncertainty regarding continuing economic improvement may result in changes in consumer and business

spending, borrowing and savings habits, which could cause us to incur losses and may adversely affect our results of operations and financial condition.

Our market areas are heavily dependent on, and we have significant credit exposure to, the oil and gas industry.
The economy in a large portion of our market areas is heavily dependent on the oil and gas industry. Many of our customers provide transportation and other services and products that support oil and gas exploration and production activities. We define an energy loan as any loan where the borrower's ability to repay is disproportionately impacted by a prolonged downturn in energy prices. Under this definition, the Bank includes direct Commercial and Industrial ("C&I") loans to energy borrowers, as well as Commercial Real Estate loans, Residential Real Estate loans and loans to energy-related borrowers where the loan's primary collateral is cash and marketable securities. Although this definition has resulted in a lack of comparability with some other energy-related banks, management believes it to be the prudent approach to monitoring and managing the Bank's energy exposure. As of December 31, 2018, we had approximately $112.6 million in loans to borrowers in the oil and gas industry, as defined above, representing approximately 12.5% of our total loans outstanding as of that date. The average loan size is approximately $377,000, and the average loan size per relationship is roughly $500,000. The oil and gas industry, especially in Louisiana and Texas, has been subject to significant volatility, including the “oil bust” of the 1980s that severely impacted the economies of many of our market areas and, more recently, volatility in oil and gas prices and volatility in the level of drilling and production activity in Texas, Louisiana and other areas of the U.S. Decisions by certain members of the Organization of Petroleum Exporting Countries to maintain higher crude oil production levels have led to increased global oil supplies, which, when coupled with the continued exporting restrictions on the U.S. oil and gas industry and weaker global demand, has resulted in sustained low domestic market oil prices. Sustained low market oil prices have compressed margins for many U.S.-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. These adverse developments in the oil and gas industry have had negative effects on the economies of our market areas in general, including adverse effects on commercial and residential real estate values and the general level of economic activity. If oil prices remain at these low levels for an extended period, the Bank could experience weaker oil and gas related loan demand and increased losses within its oil and gas loan portfolio. Furthermore, a prolonged period of low oil prices could also have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Louisiana and Texas. Accordingly, if there is further deterioration in the oil and gas industry it could have a material adverse effect on our business, prospects, financial condition and results of operations.

We may suffer losses in our loan portfolio in excess of our allowance for loan losses.
We have experienced increases in the levels of our non-performing assets and loan charge-offs in recent periods. Our total non-performing assets amounted to $30.5 million, or 1.75% of our total assets, at December 31, 2018, and we had $26.2 million of net loan charge-offs and a $16.7 million provision for loan losses for the year ended December 31, 2018. At December 31, 2018, the ratios of our ALLL to non-performing loans and to total loans outstanding were 195.40% and 1.94%, respectively. Additional increases in our non-performing assets or loan charge-offs could have a material adverse effect on our financial condition and results of operations.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. These practices include analysis of a borrower’s prior credit history, financial statements, tax returns and cash flow projections, valuation of collateral based on reports of independent appraisers and verification of liquid assets. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we still may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our ALLL. We create an ALLL in our accounting records, based on, among other considerations, the following:

- industry historical losses as reported by the FDIC;

- historical experience with our loans;
- evaluation of economic conditions;
- regular reviews of the quality mix, including our distribution of loans by risk grade within our portfolio, and size of our overall loan portfolio;
- regular reviews of delinquencies; and
- the quality of the collateral underlying our loans.

Although we maintain an ALLL at a level that we believe is adequate to absorb losses inherent in our loan portfolio, changes in economic, operating and other conditions, including conditions which are beyond our control such as a sharp decline in real estate values and changes in interest rates, may cause our actual loan losses to exceed our current allowance estimates. Additions

to the ALLL could result in a decrease in net earnings and capital and could hinder our ability to grow. Further, if our actual loan losses exceed the amount reserved, it could have a material adverse effect on our financial condition and results of operations.

In June 2016, the FASB issued Accounting Standards Update (ASU) 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," referred to as "CECL" (current expected credit loss), which replaces the current incurred loss impairment methodology with a methodology that requires the measurement of all expected credit losses for financial assets not recorded at fair value based on historical experience, current conditions, and reasonable and supportable forecasts. The Company intends to adopt ASU 2016-13 during the first quarter of 2020, and adoption of this ASU could materially affect its allowance for loan losses methodology, financial condition, capital levels and results of operations, including expenses the Company may incur in implementing this ASU.

The Company and the Bank have both been placed in troubled condition by their respective federal banking regulators, which subjects us to significant restrictions and will require us to designate a significant amount of resources to comply. A failure to comply with restrictions imposed on financial institutions in troubled condition or with the terms of the written agreement to which the Bank is subject within the required timeframes could have a material adverse effect upon our business, financial condition and results of operations.
As discussed above in Item 1 under the heading "Business - Supervision and Regulation," the Company and the Bank are both in "troubled condition" and the Bank has entered into a written agreement with the OCC. Because the Company is in troubled condition, the Company (1) must notify the Federal Reserve prior to adding or replacing a member of its board of directors or employing, or changing the responsibilities of any senior executive officer, and (2) may not, except under certain circumstances, enter into any agreements to make severance or indemnification payments or make any such payments to "institution-affiliated parties" as defined in the regulations. The Bank is subject to similar restrictions due to its troubled condition status. Under the written agreement, the Bank is also required to take certain immediate and continuing actions related to problem assets and lending practices, among other remedial actions.

If the Company or the Bank is not successful in complying with their respective regulatory restrictions, or the Bank does not comply with the written agreement within the required time frames, we could become subject to additional enforcement actions, sanctions or restrictions on our business activities. While subject to regulatory actions and restrictions, we expect that our management and Board of Directors will be required to focus considerable time and attention on taking corrective actions. We have also hired third party consultants and advisors to assist us, which will increase our non-interest expense and reduce our earnings. The Bank has appointed a committee to monitor compliance with the written agreement and is working to promptly address the requirements of the written agreement. There is no guarantee, however, that the Bank will successfully address the OCC's concerns in the written agreement or that we will be able to comply with it. If we do not comply with the written agreement, we could be subject to civil monetary penalties, further regulatory sanctions and/or other enforcement actions.

The Office of the Comptroller of the Currency has issued a Consent Order with respect to our Bank Secrecy Act compliance. Failure to comply with the Consent Order could result in additional regulatory action.
The Bank Secrecy Act, the USA Patriot Act, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program ("BSA/AML Program") and file suspicious activity and currency transaction reports as appropriate. On October 25, 2018, the Bank entered into a Stipulation to the Issuance of a Consent Order with the OCC, consenting to the issuance of a Consent Order relating to weaknesses in the Bank's BSA/AML Program. The Consent Order is expected to result in additional compliance expenses for the Bank. Issuance of the Consent Order does not preclude further enforcement actions with respect to the Bank's BSA/AML Program, including the possible imposition of fines, sanctions, and/or restrictions on the activities of the Bank. Failure to comply with the Consent Order could subject us to additional expense and result in these additional regulatory enforcement actions or enforcement of the Consent Order through court proceedings. Any of these results

could have a material adverse effect on our business, financial condition and results of operations.

We may become subject to additional enforcement actions that could have a material negative effect on our business, operations, financial condition, results of operations or the value of our common stock.

Federal and state regulators have the ability to impose substantial sanctions, restrictions and requirements on our banking subsidiaries if they determine, upon examination or otherwise, violations of laws, rules or regulations with which we or our subsidiaries must comply, or weaknesses or failures with respect to general standards of safety and soundness. Such enforcement may be formal or informal and can include directors' resolutions, memoranda of understanding, consent orders, written agreements, civil money penalties and termination of deposit insurance and bank closures. Enforcement actions may be taken regardless of the capital level of the institution. In particular, institutions that are not sufficiently capitalized in accordance with regulatory standards may also face capital directives or prompt corrective action. Enforcement actions may impose restrictions

on the payment of dividends or severance payments, require certain corrective steps (including staff additions or changes), impose limits on activities (such as lending, deposit taking, ability to accept brokered-deposits or branching), prescribe lending parameters (such as loan types, volumes and terms), require the disposition of certain assets and liabilities, require additional capital to be raised or expenses to be incurred or prevent us from conducting any expansionary activities, including acquisitions. The imposition of any additional enforcement actions or regulatory sanctions or monetary penalties could have a material negative effect on our business, operations, financial condition, results of operations or the value of our common stock.

Our controls and procedures may fail or be circumvented, which may result in a material adverse effect on our business, financial condition and results of operations.
Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

As disclosed in Part II, Item 9A “Controls and Procedures” of this Form 10-K, or Item 9A, two material weaknesses were identified in our internal control over financial reporting for the creation of tax entries and the preparation of the ALL. The specific issues leading to these conclusions are described in Item 9A in “Management’s Report on Internal Control over Financial Reporting.” A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

The material weaknesses identified in Item 9A did not result in any misstatement of our consolidated financial statements for any period presented. We have begun efforts to remediate the material weaknesses. However, our remedial measures to address the material weaknesses may be insufficient and we may in the future discover areas of our internal controls that need improvement. Failure to maintain effective controls or to timely implement any necessary improvement of our internal and disclosure controls could, among other things, result in losses from errors, harm our reputation, or cause investors to lose confidence in the reported financial information, all of which could have a material adverse effect on our results of operations and financial condition.

We may be unable to successfully implement and manage our recently announced strategic initiatives, which could result in the failure to achieve the anticipated cost savings and materially impair our profitability and financial condition.
We have begun the implementation of a number of strategic initiatives to address the regulatory concerns and market challenges and to improve the overall profitability and financial condition of the Company and the Bank. There can be no assurances that these strategic initiatives will be successful in addressing these concerns and challenges, and if we are not successful in implementing and managing these strategic initiatives our profitability and financial condition could be materially impaired in future periods. We may also incur expenses in connection with these strategic initiatives beyond our current estimates, which may result in additional losses to us and the costs of these strategic initiatives outweighing any benefits resulting therefrom. Furthermore, if these strategic initiatives do not adequately address regulatory concerns, we could become subject to additional regulatory actions, including enforcement actions as described in the preceding risk factors.

Loss of key officers or employees, or failure to successfully transition our management, could materially and adversely affect our business and operating results and may disrupt relationships with certain customers.
As a community bank, our business is primarily relationship-driven in that many of our key employees have extensive customer relationships. In addition, our success has been and will continue to be greatly influenced by the ability to

retain senior management and, with expansion, to attract and retain qualified additional senior and middle management. In May 2017, we replaced our President and Chief Executive Officer and have also recently appointed other new executive officers. Our future success will depend, to a significant extent, on the ability of our new management team to operate effectively, both individually and as a group. We must successfully manage issues that may result from the transition of the new members of our executive management. Loss of a key employee with such customer relationships may lead to the loss of business if the customers were to follow that employee to a competitor. While we believe our relationships with our key personnel are good, we cannot guarantee that all of our key personnel will remain with our organization. Loss of such key personnel, should they enter into an employment relationship with one of our competitors, could result in the loss of some of our customers.

We cannot predict the effect of recent or future legislative and regulatory initiatives.
Financial institutions have been the subject of substantial legislative and regulatory changes and may be the subject of further legislation or regulation in the future, including: (i) changes in banking, securities and tax laws and regulations and their application by our regulators, including pursuant to the Dodd-Frank Act, and following the passage of the EGRRCPA as discussed above in Item 1 under the heading "Business – Supervision and Regulation"; and (ii) changes in the scope and cost of FDIC insurance and other coverage, none of which is within our control. Significant new laws or regulations or changes in, or repeals of, existing laws or regulations may cause our results of operations to differ materially from those we currently anticipate. In addition, the cost and burden of compliance with applicable laws and regulations have significantly increased and could adversely affect our ability to operate profitably. Further, federal monetary policy significantly affects credit conditions for us, as well as for our borrowers, particularly as implemented by the Federal Reserve Board, primarily through open market operations in U.S. government securities, the discount rate for bank borrowings and reserve requirements. A material change in any of these conditions could have a material impact on us or our borrowers, and therefore on our business, prospects, financial condition and results of operations.

The short-term and long-term impact of the changing regulatory capital requirements is uncertain.
Effective as of January 1, 2019, the fully phased in Basel III Capital Rules apply to the Company and the Bank. These rules have substantially changed the regulatory risk-based capital rules applicable to the Company and the Bank and include new minimum risk-based capital and leverage ratios and modify the capital and asset definitions for purposes of calculating those ratios. Starting in January 1, 2015, the Basel III Capital Rules established a new common equity Tier 1 minimum capital requirement of 4.5%, a higher minimum Tier 1 capital to risk-weighted assets requirement of 6.0% and a higher total capital to risk-weighted assets of 8.0%. In addition, the Basel III Capital Rules provided, to be considered "well-capitalized," a new common equity Tier 1 capital requirement of 6.5% and a higher Tier 1 capital to risk-weighted assets requirement of 8.0%. Moreover, the Basel III Capital Rules limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of an additional 2.5% of common equity Tier 1 capital in addition to the 4.5% minimum common equity Tier 1 requirement and the other amounts necessary to the minimum risk-based capital requirements.

The Company and the Bank currently satisfy the fully phased in Basel III Capital Rules. However, the application of these more stringent capital requirements could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in additional regulatory actions if we are unable to comply with such requirements in the future. Furthermore, Basel III's liquidity requirements could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. The continued implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could also result in us modifying our business strategy and could limit our ability to pay dividends.

We have a concentration of exposure to a number of individual borrowers. Given the size of these loan relationships relative to capital levels and earnings, a significant loss on any one of these loans could materially and adversely affect us.
We have a concentration of exposure to a number of individual borrowers. Our largest exposure to one borrowing relationship as of December 31, 2018, was approximately $11.9 million, which is 5.4% of our total capital. In addition, as of December 31, 2018, the aggregate exposure to the ten largest borrowing relationships was approximately $96.8 million, which was 10.8% of loans and 43.6% of total capital. As a result of this concentration, a change in the financial condition of one or more of these borrowers could result in significant loan losses and have a material adverse effect on our financial condition and results of operations.

A significant percentage of our deposits are attributable to a relatively small number of customers. The loss of all or some of these customers or a significant decline in their deposit balances may have a material adverse effect on our

liquidity and results of operations.

As of December 31, 2018, our 20 largest depositors accounted for approximately 12.9% of total deposits, of which our top five depositors accounted for approximately 6.6% of total deposits. The ability to attract these types of deposits has a positive effect on our net interest margin as they provide a relatively low cost of funds to the Bank. While we believe we have strong, long-term relationships with each of these customers, the loss of one or more of our 20 largest deposit customers, or a significant decline in the deposit balances would adversely affect our liquidity and require us to attract new deposits, purchase federal funds or borrow funds on a short-term basis to replace such deposits, possibly at interest rates higher than those currently paid on such deposits. This could increase our total cost of funds and could result in a decrease in our net interest income and net earnings. If we were unable to develop alternative funding sources, we may have difficulty funding loans or meeting other deposit withdrawal requirements.

We occasionally purchase non-recourse loan participations from other banks based in part on information provided by the selling bank.
From time to time, we purchase loan participations from other banks in the ordinary course of business, usually without recourse to the selling bank. As of December 31, 2018, we had approximately $34.9 million in purchased loan participations, or approximately 3.9% of our total loan portfolio. When we purchase loan participations, we apply the same underwriting standards as we would to loans that we directly originate and seek to purchase only loans that would satisfy these standards. However, we are not as familiar with the borrower and may rely on information provided to us by the selling bank and typically must rely on the selling bank's administration of the loan relationship. We therefore have less control over, and may incur more risk with respect to, loan participations that we purchase from selling banks as compared to loans that we originate.

Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.
Most of our commercial business and commercial real estate loans are made to small business or middle market customers. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and have a heightened vulnerability to economic conditions. If general economic conditions in the markets in which we operate negatively impact this important customer sector, our results of operations and financial condition and the value of our common stock may be adversely affected. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could have a material adverse effect on our financial condition and results of operations.

Our loan portfolio includes a substantial percentage of commercial and industrial loans, which may be subject to greater risks than those related to residential loans.
Our loan portfolio includes a substantial percentage of commercial and industrial loans. Commercial and industrial loans generally carry larger loan balances and historically have involved a greater degree of financial and credit risks than residential first mortgage loans. Repayment of our commercial and industrial loans is often dependent on cash flow of the borrower, which may be unpredictable, and collateral securing these loans may fluctuate in value. Our commercial and industrial loans are primarily made based on the cash flow of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most often, this collateral consists of accounts receivable, inventory, equipment, or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. At December 31, 2018, commercial and industrial loans totaled approximately 29.7% of our total loan portfolio. Adverse changes in local economic conditions impacting our business borrowers could have a material adverse effect on our business, prospects, financial condition and results of operations.

We have a high concentration of loans secured by real estate, and an adverse change in the real estate market could have a material effect on our financial condition and results of operations.
A significant portion of our loan portfolio is dependent on real estate. At December 31, 2018, approximately 65.4%% of our loans had real estate as a primary or secondary component of collateral. The collateral in each case provides an alternate source of repayment if the borrower defaults and may deteriorate in value during the time the credit is extended. An adverse change in the economy affecting values of real estate in our primary markets could significantly impair the value of real estate collateral and the ability to sell real estate collateral upon foreclosure. Furthermore, it is likely that we would be required to increase the provision for loan losses. A related risk in connection with loans secured by real estate is the effect of unknown or unexpected environmental contamination, which could make the real estate effectively unmarketable or otherwise significantly reduce its value as collateral. If we were required to liquidate real estate collateral securing a loan to satisfy the debt during a period of reduced real estate values or to increase the allowance for loan losses, it could have a material adverse effect on our financial condition and results of

operations.

We are subject to environmental liability risk associated with our lending activities.
A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Our future earnings could be adversely affected by non-cash charges for goodwill impairment, if a future test of goodwill indicates that goodwill has been impaired.
As prescribed by Accounting Standards Codification ("ASC") Topic 350, "Intangibles — Goodwill and Other," we undertake an annual review of the goodwill asset balance reflected in our financial statements. We conduct an annual review in the fourth quarter of each year, unless there has been a triggering event prescribed by applicable accounting rules that warrants an earlier interim testing for possible goodwill impairment. After our most recent annual review in the fourth quarter of 2018, we concluded there was no goodwill impairment as of such date. As of December 31, 2018, we had $42.2 million in goodwill. Future goodwill impairment tests may result in future non-cash charges, which could adversely affect our earnings for any such future period.

Changes in the fair value of our securities may reduce our stockholders' equity and net income.
At December 31, 2018, $437.8 million of our securities (at fair value) were classified as available-for-sale. At such date, the aggregate net unrealized loss on our available-for-sale securities was $6.2 million. We increase or decrease stockholders' equity by the amount of change from the unrealized gain or loss (the difference between the estimated fair value and the amortized cost) of our available-for-sale securities portfolio, net of the related tax, under the category of accumulated other comprehensive income/loss. Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholders' equity, as well as book value per common share and tangible book value per common share. This decrease will occur even though the securities are not sold. In the case of debt securities, if these securities are never sold and there are no credit impairments, the decrease will be recovered over the life of the securities. In the case of equity securities which have no stated maturity, the declines in fair value may or may not be recovered over time.

We monitor the fair value of our entire securities portfolio as part of our ongoing other than temporary impairment ("OTTI") evaluation process. No assurance can be given that we will not need to recognize OTTI charges related to securities in the future. In addition, as a condition to membership in the Federal Home Loan Bank of Dallas ("FHLB-Dallas"), we are required to purchase and hold a certain amount of FHLB-Dallas stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB-Dallas. At December 31, 2018, we had stock in the FHLB-Dallas totaling approximately $3.5 million. The FHLB-Dallas stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. For the year ended December 31, 2018, we did not recognize an impairment charge related to our FHLB-Dallas stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB-Dallas may not require us to recognize an impairment charge with respect to such holdings.

The CFPB may reshape the consumer financial laws through rulemaking and enforcement of the prohibitions against unfair, deceptive and abusive business practices, which may directly impact the business operations of depository institutions offering consumer financial products or services, including the Bank.
The CFPB has broad rulemaking authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer to consumers covered financial products and services. The CFPB has also been directed to write rules identifying practices or acts that are unfair, deceptive or abusive in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. The concept of what may be considered to be an "abusive" practice is new under the law. While the Bank will not be supervised by the CFPB, it will still be subject to the regulations and policies promulgated by the CFPB and may be examined by the OCC for compliance therewith. The costs and limitations related to complying with any new regulations established by the CFPB have yet to be fully determined and could be material. Further, the limitations and restrictions that will be placed upon the Bank with respect to its consumer product offerings and services may also produce significant, material effects on the Bank's (and our) profitability.

A natural disaster, especially one affecting one of our market areas, could adversely affect us.

Since most of our business is conducted in Louisiana and Texas, most of our credit exposure is in those states. Historically, Louisiana and Texas have been vulnerable to natural disasters. Therefore, we are susceptible to the risks of natural disasters, such as hurricanes, floods and tornadoes. Natural disasters could harm our operations directly through interference with communications, including the interruption or loss of our websites, which would prevent us from gathering deposits, originating loans and processing and controlling our flow of business, as well as through the destruction of facilities and our operational, financial and management information systems. A natural disaster or recurring power outages may also impair the value of our largest class of assets, our loan portfolio, as uninsured or underinsured losses, including losses from business disruption, may reduce borrowers' ability to repay their loans. Disasters may also reduce the value of the real estate securing our loans, impairing our ability to recover on defaulted loans through foreclosure and making it more likely that we would suffer losses on defaulted loans. Although we have implemented several back-up systems and protections (and maintain business interruption insurance), these measures may not protect us fully from the effects of a natural disaster. The occurrence of natural disasters in our market areas could have a material adverse effect on our business, prospects, financial condition and results of operations.

Our profitability is vulnerable to interest rate fluctuations.
Our profitability is dependent to a large extent on net interest income, which is the difference between our interest income on interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Conversely, when interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income. Furthermore, some of our variable interest rate loans have minimum fixed interest rates ("floors") that are currently above the contractual variable interest rate. If interest rates rise, the interest income from our variable interest rate loans with floors may not increase as quickly as interest expense on our liabilities, which would negatively impact our net interest income.

The banking industry has experienced a prolonged period of unusually low interest rates. The Federal Reserve began raising rates in late 2015 and their benchmark rate and market rates increased during 2016, 2017, and 2018. Although financial markets anticipate that the Federal Reserve may raise its benchmark rate multiple times during 2019, there is substantial uncertainty regarding the pace and extent to which interest rates may increase in 2019 and future periods and what the future effects of any such increases will be. There is no assurance that recent forecasts regarding interest rate increases will be realized.

In periods of increasing interest rates, loan originations may decline, depending on the performance of the overall economy, which may adversely affect income from lending activities and rates paid on deposits and borrowings may reprice before rates earned on loans or investment securities. Also, increases in interest rates could adversely affect the market value of fixed income assets. In addition, an increase in the general level of interest rates may affect the ability of certain borrowers to pay the interest and principal on their obligations.

Uncertainty about the future of the London Inter-Bank Offered Rate ("LIBOR"), and its accepted alternatives, may adversely affect our business.
From time to time, the Company and the Bank hold certain financial instruments or engage in transactions that have an interest rate indexed to LIBOR. On July 27, 2017, the Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced that it intends to stop persuading or compelling banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. The announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. It is impossible to predict whether and to what extent banks will continue to provide LIBOR submissions to the administrator of LIBOR or whether any additional reforms to LIBOR may be enacted in the United Kingdom or elsewhere. At this time, no consensus exists as to what rate or rates may become accepted alternatives to LIBOR and it is impossible to predict the effect of any such alternatives on the value of LIBOR-based financial instruments given LIBOR's role in determining market interest rates globally.

Uncertainty as to the nature of alternative reference rates and as to potential changes or other reforms to LIBOR may adversely affect LIBOR rates and interest rates indexed to LIBOR, as well as other interest rates. At this time, it is not possible to predict how markets will respond to any alternative reference rates, and the effect of any changes or reforms to LIBOR or discontinuation of LIBOR on new or existing financial instruments to which we have exposure. If LIBOR ceases to exist, or if the methods of calculating LIBOR change from current methods for any reason, interest rates on financial instruments whose value is tied to LIBOR may be adversely affected. The manner and impact of this transition and related developments, as well as the effect of these developments on our funding costs, investment and trading securities portfolios, and business, is uncertain and may be materially adverse to our profitability.

Non-performing assets take significant time to resolve and adversely affect our results of operations and financial condition.

Non-performing assets adversely affect our net earnings in various ways. We generally do not record interest income on non-performing loans or other real estate owned, thereby adversely affecting our earnings, and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we mark the related asset to the then fair market value of the collateral less estimated selling costs, which may result in a loss. An increase in the level of non-performing assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile. While we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of non-performing assets, including taking actions required by the Bank's written agreement with the OCC, requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. We may also hire third party consultants and advisors to assist us, which would increase our non-interest expense and reduce our earnings. There can be no assurance that we will not experience future increases in non-performing assets.

The soundness of other financial institutions could adversely affect us.
Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse effect on our business, prospects, financial condition and results of operations.

We operate within a highly regulated environment and our business and results are affected by the regulations to which we are subject.
We operate within a highly regulated environment. The regulations to which we are subject will continue to have an impact on our operations and the degree to which we can grow and be profitable. Certain regulators, to which we are subject, have significant power in reviewing our operations and approving our business practices. In recent years the Bank, as well as other financial institutions, has experienced increased regulation and regulatory scrutiny, often requiring additional resources. In addition, investigations or proceedings brought by regulatory agencies may result in judgments, settlements, fines, penalties, or other results adverse to us. There is no assurance that any change to the regulatory requirements to which we are subject, or the way in which such regulatory requirements are interpreted or enforced, will not have a negative effect on our ability to conduct our business and our results of operations.

Our operations may be adversely affected by cybersecurity risks.
In the ordinary course of business, we collect and store sensitive data, including proprietary business information and personally identifiable information of our customers and employees in systems and on networks. The secure processing, maintenance, and use of this information is critical to our operations and business strategy. We are subject to complex laws and regulations governing the privacy and protection of such personally identifiable information. For example, our business is subject to the Gramm-Leach-Bliley Act which, among other things: (i) imposes certain limitations on our ability to share nonpublic personal information about customers with nonaffiliated third parties; (ii) requires that we provide certain disclosures to customers about information collection, sharing and security practices and afford customers the right to “opt out” of any information sharing by us with nonaffiliated third parties (with certain exceptions); and (iii) require that we develop, implement and maintain a written comprehensive information security program containing appropriate safeguards based on our size and complexity, the nature and scope of its activities, and the sensitivity of customer information processed, as well as plans for responding to data security breaches. Various state and federal laws and regulations impose data security breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in certain circumstances in the event of a security breach. Ensuring that our collection, use, transfer and storage of personal information complies with all applicable laws and regulations can increase costs.

In addition, we rely heavily on communications and information systems to conduct our business. Any failure, interruption, or breach in security or operational integrity of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan, and other systems. We have invested in accepted technologies, and continually review processes and practices that are designed to protect its networks, computers, and data from damage or unauthorized access. Despite these security measures, our computer systems and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance, or other disruptions. A breach of any kind could compromise systems and the information stored there could be accessed, damaged, or disclosed. A breach in security or other failure could result in legal claims, regulatory penalties, disruption in operations, increased expenses, loss of customers and business partners, and damage to our reputation, which could adversely affect our business and financial condition. Furthermore, as cyber threats continue to evolve and increase,

we may be required to expend significant additional financial and operational resources to modify or enhance its protective measures, or to investigate and remediate any identified information security vulnerabilities.

We rely heavily on technology and computer systems. The negative effects of computer system failures and unethical individuals with the technological ability to cause disruption of service could adversely affect our reputation and our ability to generate deposits.

Our ability to compete depends on our ability to continue to adapt and deliver technology on a timely and cost-effective basis to meet customers' demands for financial services. We provide our customers the ability to bank online and many customers now remotely submit deposits to us through remote-capture systems. The secure transmission of confidential information over the Internet is a critical element of these services. Our network could be vulnerable to unauthorized access, computer viruses,

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phishing schemes and other security problems. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation and our ability to generate deposits.

We rely on third parties to provide key components of our business infrastructure.
Third parties provide key components of our business operations such as data processing, recording and monitoring transactions, online banking interfaces and services, Internet connections and network access. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including those resulting from disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher volumes, cyber-attacks and security breaches at a vendor, failure of a vendor to provide services for any reason or poor performance of services, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third party vendor could also hurt our operations if those difficulties interfere with the vendor's ability to serve us. Furthermore, our vendors could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints. Replacing these third party vendors could also create significant delay and expense. Accordingly, use of such third parties creates an unavoidable inherent risk to our business operations.

Cybersecurity and data privacy are areas of heightened legislative and regulatory focus.
As cybersecurity and data privacy risks for banking organizations and the broader financial system have significantly increased in recent years, cybersecurity and data privacy issues have become the subject of increasing legislative and regulatory focus. The federal banking agencies have proposed, but not finalized, enhanced cyber risk management standards, which could apply to a wide range of financial institutions and third-party service providers, including the Company and the Bank, and would focus on cyber risk governance and management, management of internal and external dependencies, and incident response, cyber resilience and situational awareness. Several states have also proposed or adopted cybersecurity legislation and regulations, which require, among other things, notification to affected individuals in certain circumstances. In addition, we may become subject to new legislation or regulation concerning cybersecurity or the privacy of personally identifiable information and personal financial information or of any other information we may store or maintain. We could be adversely affected if new legislation or regulations are adopted or if existing legislation or regulations are modified such that we are required to alter our systems or require changes to business practices or privacy policies. If cybersecurity, data privacy, data protection, data transfer or data retention laws are implemented, interpreted or applied in a manner inconsistent with our current practices, we may become subject to fines, litigation or regulatory enforcement actions or ordered to change our business practices, policies or systems in a manner that adversely impacts our operating results. For more information about cybersecurity and privacy regulations, please see the "Supervision and Regulation" section of this report.

Consumers may decide not to use banks to complete their financial transactions.
Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

Risks Relating to an Investment in Our Common Stock

Our future ability to pay dividends and repurchase stock is subject to restrictions and we may be unable to pay future dividends even if we desire to do so.
Holders of our common stock are only entitled to receive such cash dividends as our board of directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and may reduce or eliminate our common stock cash dividend in the future. This could adversely affect the market price of our common stock. Since we are a holding company, we have no material source of income other than dividends received from the Bank. Although we had $44.8 million of cash at December 31, 2018, historically, our ability to pay dividends to our shareholders has depended on the Bank's ability to pay dividends to us. Moreover, banks and bank holding companies are both subject to certain federal and state regulatory restrictions on cash dividends. We are also restricted from paying dividends if we have deferred payments of the interest on, or an event of default has occurred with respect to, our trust preferred securities, Series B Preferred Stock or Series C Preferred Stock. Additionally, terms and conditions of our outstanding shares of preferred stock place certain restrictions and limitations on our common stock dividends and repurchases of our common stock.

The holders of our preferred stock and trust preferred securities have rights that are senior to those of stockholders and that may impact our ability to pay dividends on our common stock and net income available to our common stockholders.
At December 31, 2018, we had outstanding $22.2 million of trust preferred securities. These securities are senior to shares of common stock. As a result, we must make payments on our trust preferred securities before any dividends can be paid on our common stock. Moreover, in the event of our bankruptcy, dissolution, or liquidation, the obligations outstanding with respect to our trust preferred securities must be satisfied before any distributions can be made to our stockholders. While we have the right to defer dividends on the trust preferred securities for a period of up to five years, if any such election is made, no dividends may be paid to our common or preferred stockholders during that time.

In addition, with respect to the $32.0 million in Series B Preferred Stock outstanding that was issued to the Treasury in the Small Business Lending Fund "SBLF" transaction, we are required to pay cumulative dividends on the Series B Preferred Stock at an annual rate. The dividend rate was set at 1.00% beginning in the fourth quarter of 2013 due to attaining the target 10% growth rate in qualified small business loans during the second quarter of 2013. Beginning February 25, 2016, the dividend rate increased to 9% per annum. The $9.0 million in Series C Preferred Stock currently outstanding that was originally issued in connection with the PSB acquisition calls for the non-cumulative payment of dividends at an annual rate of 4.0%. Dividends paid on our Series B Preferred Stock or Series C Preferred Stock will also reduce the net income available to our common stockholders and our earnings per common share. We may not declare or pay dividends on our common stock or repurchase shares of our common stock without first having paid all accrued preferred dividends that are due.

Share ownership may be diluted by the issuance of additional shares of common stock in the future.
Our stock incentive plan provides for the granting of stock incentives to directors, officers, and employees. As of December 31, 2018, there were 75,826 shares issued under options. Likewise, approximately 522,156 shares may be issued in the future to directors, officers, and employees under our existing equity incentive plans. In addition, in 2009, as part of our participation in the Treasury's Capital Purchase Program ("CPP"), we issued a stock purchase warrant that currently entitles the holder to purchase 104,384 shares of our common stock at an exercise price of $14.37 per share. It is probable that options and/or warrants will be exercised during their respective terms if the stock price exceeds the exercise price of the particular option or warrant. The incentive plan also provides that all issued options automatically and fully vest upon a change in control. If the options are exercised, share ownership will be diluted.

Additionally, share ownership of our common stock will be diluted from shares issued upon conversion of the Series C Preferred Stock issued in the PSB acquisition. As of December 31, 2018, there were 89,721 shares of Series C Preferred Stock issued and outstanding. Holders may convert the Series C Preferred Stock at any time into shares of the Company's common stock at a conversion price of $18.00 per share, subject to customary antidilution adjustments. In addition, the Company currently has the option to require conversion of the Series C Preferred Stock if the closing price of the Company's common stock for 20 trading days within any period of 30 consecutive trading days, exceeds 130% of the conversion price.

In addition, our articles of incorporation authorize the issuance of up to 30,000,000 shares of common stock and 5,000,000 shares of preferred stock, but do not provide for preemptive rights to the stockholders; therefore, stockholders will not automatically have the right to subscribe for additional shares. As a result, if we issue additional shares to raise additional capital or for other corporate purposes, you may be unable to maintain your pro rata ownership in the Company.

Only a limited trading market exists for our common stock, which could lead to price volatility.
Our common stock is listed for trading on the NYSE under the trading symbol "MSL," but there is low trading volume in our common stock. The limited trading market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which might occur in a more active trading market of our common stock. Future sales of substantial amounts of common stock in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of our common stock. In addition, even if a more active market in our common stock develops, we cannot assure you that such a market will continue.

Our directors and executive management own a significant number of shares of stock, allowing further control over business and corporate affairs.
Our directors and executive officers beneficially own approximately 1.1 million shares, or 6.7%, of our outstanding common stock as of December 31, 2018. As a result, in addition to their day-to-day management roles, they will be able to exercise significant influence on our business as stockholders, including influence over election of the Board and the authorization of other corporate actions requiring shareholder approval. In deciding on how to vote on certain proposals, our stockholders should be aware that our directors and executive officers may have interests that are different from, or in addition to, the interests of our stockholders generally.

Provisions of our articles of incorporation and by-laws, Louisiana law, and state and federal banking regulations could delay or prevent a takeover by a third party.
Our articles of incorporation and by-laws could delay, defer, or prevent a third party takeover, despite possible benefit to the stockholders, or otherwise adversely affect the price of our common stock. Our governing documents:

- permit directors to be removed by stockholders only for cause and only upon an 80% vote;
- require 80% of the voting power for stockholders to amend the by-laws, call a special meeting, or amend the articles of incorporation, in each case if the proposed action was not approved by the Board;
- authorize a class of preferred stock that may be issued in series with terms, including voting rights, established by the Board without stockholder approval;
- authorize approximately 30 million shares of common stock and 5 million shares of preferred stock that may be issued by the Board without shareholder approval;
- classify our Board with staggered three year terms, preventing a change in a majority of the Board at any annual meeting;
- require advance notice of proposed nominations for election to the Board and business to be conducted at a shareholder meeting; and
- require 80% of the voting power for stockholders to approve business combinations not approved by the Board.

These provisions would likely preclude a third party from removing incumbent directors and simultaneously gaining control of the Board by filling the vacancies thus created with its own nominees. Under the classified Board provisions, it would take at least two elections of directors for any individual or group to gain control of the Board. Accordingly, these provisions could discourage a third party from initiating a proxy contest, making a tender offer or otherwise attempting to gain control. These provisions may have the effect of delaying consideration of a shareholder proposal until the next annual meeting unless a special meeting is called by the Board or the chairman of the Board. Moreover, even in the absence of an attempted takeover, the provisions make it difficult for stockholders dissatisfied with the Board to effect a change in the Board's composition, even at annual meetings.

A shareholder's investment is not an insured deposit.
An investment in our common stock is not a bank deposit and is not insured or guaranteed by the FDIC or any other government agency. Your investment in our common stock will be subject to investment risk and you may lose all or part of your investment.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease our principal executive and administrative offices and principal facility in Lafayette, Louisiana under a lease expiring July 31, 2021. In addition to our principal facility, we also have six other branches located in Lafayette, Louisiana, two in New Iberia, Louisiana, four in Baton Rouge, Louisiana, two in Natchitoches, Louisiana, two in Lake Charles and Many, Louisiana, and one branch in each of the following Louisiana cities: Breaux Bridge, Houma, St. Martinville, Opelousas, Carencro, Morgan City, Jennings, Sulphur, Thibodaux, Greenwood, Zwolle, and Mansfield. We also have an operations office in Breaux Bridge, Louisiana. Twenty-eight of these offices are owned and four are leased.

Additionally, in our Texas market area we have two full service branches located in Beaumont, Texas. Our additional full service branches in the Texas market area are located in Houston, Conroe, College Station, Plano, Mesquite, Rockwall, Greenville, and Tyler. Of these offices, eight are owned and two are leased.

ITEM 3. LEGAL PROCEEDINGS

The Bank has been named as a defendant in various other legal actions arising from normal business activities in which damages of various amounts are claimed. While the amount, if any, of ultimate liability with respect to such matters cannot be currently determined, management believes, after consulting with legal counsel, that any such liability will not have a material adverse effect on the Company’s consolidated financial position, results of operations, or cash flows. However, in the event of unexpected future developments in these matters, if the ultimate resolution of any such matter is unfavorable, the result may be material to the Company’s consolidated financial position, consolidated results of operations or consolidated cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

None.

Executive Officers of the Registrant

The names, ages as of December 31, 2018, and positions of our current executive officers are listed below along with their business experience during the past five years.

James R. McLemore, 59 – President and Chief Executive Officer of the Company and the Bank since May 2017. Mr. McLemore previously served as the Company's Interim President and Chief Executive Officer since April 2017 and Chief Financial Officer since July 2009. Mr. McLemore has over 30 years in banking experience. Prior to joining the Company, Mr. McLemore served as Executive Vice President and Chief Financial Officer of Security Bank Corporation from 2002 until July 2009. In July 2009, subsequent to Mr. McLemore's departure, the six subsidiary banks of Security Bank Corporation were closed and the FDIC was appointed receiver of the banks. Security Bank Corporation subsequently filed for bankruptcy in August of 2009. Mr. McLemore has also been a member of the Board of Directors of the Company and the Bank since June 2017.

Lorraine Miller, 55 – Executive Vice President and Chief Financial Officer of the Company and the Bank since May 2017. Ms. Miller previously served as the Senior Vice President, Director of Mergers and Acquisitions of the Company and the Bank since February 2010, and the Treasurer of the Company and the Bank since January 2013. Ms. Miller has over 25 years of banking experience.

John Davis,55 – Chief Operating Officer of the Company and the Bank since August 2018. Mr. Davis has over 25 years of banking experience including approximately 10 years at Yadkin Bank in North Carolina, having most recently served as Senior Vice President and Director of Operations.

Chris Mosteller,38 – Chief Banking Officer of the Company since July 2018 and the Bank since March 2018. Mr. Mosteller joined MidSouth Bank in 2016 as North Texas Regional President after spending more than a decade with Wells Fargo, most recently as Business Banking Manager. He has over 15 years of banking experience.

Clay Abington, 52 – Executive Vice President Corporate Efficiency of the Company and the Bank since May 2017. Mr. Abington previously served as First Vice President Business Process Manager of the Bank since October 2013. He has 16 years of banking experience. Mr. Abington is the son of Mr. Leonard Q. "Pete" Abington, a member of the Company's board of directors.

Dawn Bastarache,49 – Executive Vice President Corporate Development and Strategic Planning since June 2018. Ms. Bastarache previously served as Director of Operational Risk at Cadence Bank, Senior Vice President and Omni Channel Director at Hancock Bank, and in various Risk and IT roles at Regions Bank over a span of 25 years.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED SHAREHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company’s common stock trades on the NYSE under the symbol “MSL.” As of February 28, 2019, there were 842 common stockholders of record.

ITEM 6. SELECTED FINANCIAL DATA

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide information under this item.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our consolidated financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes. Historical results of operations and the percentage relationships among any amounts included, and any trends that may appear, may not indicate trends in operations or results of operations for any future periods.

Overview

We are a bank holding company, headquartered in Lafayette, Louisiana, that through our community banking subsidiary, MidSouth Bank, N.A., operates 42 offices in Louisiana and Texas. We had approximately $1.7 billion in total consolidated assets as of December 31, 2018. We derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Interest-bearing deposits represent 73.6% of our total deposits. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. The resulting ratio of that difference as a percentage of our average earning assets represents our net interest margin. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread. In addition to earning interest on our loans and investments, we earn income through fees and other charges to our customers. We have also included a discussion of the various components of this noninterest income, as well as of our noninterest expense.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We maintain this allowance by charging a provision for loan losses against our operating earnings for each period. We have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses.

The economy in a large portion of our market areas is heavily dependent on the oil and gas industry. Over the past several years, we have experienced sustained low oil and gas prices that has led to an increase in our classified assets. While most of our customers are not directly involved in oil and gas exploration, many of our customers provide transportation and other services and products that support oil and gas exploration and production activities and are therefore indirectly impacted by low commodity prices. In addition, these adverse developments in the oil and gas industry have had negative effects on the economies of our market areas in general, including adverse effects on commercial and residential real estate values and the general level of economic activity. The oil and gas industry, especially in Louisiana and Texas, has historically been subject to significant volatility, and these market areas have experienced a slower recovery from this current economic cycle which has adversely impacted the Bank's customers and their ability to recover from this downturn. As of December 31, 2018, we had approximately $112.6 million in loans to borrowers in the oil and gas industry representing approximately 12.5% of our total loans outstanding as of that date, which represents a reduction of $67.1 million of these types of loans, or 37.3%, since December 31, 2017, and we continue to make efforts to reduce our concentrations in these loans.

The Company and the Bank have both been placed in troubled condition by their respective federal banking regulators. The Bank has also entered into a written agreement with the OCC and has also been issued a Consent Order by the OCC. These designations, the written agreement and the Consent Order subject us to significant restrictions and will require us to designate a significant amount of resources to comply. See Part I, Item 1 under the heading “Business - Supervision and Regulation - Regulatory Matters” for additional information.

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the financial statements accompanying or incorporated by reference in this report. We encourage you to read this discussion and analysis in conjunction with our consolidated financial statements and the notes thereto and other statistical information included and incorporated by reference in this annual report on Form 10-K.

Critical Accounting Policies

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements. Our significant accounting policies are described in the notes to the consolidated financial statements included in this report. The accounting principles we follow and the methods of applying these principles conform to accounting principles generally accepted in the United States of America ("GAAP") and general banking practices. Our most critical accounting policy relates to the determination of the allowance for loan losses, which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. The determination of the adequacy of the allowance involves significant judgment and complexity and is based on many factors. If the financial condition of our borrowers were to deteriorate, resulting in an impairment of their ability to make payments, the estimates would be updated and additional provisions for loan losses may be required. See Asset Quality – Allowance for Loan Losses and Note 1 and Note 3 of the notes to the consolidated financial statements.

Another of our critical accounting policies relates to the valuation of goodwill, intangible assets and other purchase accounting adjustments. We account for acquisitions in accordance with ASC Topic No. 805, which requires the use of the purchase method of accounting. Under this method, we are required to record assets acquired and liabilities assumed at their fair value, including intangible assets. Determination of fair value involves estimates based on internal valuations of discounted cash flow analyses performed, third party valuations, or other valuation techniques that involve subjective assumptions. Additionally, the term of the useful lives and appropriate amortization periods of intangible assets is subjective. Resulting goodwill from an acquisition under the purchase method of accounting represents the excess of the purchase price over the fair value of net assets acquired. Goodwill is not amortized, but is evaluated for impairment annually or more frequently if deemed necessary. If the fair value of an asset exceeds the carrying amount of the asset, no charge to goodwill is made. If the carrying amount exceeds the fair value of the asset, goodwill will be adjusted through a charge to earnings. In evaluating the goodwill on our consolidated balance sheet for impairment at December 31, 2018, we first assessed qualitative factors to determine whether it is more likely than not that the fair value of our acquired assets is less than the carrying amount of the acquired assets, as allowed under ASU 2011-08, Intangibles- Goodwill and Other (Topic 350): Testing Goodwill for Impairment. After making the assessment based on several factors, which included but was not limited to the current economic environment, the economic outlook in our markets, our financial performance and common stock value as compared to our peers, we determined it is more likely than not that the fair value of our acquired assets is greater than the carrying amount and, accordingly, no impairment of goodwill was recorded for the year ended December 31, 2018.

Given the instability of the economic environment, it is reasonably possible that the methodology of the assessment of potential loan losses and goodwill impairment could change in the near-term or could result in impairment going forward.

Another of our critical accounting policies relates to deferred tax assets and liabilities. We record deferred tax assets and deferred tax liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax benefits, such as net operating loss carry forwards, are recognized to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the assets and liabilities are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. In the event the future tax consequences of differences between the financial reporting bases and the tax bases of our assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such assets is required. A valuation allowance is provided when it is more likely than not that a portion or the full amount of the deferred tax asset will not be realized. In assessing the ability to realize the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies. A deferred tax liability is not recognized for portions of the allowance for loan losses for

income tax purposes in excess of the financial statement balance. Such a deferred tax liability will only be recognized when it becomes apparent that those temporary differences will reverse in the foreseeable future. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent more likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

Yield Analysis

Net loss available to common shareholders for the year ended December 31, 2018 totaled $30.8 million compared to net loss available to common shareholders of $15.0 million for the year ended December 31, 2017. A loss of $1.85 per diluted common share was reported for the year ended December 31, 2018, compared to diluted loss per common share of $1.06 for 2017. The 2018 net loss included $49,000 of loss on sales of securities, $19.7 million of regulatory remediation costs, $145,000 of charges related to branch closure expenses, and a $987,000 loan held-for-sale expense, offset by $726,000 in discount accretion acceleration. A $13.5 million decrease in provision for loan losses was partially offset by a $8.6 million increase in income tax expense for 2018 compared to 2017.

The following table shows the relationship between interest revenue and expense and the average balances of interest-earning assets are interest-bearing liabilities as of the dates indicated (in thousands):

	Year Ended December 31,							
	2018				2017			
	Average Volume	Interest	Average Yield/ Rate		Average Volume	Interest	Average Yield/ Rate	
Assets								
Taxable securities	$354,153	$9,246	2.61	%	$372,523	$9,180	2.46	%
Tax-exempt securities (*)	45,117	1,451	3.22	%	56,569	2,283	4.04	%
Total investment securities	399,270	10,697	2.68	%	429,092	11,463	2.67	%
Federal funds sold	5,785	104	1.80	%	3,979	43	1.08	%
Time and interest-bearing deposits in other banks	197,329	4,069	2.06	%	71,754	854	1.19	%
Other investments	15,466	461	2.98	%	11,790	340	2.88	%
Loans	1,058,379	60,485	5.71	%	1,255,488	68,708	5.47	%
Total interest earning assets	1,676,229	75,816	4.52	%	1,772,103	81,408	4.59	%
Non-interest earning assets	159,409				157,435			
Total assets	$1,835,638				$1,929,538			
Interest-bearing liabilities:								
Deposits	$1,075,302	$5,919	0.55	%	$1,121,004	$4,099	0.37	%
Repurchase agreements	23,406	98	0.42	%	78,347	685	0.87	%
FHLB advances	33,182	466	1.40	%	30,691	412	1.34	%
Junior subordinated debentures	22,167	1,025	4.62	%	22,167	830	3.74	%
Total interest-bearing liabilities	1,154,057	7,508	0.65	%	1,252,209	6,026	0.48	%
Non-interest bearing liabilities	431,559				431,326			
Shareholders' equity	250,022				246,003			
Total liabilities and shareholders' equity	$1,835,638				$1,929,538			
Net interest income (TE) and spread		$68,308	3.87	%		$75,382	4.11	%
Net interest margin (TE)			4.08	%			4.25	%

(*) Reflects taxable equivalent adjustments using the federal statutory tax rate of 21% (2018) and 35% (2017) in adjusting interest on tax-exempt securities to a fully taxable basis. The taxable equivalent adjustments included above amount to $305,000 for 2018 and $785,000 for 2017.

Earnings Analysis

Net Interest Income

Net interest income represents the amount by which interest income on interest-earning assets exceeds interest expense incurred on interest-bearing liabilities. Net interest income is the largest component of our income and is affected by the interest rate environment and the volume and composition of interest-earning assets and

interest-bearing liabilities. Our interest-earning assets include loans, investment securities , other investments, interest-bearing deposits in banks, federal funds sold and time deposit in other banks. Our interest-bearing liabilities include deposits, securities sold under agreements to repurchase, other borrowings and subordinated deferrable interest debentures.

Our primary source of earnings is net interest income, which is the difference between interest earned on loans and investments and interest paid on deposits and other interest-bearing liabilities. Changes in the volume and mix of earning assets and interest-bearing liabilities combined with changes in market rates of interest greatly affect net interest income. For 2018 and 2017 our net interest spread was 3.87% and 4.11% , respectively, while the net interest margin on a taxable equivalent basis, which is net interest income as a percentage of average earning assets, was 4.08% and 4.25%.

Net interest income was $68.0 million in 2018, a decrease of $6.6 million or 8.8%, from 2017. Taxable equivalent net interest income for 2018 decreased $7.1 million, or 9.4%, from 2017.

Average interest-earning assets for 2018 decreased $95.9 million, or 5.4%, from 2017, due primarily to the decrease in loans offset by the increase in time and interest-bearing deposits at other banks. Average loans decreased $197.1 million, from 2017, while the yield on loans increased 24 basis points, reflecting the effect of rising interest rates on the floating rate loans in the portfolio. Average time and interest-bearing deposits at other banks increased $125.6 million while the yield on these deposits also increased 10 basis points.

Average interest-bearing liabilities in 2018 decreased $98.2 million, or 7.8%, from the prior year, due to the decline in deposits and securities under agreement to repurchase. The average cost of interest-bearing deposits for 2018 was 0.55% compared to 0.37% for 2017, reflecting a higher average rate on interest-bearing deposits.

The following table shows the relative effect on net interest revenue resulting from changes in the average outstanding balances (volume) of interest-earning assets and interest-bearing liabilities and the rates earned and paid by the Company on such assets and liabilities (in thousands).

	2018 Compared to 2017			2017 Compared to 2016		
	Total Increase (Decrease)	Change Attributable to Volume	Change Attributable to Rates	Total Increase (Decrease)	Change Attributable to Volume	Change Attributable to Rates
Taxable-equivalent interest earned on:						
Investment securities						
Taxable	$ 66	$ (470)	$ 536	$ 1,256	$ 420	$ 836
Tax-exempt	(832)	(416)	(416)	(397)	(301)	(96)
Federal funds sold	61	25	36	27	4	23
Time and interest-bearing deposits in other banks	3,215	2,272	943	455	(25)	480
Other investments	121	109	12	(11)	14	(25)
Loans, including fees	(8,223)	(11,136)	2,913	1,124	(443)	1,567
Total	(5,592)	(9,616)	4,024	2,454	(331)	2,785
Interest paid on:						
Interest-bearing deposits	1,820	(171)	1,991	445	(180)	625
Securities sold under agreements to repurchase	(587)	(337)	(250)	(258)	(102)	(156)
FHLB advances	54	34	20	23	(12)	35
Junior subordinated debentures	195	—	195	126	—	126
Total	1,482	(474)	1,956	336	(294)	630
Taxable-equivalent net interest income	$ (7,074)	$ (9,142)	$ 2,068	$ 2,118	$ (37)	$ 2,155

NOTE: Changes due to both volume and rate have generally been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts to the changes in each.

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The following table shows the return on assets and equity for our Company at December 31 for each of the years indicated.

	2018	2017
Return on average assets	(1.68)%	(0.78)%
Return on average common equity	(14.87)%	(7.32)%
Dividend payout ratio on common stock	(2.16)%	(18.87)%
Average common equity to average assets	11.27 %	12.75 %

Return on average assets and return on average common equity for 2018 were impacted by $19.7 million of regulatory remediation costs, $145,000 of one-time charges related to branch closure expense, a $987,000 in loan resolution expense, and a $7.7 million expense from establishment of a valuation allowance, offset by $726,000 in discount accretion acceleration. Excluding these non-operating items, negative return on average assets for the year ended December 31, 2018 was 0.39% and negative return on average common equity for the year ended December 31, 2018 was 3.47%. 2017 return on average assets and return on average common equity were impacted by $2.6 million in regulatory remediation costs, $6.0 million in loss on transfer of loans to held for sale, $1.5 million service and retention expenses, $1.4 million in branch closure expenses, and a $3.6 million write down of net deferred tax asset resulting from the Tax Cuts and Jobs Act. Excluding these non-operating items, negative return on average assets for the year ended December 31, 2017 was 0.20% and negative return on average common equity for the year ended December 31, 2017 was 1.59%.

Results of Operation

Noninterest Income
Noninterest income totaled $19.5 million at December 31, 2018 compared to $21.8 million at December 31, 2017. Our recurring non-interest income includes service charges and fees on deposit accounts, ATM and debit card income and credit card income.

The following table presents noninterest income for the years ended December 31, 2018 and 2017 (in thousands).

	2018	2017
Service charges on deposit accounts	$7,844	$8,968
ATM and debit card income	8,081	7,668
Credit card income	1,518	1,543
Gain (loss) on securities, net	(49)	347
Gain on sale of branches	—	744
Other	2,109	2,511
Total noninterest income	$19,503	$21,781

Income from service charges and fees on deposit accounts, including insufficient funds fees ("NSF" fees), decreased $1.1 million in 2018, as a result of a $785,000 decrease in retail NSF income. ATM and debit card income increased $413,000 in 2018. The increase in ATM and debit card income during 2018 was a result of a continued increase in electronic transactions processed. Credit card income remained stable at $1.5 million. Other noninterest income decreased $402,000 in 2018. The decrease in 2018 was primarily due to a $669,000 decrease in mortgage lending income.

Noninterest Expense

Noninterest expense totaled $92.3 million for the year ended December 31, 2018 compared to $80.5 million for the year ended December 31, 2017. Our recurring non-interest expense consists of salaries and employee benefits, occupancy expense, ATM and debit card expense and other operating expenses.

The following table presents noninterest expense for the years ended December 31, 2018 and 2017 (in thousands).

	2018	2017
Salaries and employee benefits	$32,292	$33,889
Occupancy expense	12,501	15,670
ATM and debit card	2,555	2,721
Legal and professional fees	8,789	3,319
FDIC premiums	1,599	1,572
Marketing	1,105	1,197
Corporate development	1,107	1,016
Data processing	2,889	2,640
Amortization of core deposit intangibles	1,106	1,107
Loss on transfer of loans to held-for-sale	987	6,030
Regulatory remediation costs	19,721	2,628
Other	7,666	8,748
Total noninterest expense	$92,317	$80,537

At December 31, 2018 noninterest expense totaled $92.3 million, an increase $11.8 million or 14.6% compared to the same period in 2017. Our largest noninterest expense, salaries and employee benefits totaled $32.3 million, a decrease of $1.6 million, or 4.7% as of December 31, 2018 compared to the same period in 2017. The number of employees on

a full-time equivalent ("FTE") basis increased by 7 during 2018, from 467 at year end 2017 to 474 at year end 2018.

At December 31, 2018, occupancy expense totaled $12.5 million, a decrease of $3.2 million or 20.2% compared to the same period in 2017. The decrease was primarily due to the closure and sale of 9 branches in 2017 resulting in fewer branches in 2018 to service.

At December 31, 2018, legal and professional fees totaled $8.8 million, an increase of $5.5 million or 164.8% compared to the same period in 2017. The increase during the year is primarily a result of management's initiative to address and comply with the terms of the written regulatory order which includes the increased need for outside legal and professional assistance.

At December 31, 2018, regulatory remediation costs totaled $19.7 million, an increase of $17.1 million or 650.4% from the same period in 2017. The increase is related to consulting and outsourcing costs for assistance with addressing and complying with the terms of the written regulatory order.

Income Taxes

Income tax expense increased $8.6 million in 2018. The increase is a result of the Company recording a deferred tax asset valuation allowance of $11.1 million as of December 31, 2018. Our effective tax rate approximated (27.7%) and 18.1% in 2018 and 2017, respectively. The effective tax rate for 2018 was impacted by the adjustment of our net deferred tax assets related to the temporary establishment of a valuations allowance to fully reserve against deferred tax assets. The impact of nontaxable municipal interest income and other tax considerations also contributed to lower effective tax rates for each of the years ended December 31, 2018 and 2017, respectively.

Balance Sheet Analysis

Investment Securities

The following table shows the carrying value of the Company's debt securities for the years ended as of December 31 (in thousands).

Available-for-sale securities	2018	2017	2016
U.S. Agencies	$3,072	$—	$—
State, county, and municipal securities	44,088	22,809	29,141
Mortgage-backed securities	365,877	259,519	296,862
Corporate debt securities	24,717	24,802	13,811
Total available-for-sale securities	$437,754	$307,130	$339,814
Held-to-maturity securities			
State, county, and municipal securities	$1,977	$35,908	$40,515
Mortgage-backed securities	35,782	45,144	57,696
Total held-to-maturity securities	$37,759	$81,052	$98,211
Total investment securities	$475,513	$388,182	$438,025

The following table shows the debt securities maturities and the associated average taxable-equivalents yields at December 31, 2018 (in thousands).

	One year or less		After one year through five years		After five years through ten years		After ten years		
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total
Securities available-for-sale:									
U.S. Agencies	$—	— %	$—	— %	$3,072	3.46%	$—	— %	$3,072
State, county, and municipal securities[1]	—	— %	2,789	2.62%	14,752	2.90%	26,547	3.48%	44,088
Mortgage-backed securities	—	— %	30	4.31%	27,911	2.73%	337,936	2.89%	365,877
Corporate debt securities	—	— %	6,920	5.64%	17,797	5.96%	—	— %	24,717
Total fair value	$—		$9,739		$63,532		$364,483		$437,754

	One year or less		After one year through five years		After five years through ten years		After ten years		
Held-to-Maturity:	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total
State, county, and municipal securities [1]	$766	2.56%	$1,211	2.64%	$—	— %	$—	— %	$1,977
Mortgage-backed securities	—	— %	—	— %	28,414	2.47%	7,368	1.73%	35,782
Total cost	$766		$1,211		$28,414		$7,368		$37,759

[1] Tax exempt yields are expressed on a fully taxable equivalent basis.

The composition of the investment securities portfolio reflects our investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of revenue. The investment securities portfolio also provides a balance to interest rate risk in other categories of the balance sheet, while providing a vehicle for the investment of available funds, furnishing liquidity, and supplying securities to pledge as required collateral for certain deposits and borrowings, including repurchase agreements. Total investment securities at December 31, 2018 increased $87.3 million or 22.5% compared to the same period 2017.

At December 31, 2018 and 2017, we had debt securities held-to-maturity with a carrying value of $37.8 million and $81.1 million, respectively, and debt securities available-for-sale totaling $437.8 million and $307.1 million, respectively. At December 31, 2018 and 2017, the securities portfolio represented approximately 27.3% and 20.6%, respectively, of total assets. At December 31, 2018, the effective duration of the investment portfolio was 3.42 years, compared with 3.2 years at December 31, 2017.

Additional information on our investment securities portfolio is provided in Note 2 of the notes to consolidated financial statements.

Loan Portfolio

The following table shows the composition of the Company's loan portfolio for the last five years as of December 31 (in thousands).

	2018	2017	2016	2015	2014
Commercial, financial, and agricultural	$267,340	$435,207	$459,574	$454,028	$467,147
Real estate – construction	87,506	90,287	100,959	74,952	68,577
Real estate – commercial	368,449	454,051	481,922	472,624	469,920
Real estate – residential	132,435	146,751	157,872	149,064	154,602
Consumer and other	43,506	56,398	82,660	111,009	119,328
Lease financing receivable	549	732	1,095	1,968	4,857
Total loans	$899,785	$1,183,426	$1,284,082	$1,263,645	$1,284,431

The following table sets forth the maturity distribution, including the interest sensitivity for loans maturing after one year at December 31, 2018 (in thousands).

	Fixed and Variable Rate Loans at Stated Maturities				Amounts Over One Year With		
	One year or less	One year – five years	Over five years	Total	Predetermined Rates	Floating Rates	Total
Real estate – residential	4,596	34,923	92,916	132,435	52,261	75,578	127,839
Consumer and other	13,346	26,721	3,439	43,506	26,135	4,025	30,160
Lease financing receivable	35	78	436	549	514	—	514
Total	$17,977	$61,722	$96,791	$176,490	$78,910	$79,603	$158,513

The loan portfolio decreased $283.6 million, or 23.97%, during 2018 when compared to the same period 2017. The decrease was primarily a result of our continued focus on reducing our nonperforming loans. One such effort is our intention to sell a portion of these nonperforming loans through a bulk loan sale which was the main source of our net charge-offs of $26.2 million as of December 31, 2018 compared to $27.7 million the same period 2017.

Our loan portfolio is diversified throughout our Louisiana and Texas markets, with a focus on Commercial & Industrial ("C&I") as well as Commercial Real Estate ("CRE") loans. The C&I portfolio consists primarily of term loans or revolving lines of credit. The term loans are generally fixed rates and have maturities of three to five years. The CRE portfolio consists primarily of three to five year fixed rate maturities with fifteen to twenty year amortization terms.

The Company strives to maintain a diversified loan portfolio across our footprint within various loan types. At December 31, 2018, our concentration within the oil and gas portfolio aggregated to more than 10% of our total loan portfolio. We define an energy loan as any loan where the borrower's ability to repay is disproportionately impacted by a prolonged downturn in energy prices. Under this definition, the Bank includes direct C&I loans to energy borrowers, as well as CRE loans, Residential Real Estate loans and loans to energy-related borrowers where the loan's primary collateral is cash and marketable securities. Although this definition has resulted in a lack of comparability with some other energy-related banks, management believes it to be the

prudent approach to monitoring and managing the Bank's energy exposure. Our exposure in the oil and gas industry, as defined above, totaled approximately $112.6 million, or 12.5% of total loans. The average loan size is approximately $377,000, and the average loan size per relationship is roughly $500,000. Of the $112.6 million loans to borrowers in the oil and gas industry, $4.3 million or 3.8% were on nonperforming assets at December 31, 2018, with $2.1 million being included in nonperforming loans held for sale. We are closely monitoring the effects of the sustained decline in energy prices on our energy related loan portfolio. We continue to communicate with our customers who provide valuable insight on the present energy cycle. The energy reserve as a percentage of total energy loans was 3.2% at December 31, 2018.

Nonperforming Assets

The following table presents information on nonperforming assets, including loans past due 90 days or more and still accruing for the periods presented (in thousands):

	December 31,				
	2018	2017	2016	2015	2014
Loans on nonaccrual	$8,920	$49,278	$62,580	$50,051	$10,701
Loans past due 90 days or more and still accruing	—	728	268	147	187
Total nonperforming loans	$8,920	$50,006	$62,848	$50,198	$10,888
Nonperforming loans held-for-sale	20,441	5,067	—	—	—
Other real estate owned	1,067	2,001	2,175	4,187	4,234
Other assets repossessed	55	192	16	38	—
Total nonperforming assets	$30,483	$57,266	$65,039	$54,423	$15,122
Troubled debt restructurings, accruing [1]	$1,334	$1,360	$152	$164	$176
Nonperforming loans to total loans + ORE + other foreclosed assets	3.17 %	4.58 %	5.06 %	4.29 %	1.17 %
Nonperforming assets to total assets	1.75 %	3.04 %	3.35 %	2.82 %	0.78 %
ALLL to nonperforming loans	195.40 %	53.77 %	38.78 %	37.87 %	103.10 %
ALLL to total loans	1.94 %	2.27 %	1.90 %	1.50 %	0.87 %

[1]Does not include $8.6 million, $25.1 million, $20.9 million, and $234,000 of TDRs reported in nonaccrual loans at, December 31, 2017, 2016, 2015 and 2014, respectively. There were not any TDRs on nonaccrual staus at December 31, 2018.

At December 31, 2018, nonperforming assets totaled $30.5 million, a decrease of $26.8 million compared to the same period in 2017. The decrease resulted primarily from a $40.4 million decrease in nonaccrual loans, which was partially offset by a $15.4 million increase in nonperforming loans held-for-sale at December 31, 2018. Troubled debt restructurings ("TDRs") totaled $1.3 million and $9.9 million at December 31, 2018 and 2017, respectively.

A loan is placed on nonaccrual status when, in management's judgment, the collection of principal or interest income is doubtful. Past due loans are placed on nonaccrual status when principal or interest is past due 90 days or more unless the loan is well secured and in the process of collection. In some cases, where borrowers are experiencing financial difficulties, loans may be restructured to provide terms significantly different from the original contractual terms. Our policy provides that unsecured retail (consumer) loans that become 90 days delinquent be routinely charged off. Loans classified for regulatory purposes but not included in the table above do not represent material amounts that we have serious doubts as to the ability of the borrower to comply with loan repayment terms. Further information regarding our loan policy is provided in the notes to the consolidated financial statements.

Allowance for Loan Losses

The allowance for loan losses represents a reserve for probable incurred losses in the loan portfolio. The adequacy of the allowance for loan losses is evaluated quarterly in accordance with GAAP and regulatory guidelines and includes a review of the loan portfolio, with particular emphasis on non-accruing, past due and other loans management believes may warrant additional attention. The loan portfolio is segregated based on loan type as a way to evaluate exposures to risks with the loan portfolio. Our methodology for assessing the appropriateness of the allowance for loan losses is a combination of specific allowances for identified problem loans and a general valuation allowance on the remainder of the loan portfolio. There are certain loans that are individually reviewed when it is determined by management that the general allocation is not sufficient to appropriately capture potential inherent weaknesses that may expose the Bank to loss. In these instances, we establish a specific allowance to those loans determined to be impaired. Loss is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. We establish a general allowance for smaller balance, homogenous loans with similar risk characteristics of for which have not been specifically reviewed for probable incurred losses. We evaluate loss factors by taking into consideration both quantitative and qualitative components impacting our probable incurred losses. These components include, but are not limited to historical charge-offs; known deterioration in concentrations of credit; trends in nonperforming assets; volume, maturity and composition of the loan portfolio; off-balance sheet credit risk; lending policies and control systems; national and local economic conditions; the experience, ability and depth of lending management; and the results of examinations of the loan portfolio by regulatory agencies and others.

Our allowance for loan losses totaled $17.4 million and $26.9 million for the years ended December 31, 2018 and 2017, respectively. The following table presents activity in the allowance for loan losses for the periods indicated (in thousands):

	December 31,				
	2018	2017	2016	2015	2014
Balance at beginning of year	$26,888	$24,372	$19,011	$11,226	$8,779
Charge-offs:					
Commercial, financial, and agricultural	17,815	20,451	4,366	4,936	2,843
Real estate – construction	78	70	—	105	1
Real estate – commercial	8,956	6,648	218	183	93
Real estate – residential	667	543	24	87	273
Consumer and other	738	1,165	1,407	1,263	706
Total charge-offs	28,254	28,877	6,015	6,574	3,916
Recoveries:					
Commercial, financial, and agricultural	1,704	652	459	235	164
Real estate – construction	—	—	—	3	—
Real estate – commercial	7	162	123	26	407
Real estate – residential	41	105	5	12	47
Consumer and other	304	274	189	183	120
Total recoveries	2,056	1,193	776	459	738
Net charge-offs	26,198	27,684	5,239	6,115	3,178
Provision for loan losses	16,740	30,200	10,600	13,900	5,625
Balance at end of year	$17,430	$26,888	$24,372	$19,011	$11,226