

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 8-K

**CURRENT REPORT
PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

Date of Report (date of earliest event reported): **August 1, 2017**

VERITEX HOLDINGS, INC.

(Exact name of Registrant as specified in its charter)

Texas

(State or other jurisdiction of
incorporation or organization)

001-36682

(Commission File Number)

27-0973566

(I.R.S. Employer
Identification Number)

8214 Westchester Drive, Suite 400

Dallas, Texas 75225

(Address of principal executive offices)

(972) 349-6200

(Registrant's telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

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.

Item 1.01 Entry into a Material Definitive Agreement and Item 3.02 Unregistered Sales of Equity Securities.

In connection with the completion of the acquisition (the “Merger”) by Veritex Holdings, Inc. (“Veritex”), a Texas corporation and parent company of Veritex Community Bank, of Sovereign Bancshares, Inc. (“Sovereign Bancshares”), a Texas corporation and parent company of Sovereign Bank, pursuant to that certain previously announced Agreement and Plan of Reorganization, dated December 14, 2016 (the “Agreement”), by and among Veritex, Spartan Merger Sub, Inc. (“Merger Sub”), a wholly owned subsidiary of Veritex, and Sovereign Bancshares, Veritex and Merger Sub entered into an Assignment and Assumption Agreement, dated August 1, 2017 (the “Assignment and Assumption Agreement”), with Sovereign Bancshares whereby Veritex assumed, among other things, the obligations of Sovereign Bancshares’ outstanding Senior Non-Cumulative Perpetual Preferred Stock, Series C (the “Sovereign Bancshares Series C Preferred Stock”) that was previously issued to the United States Department of the Treasury (the “Treasury Department”) pursuant to that certain Securities Purchase Agreement, dated as of September 22, 2011, by and between the Treasury Department and Sovereign Bancshares.

In connection therewith, Veritex issued 24,500 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series D (the “Veritex Series D Preferred Stock”) to the Treasury Department in exchange for the 24,500 shares of Sovereign Bancshares Series C Preferred Stock held by the Treasury Department. The Veritex Series D Preferred Stock is senior to Veritex common stock with respect to dividend rights and rights upon liquidation, winding up and termination. Holders of the Veritex Series D Preferred Stock are entitled to (a) receive at the end of each quarterly dividend period an amount equal to one fourth of the applicable dividend rate (which will be 9% following the Merger) multiplied by the liquidation amount per share and (b) a liquidation preference equal to \$1,000 per share (\$24.5 million in the aggregate) plus any accrued and unpaid dividends. The shares of Veritex Series D Preferred Stock have no general voting rights other than as required by the laws of the State of Texas, but, unless the shares of Veritex Series D Preferred Stock are being redeemed, such shares have certain consent rights regarding the authorization of senior securities as regards dividends and liquidation preferences, any amendment to the statement of designation that would adversely affect the rights of the Veritex Series D Preferred Stock, certain share exchanges or reclassifications, the sale of all or substantially all the assets of Veritex and the consummation of certain change of control transactions. The holders of the Veritex Series D Preferred Stock have certain registration rights pursuant to which they can require Veritex to register with the Securities and Exchange Commission (the “SEC”) such shares for sale in a public offering. Holders of Veritex Series D Preferred Stock have no preemptive rights or rights to exchange or convert their shares of Veritex Series D Preferred Stock into any other securities of Veritex.

The Company has the option to redeem, in whole or in part, shares of Veritex Series D Preferred Stock, subject to any regulatory approval, for \$1,000 per share (currently \$24.5 million in the aggregate) plus accrued and unpaid dividends for the then quarterly dividend period up to the day before the redemption date. Veritex may not repurchase or redeem any of its shares of capital stock, including any equity securities or trust preferred securities issued by Veritex or any of its affiliates, unless after giving effect to such repurchase or redemption, Veritex’s Tier 1 capital would be at least equal to the Tier 1 dividend threshold and all dividends have been paid on the Veritex Series D Preferred Stock for the most recently completed quarterly dividend period (or sufficient funds have been reserved for that purpose). If Veritex does not declare and pay the required dividends on the Veritex Series D Preferred Stock, then for the period of time beginning on the last day of such quarterly dividend period until the last day of the third quarterly dividend period immediately following, Veritex will be prohibited from redeeming, purchasing, repurchasing or otherwise acquiring any shares of the Veritex capital stock at any time, subject to certain enumerated exceptions.

A majority of the outstanding shares of Veritex Series D Preferred Stock have the right to designate a representative to be invited to attend all meetings of the Veritex Board of Directors, in a nonvoting capacity, in the event that Veritex has failed to timely pay dividends due upon the Veritex Series D Preferred Stock for an aggregate of five quarterly dividend periods, whether or not consecutive. This right to select an observer terminates upon timely dividend payments for four consecutive quarterly dividend periods, but would be revived in the event there are additional failures to make timely dividend payments for five quarters, in the aggregate, following the termination of observer rights.

Whenever dividends on the Veritex Series D Preferred Stock have not been declared and timely paid in full for an aggregate of six quarterly dividend periods, whether or not consecutive, and the aggregate liquidation preference of the then-outstanding shares of Veritex Series D Preferred Stock is greater than or equal to \$25 million, the authorized number of Veritex directors would be increased by two, and the holders of the Veritex Series D Preferred Stock, voting together as a single class, would have the right to elect two directors to fill those newly created directorships at either its next annual meeting (if one is to be held within thirty days) or at a special meeting of shareholders, and this right would continue until complete and timely dividend payments have been made for four consecutive quarterly dividend periods. This right to appoint directors revives in the event of any such future failure of Veritex to pay complete and timely dividends.

The foregoing exchange of the Veritex Series D Preferred Stock was made in reliance upon an exemption from the registration provisions of the Securities Act of 1933, as amended (the "Securities Act"), set forth in Section 4(2) thereof, relative to sales by an issuer not involving a public offering, and the rules and regulations promulgated thereunder.

The Assignment and Assumption Agreement and the related Securities Purchase Agreement are attached as Exhibit 10.1 to this Current Report on Form 8-K.

Item 2.01 Completion of Acquisition or Disposition of Assets.

On August 1, 2017, Veritex completed the Merger pursuant to the terms of the Agreement. At the effective time of the Merger (the "Effective Time"), Merger Sub merged with and into Sovereign Bancshares, with Sovereign Bancshares surviving the Merger as a wholly-owned subsidiary of Veritex. Following the Effective Time, Sovereign Bancshares merged with and into Veritex, with Veritex surviving the merger and thereafter, Sovereign Bank merged with and into Veritex Community Bank, with Veritex Community Bank surviving the merger.

Pursuant to the Agreement, at the Effective Time each outstanding share of Sovereign Bancshares common stock was converted into the right to receive (i) 0.9596 shares of common stock, par value \$0.01 per share, of Veritex, and (ii) \$10.54 in cash. In the aggregate, Veritex issued 5,117,647 shares of its common stock and paid \$56,209,647 in cash to former holders of Sovereign Bancshares' common stock.

Sovereign Bancshares' (i) Gross Transaction Expenses (as defined in the Agreement) were \$16,889,853, and (ii) Tangible Common Equity (as defined in the Agreement) was \$87,929,785, and such amounts were calculated in accordance with the terms of the Agreement.

The foregoing description of the Agreement does not purport to be complete and is qualified in its entirety by reference to the full text of the Agreement, which is attached hereto as Exhibit 2.1 and is incorporated herein by reference.

Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of Registrant.

In connection with the Merger, pursuant to that certain First Supplemental Indenture, dated as of August 1, 2017 (the "Supplemental Indenture"), by and among Veritex, Sovereign Bancshares and Wilmington Trust Company, as trustee (the "Trustee"), the Company assumed Sovereign Bancshares' rights, title and obligations under the Indenture, dated as of May 29, 2008 (the "Indenture"), by and between Sovereign Bancshares and the Trustee, pursuant to which Indenture, Sovereign Bancshares had issued \$8,609,000 of its Floating Rate Junior Subordinated Deferrable Interest Notes due July 1, 2038. The transaction documents governing such securities, including the Supplemental Indenture and the Indenture, have not been filed herewith pursuant to Item 601(b)(4)(v) of Regulation S-K under the Securities Act. Veritex agrees to furnish a copy of such documents to the SEC upon request.

Item 5.02 Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers; Compensatory Arrangements of Certain Officers.

In connection with the Merger, the Veritex Board of Directors appointed on July 28, 2017 (i) T.J. Falgout as a director of both Veritex and Veritex Community Bank, as well as a Vice Chairman of both Veritex and Veritex Community Bank, and (ii) Thomas J. Mastor as a director of both Veritex and Veritex Community Bank, to be effective as of the Effective Time, in accordance with the terms of the Agreement.

Messrs. Falgout and Mastor will participate in Veritex's standard compensation arrangements for non-employee directors as described in Veritex's definitive proxy statement relating to its 2017 Annual Meeting of Shareholders filed with the SEC on April 10, 2017. Other than pursuant to the Agreement, there are no other arrangements or understandings between Messrs. Falgout and Mastor and any other person pursuant to which they were selected as directors. Since the beginning of the last fiscal year, there have been no related party transactions between Veritex and Messrs. Falgout or Mastor that would be reportable under Item 404(a) of Regulation S-K.

Item 5.03 Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year.

On July 28, 2017, Veritex amended its Certificate of Formation by filing a Statement of Designation (the "Statement of Designation") with the Secretary of State of the State of Texas designating the Veritex Series D Preferred Stock as a series of its authorized preferred stock, such series having 24,500 authorized shares.

The Statement of Designation for the Veritex Series D Preferred Stock is attached as Exhibit 3.1 to this Current Report on Form 8-K. Such shares of Veritex Series D Preferred Stock were issued to the Treasury Department as described under Item 3.02 above.

Item 7.01 Regulation FD Disclosure.

On August 1, 2017, Veritex issued a press release announcing the closing of the Merger. A copy of the press release is furnished as Exhibit 99.1 to this Current Report on Form 8-K and is incorporated herein by reference.

The information in this Item 7.01, including Exhibit 99.1, is being furnished pursuant to Item 7.01 of Form 8-K and shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or otherwise subject to liabilities of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, unless specifically identified therein as being incorporated therein by reference.

Item 9.01 Financial Statements and Exhibits.

(a) Financial Statements of Businesses Acquired.

- (i) The audited consolidated balance sheets of Sovereign Bancshares as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders’ equity and cash flows for each of the two years in the period ended December 31, 2016, and the related notes and report of the independent auditors thereto, required by this item are included as Exhibit 99.2 and are incorporated by reference herein.
- (ii) The unaudited consolidated balance sheet of Sovereign Bancshares as of June 30, 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders’ equity and cash flows for the six months ended June 30, 2017 and 2016, and the related notes required by this item, are included as Exhibit 99.3 and are incorporated herein by reference.

(b) Pro Forma Financial Information.

- (i) The unaudited pro forma combined condensed consolidated balance sheet as of June 30, 2017, and the unaudited pro forma combined condensed consolidated statements of income for the six months ended June 30, 2017, and the year ended December 31, 2016, required by this item are incorporated herein by reference to Exhibit 99.4.

(c) Shell Company Transactions

- (i) Not applicable.

(d) Exhibits.

Exhibit Number	Description
2.1	Agreement and Plan of Reorganization, dated December 14, 2016, by and among Veritex Holdings, Inc., Spartan Merger Sub, Inc., and Sovereign Bancshares, Inc. (incorporated by reference to Exhibit 2.1 to Veritex Holdings, Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on December 14, 2016).
3.1	Statement of Designation of Senior Non-Cumulative Perpetual Preferred Stock, Series D of Veritex Holdings, Inc., as filed with the Office of the Secretary of State of the State of Texas on July 28, 2017.
10.1	Assignment and Assumption Agreement, dated August 1, 2017, by and among Veritex Holdings, Inc, Spartan Merger Sub, Inc. and Sovereign Bancshares, Inc., and the related Securities Purchase Agreement, dated as of September 22, 2011, by and between the United States Department of the Treasury and Sovereign Bancshares, Inc.
23.1	Consent of RSM US LLP.
99.1	Press Release, dated August 1, 2017.
99.2	Audited Consolidated Financial Statements of Sovereign Bancshares, Inc. as of and for the years ended December 31, 2016 and 2015.
99.3	Unaudited Consolidated Financial Statements of Sovereign Bancshares, Inc. as of June 30, 2017 and for the six months ended June 30, 2017 and June 30, 2016.
99.4	Unaudited Pro Forma Combined Condensed Consolidated Financial Statements.

SIGNATURE

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

Veritex Holdings, Inc.

By: /s/ C. Malcolm Holland, III

C. Malcolm Holland, III

Chairman and Chief Executive Officer

Date: August 1, 2017

EXHIBIT INDEX

Exhibit Number	Description
2.1	Agreement and Plan of Reorganization, dated December 14, 2016, by and among Veritex Holdings, Inc., Spartan Merger Sub, Inc., and Sovereign Bancshares, Inc. (incorporated by reference to Exhibit 2.1 to Veritex Holdings, Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on December 14, 2016).
3.1	Statement of Designation of Senior Non-Cumulative Perpetual Preferred Stock, Series D of Veritex Holdings, Inc., as filed with the Office of the Secretary of State of the State of Texas on July 28, 2017.
10.1	Assignment and Assumption Agreement, dated August 1, 2017, by and among Veritex Holdings, Inc, Spartan Merger Sub, Inc. and Sovereign Bancshares, Inc., and the related Securities Purchase Agreement, dated as of September 22, 2011, by and between the United States Department of the Treasury and Sovereign Bancshares, Inc.
23.1	Consent of RSM US LLP.
99.1	Press Release, dated August 1, 2017.
99.2	Audited Consolidated Financial Statements of Sovereign Bancshares, Inc. as of and for the years ended December 31, 2016 and 2015.
99.3	Unaudited Consolidated Financial Statements of Sovereign Bancshares, Inc. as of June 30, 2017 and for the six months ended June 30, 2017 and June 30, 2016.
99.4	Unaudited Pro Forma Combined Condensed Consolidated Financial Statements.

**STATEMENT OF DESIGNATION
OF
SENIOR NON-CUMULATIVE PERPETUAL PREFERRED STOCK, SERIES D
OF VERITEX HOLDINGS, INC.**

Veritex Holdings, Inc., a corporation existing under the laws of the State of Texas (the “Issuer”), in accordance with the provisions of Section 21.152 of the Texas Business Organizations Code thereof, does hereby certify:

The board of directors of the Issuer (the “Board of Directors”), in accordance with the Second Amended and Restated Certificate of Formation and bylaws of the Issuer and applicable law, adopted the following resolution on July 28, 2017, creating a series of 24,500 shares of Preferred Stock of the Issuer designated as “Senior NonCumulative Perpetual Preferred Stock, Series D”.

RESOLVED, that pursuant to the provisions of the Second Amended and Restated Certificate of Formation and bylaws of the Issuer and applicable law, a series of Preferred Stock, \$0.01 par value per share, of the Issuer be and hereby is created, and that the designation and number of shares of such series, and the voting and other powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations and restrictions thereof, of the shares of such series, are as follows:

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Issuer a series of preferred stock designated as the “Senior Non-Cumulative Perpetual Preferred Stock, Series D” (the “Designated Preferred Stock”). The authorized number of shares of Designated Preferred Stock shall be 24,500.

Part 2. Standard Provisions. The Standard Provisions contained in Schedule A attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of this Statement of Designation to the same extent as if such provisions had been set forth in full herein.

Part 3. Definitions. The following terms are used in this Statement of Designation (including the Standard Provisions in Schedule A hereto) as defined below:

(a) “Common Stock” means the common stock, par value \$0.01 per share, of the Issuer.

(b) “Definitive Agreement” means that certain Securities Purchase Agreement by and between Issuer and Treasury, dated as of the Signing Date.

(c) “Junior Stock” means the Common Stock and any other class or series of stock of the Issuer the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend and redemption rights and/or as to rights on liquidation, dissolution or winding up of the Issuer.

(d) “Liquidation Amount” means \$1,000 per share of Designated Preferred Stock.

(e) “Minimum Amount” means (i) the amount equal to twenty-five percent (25%) of the aggregate Liquidation Amount of Designated Preferred Stock issued on the Original Issue Date or (ii) all of the outstanding Designated Preferred Stock, if the aggregate liquidation preference of the outstanding Designated Preferred Stock is less than the amount set forth in the preceding clause (i).

(f) “Parity Stock” means any class or series of stock of the Issuer (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer (in each case without regard to whether dividends accrue cumulatively or non-cumulatively). Without limiting the foregoing, Parity Stock shall include the Issuer’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A and Fixed Rate Cumulative Perpetual Preferred Stock, Series B, and Senior Non-Cumulative Perpetual Preferred Stock, Series C.

(g) “Signing Date” means September 22, 2011.

(h) “Treasury” means the United States Department of the Treasury and any successor in interest thereto.

Part 4. Certain Voting Matters. Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.

[Remainder of Page Intentionally Left Blank]

IN WITNESS WHEREOF, Veritex Holdings, Inc. has caused this Statement of Designation to be signed by C. Malcolm Holland, III, its Chairman and Chief Executive Officer, this 28th day of July, 2017.

VERITEX HOLDINGS, INC.

By: /s/ C. Malcolm Holland, III
Name: C. Malcolm Holland, III
Chairman and Chief Executive
Title: Officer

[Signature Page to Statement of Designation]

STANDARD PROVISIONS

Section 1. General Matters. Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Statement of Designation. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Issuer, as set forth below.

Section 2. Standard Definitions. As used herein with respect to Designated Preferred Stock:

(a) “Acquiror,” in any Holding Company Transaction, means the surviving or resulting entity or its ultimate parent in the case of a merger or consolidation or the transferee in the case of a sale, lease or other transfer in one transaction or a series of related transactions of all or substantially all of the consolidated assets of the Issuer and its subsidiaries, taken as a whole.

(b) “Affiliate” means, with respect to any person, any person directly or indirectly controlling, controlled by or under common control with, such other person. For purposes of this definition, “control” (including, with correlative meanings, the terms “controlled by” and “under common control with”) when used with respect to any person, means the possession, directly or indirectly through one or more intermediaries, of the power to cause the direction of management and/or policies of such person, whether through the ownership of voting securities by contract or otherwise.

(c) “Applicable Dividend Rate” has the meaning set forth in Section 3(a).

(d) “Appropriate Federal Banking Agency” means the “appropriate Federal banking agency” with respect to the Issuer as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. § 1813(q)), or any successor provision.

(e) “Bank Holding Company” means a company registered as such with the Board of Governors of the Federal Reserve System pursuant to 12 U.S.C. § 1842 and the regulations of the Board of Governors of the Federal Reserve System promulgated thereunder.

(f) “Baseline” means the “Initial Small Business Lending Baseline” set forth on the Initial Supplemental Report (as defined in the Definitive Agreement), subject to adjustment pursuant to Section 3(a).

(g) “Business Combination” means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Issuer’s stockholders.

(h) “Business Day” means any day except Saturday, Sunday and any day on which banking institutions in the State of New York or the District of Columbia generally are authorized or required by law or other governmental actions to close.

(i) “Bylaws” means the bylaws of the Issuer, as they may be amended from time to time.

(j) “Call Report” has the meaning set forth in the Definitive Agreement.

(k) “Charge-Offs” means the net amount of loans charged off by the Issuer or, if the Issuer is a Bank Holding Company or a Savings and Loan Holding Company, by the IDI Subsidiary(ies) during quarters that begin on or after the Signing Date, determined as follows:

(i) if the Issuer or the applicable IDI Subsidiary is a bank, by subtracting (A) the aggregate dollar amount of recoveries reflected on line RIAD4605 of its Call Reports for such quarters from (B) the aggregate dollar amount of charge-offs reflected on line RIAD4635 of its Call Reports for such

quarters (without duplication as a result of such dollar amounts being reported on a year-to-date basis); or

(ii) if the Issuer or the applicable IDI Subsidiary is a thrift, by subtracting (A) the sum of the aggregate dollar amount of recoveries reflected on line VA140 of its Call Reports for such quarters and the aggregate dollar amount of adjustments reflected on line VA150 of its Call Reports for such quarters from (B) the aggregate dollar amount of charge-offs reflected on line VA160 of its Call Reports for such quarters.

(l) “Charter” means the Issuer’s certificate or articles of incorporation, articles of association, or similar organizational document.

(m) “CPP Lending Incentive Fee” has the meaning set forth in Section 3(e).

(n) “Current Period” has the meaning set forth in Section 3(a)(i)(2).

(o) “Dividend Payment Date” means January 1, April 1, July 1, and October 1 of each year.

(p) “Dividend Period” means the period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date; *provided, however*, the initial Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date (the “Initial Dividend Period”).

(q) “Dividend Record Date” has the meaning set forth in Section 3(b).

(r) “Dividend Reference Period” has the meaning set forth in Section 3(a)(i)(2).

(s) “GAAP” means generally accepted accounting principles in the United States.

(t) “Holding Company Preferred Stock” has the meaning set forth in Section 7(c)(v).

(u) “Holding Company Transaction” means the occurrence of (a) any transaction (including, without limitation, any acquisition, merger or consolidation) the result of which is that a “person” or “group” within the meaning of Section 13(d) of the Securities Exchange Act of 1934, as amended, (i) becomes the direct or indirect ultimate “beneficial owner,” as defined in Rule 13d-3 under that Act, of common equity of the Issuer representing more than 50% of the voting power of the outstanding Common Stock or (ii) is otherwise required to consolidate the Issuer for purposes of generally accepted accounting principles in the United States, or (b) any consolidation or merger of the Issuer or similar transaction or any sale, lease or other transfer in one transaction or a series of related transactions of all or substantially all of the consolidated assets of the Issuer and its subsidiaries, taken as a whole, to any Person other than one of the Issuer’s subsidiaries; *provided that*, in the case of either clause (a) or (b), the Issuer or the Acquiror is or becomes a Bank Holding Company or Savings and Loan Holding Company.

(v) “IDI Subsidiary” means any Issuer Subsidiary that is an insured depository institution.

(w) “Increase in QSBL” means:

(i) with respect to the first (1st) Dividend Period, the difference obtained by subtracting (A) the Baseline from (B) QSBL set forth in the Initial Supplemental Report (as defined in the Definitive Agreement); and

(ii) with respect to each subsequent Dividend Period, the difference obtained by subtracting (A) the Baseline from (B) QSBL for the Dividend Reference Period for the Current Period.

(x) “Initial Dividend Period” has the meaning set forth in the definition of “Dividend Period”.

- (y) “Issuer Subsidiary” means any subsidiary of the Issuer.
- (z) “Liquidation Preference” has the meaning set forth in Section 4(a).
- (aa) “Non-Qualifying Portion Percentage” means, with respect to any particular Dividend Period, the percentage obtained by subtracting the Qualifying Portion Percentage from one (1).
- (ab) “Original Issue Date” means the date on which shares of Designated Preferred Stock are first issued.
- (ac) “Percentage Change in QSBL” has the meaning set forth in Section 3(a)(ii).
- (ad) “Person” means a legal person, including any individual, corporation, estate, partnership, joint venture, association, joint-stock company, limited liability company or trust.
- (ae) “Preferred Director” has the meaning set forth in Section 7(c).
- (af) “Preferred Stock” means any and all series of preferred stock of the Issuer, including the Designated Preferred Stock.
- (ag) “Previously Acquired Preferred Shares” has the meaning set forth in the Definitive Agreement.
- (ah) “Private Capital” means, if the Issuer is Matching Private Investment Supported (as defined in the Definitive Agreement), the equity capital received by the Issuer or the applicable Affiliate of the Issuer from one or more non-governmental investors in accordance with Section 1.3(m) of the Definitive Agreement.
- (ai) “Publicly-traded” means a company that (i) has a class of securities that is traded on a national securities exchange and (ii) is required to file periodic reports with either the Securities and Exchange Commission or its primary federal bank regulator.
- (aj) “Qualified Small Business Lending” or “QSBL” means, with respect to any particular Dividend Period, the “Quarter-End Adjusted Qualified Small Business Lending” for such Dividend Period set forth in the applicable Supplemental Report.
- (ak) “Qualifying Portion Percentage” means, with respect to any particular Dividend Period, the percentage obtained by dividing (i) the Increase in QSBL for such Dividend Period by (ii) the aggregate Liquidation Amount of then-outstanding Designated Preferred Stock.
- (al) “Savings and Loan Holding Company” means a company registered as such with the Board of Governors of the Federal Reserve System.
- (am) “Share Dilution Amount” means the increase in the number of diluted shares outstanding (determined in accordance with GAAP applied on a consistent basis, and as measured from the date of the Issuer’s most recent consolidated financial statements prior to the Signing Date) resulting from the grant, vesting or exercise of equity-based compensation to employees and equitably adjusted for any stock split, stock dividend, reverse stock split, reclassification or similar transaction.
- (an) “Signing Date Tier I Capital Amount” means \$75,896,961.
- (ao) “Standard Provisions” mean these Standard Provisions that form a part of the Statement of Designation relating to the Designated Preferred Stock.
- (ap) “Statement of Designation” means the Statement of Designation or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.

(aq) “Supplemental Report” means a Supplemental Report delivered by the Issuer to Treasury pursuant to the Definitive Agreement.

(ar) “Tier I Dividend Threshold” means, as of any particular date, the result of the following formula:

$$(A + B - C) * 0.9 - D$$

where:

A = Signing Date Tier I Capital Amount;

B = the aggregate Liquidation Amount of the Designated Preferred Stock issued to Treasury;

C = the aggregate amount of Charge-Offs since the Signing Date; and

D = (i) beginning on the first day of the eleventh (11th) Dividend Period, the amount equal to ten percent (10%) of the aggregate Liquidation Amount of the Designated Preferred Stock issued to Treasury as of the Effective Date (without regard to any redemptions of Designated Preferred Stock that may have occurred thereafter) for every one percent (1%) of positive Percentage Change in Qualified Small Business Lending between the ninth (9th) Dividend Period and the Baseline; and

(ii) zero (0) at all other times.

(as) “Voting Parity Stock” means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Section 7(d) of these Standard Provisions that form a part of the Statement of Designation, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

Section 3. Dividends.

(a) Rate.

(i) The “Applicable Dividend Rate” shall be determined as follows:

(1) With respect to the Initial Dividend Period, the Applicable Dividend Rate shall be five percent (5.0%).

(2) With respect to each of the second (2nd) through the tenth (10th) Dividend Periods, inclusive (in each case, the “Current Period”), the Applicable Dividend Rate shall be:

(A) (x) the applicable rate set forth in column “A” of the table in Section 3(a)(iii), based on the Percentage Change in QSBL between the Dividend Period that was two Dividend Periods prior to the Current Period (the “Dividend Reference Period”) and the Baseline, multiplied by (y) the Qualifying Portion Percentage; plus

(B) (x) five percent (5%) multiplied by (y) the Non- Qualifying Portion Percentage.

In each such case, the Applicable Dividend Rate shall be determined at the time the Issuer delivers a complete and accurate Supplemental Report to Treasury with respect to the Dividend Reference Period.

(3) With respect to the eleventh (11th) through the eighteenth (18th) Dividend Periods, inclusive, and that portion of the nineteenth (19th) Dividend Period prior to, but not including, the four and one half (4 ½) year anniversary of the Original Issue Date, the Applicable Dividend Rate shall be:

- (A) (x) the applicable rate set forth in column “B” of the table in Section 3(a)(iii), based on the Percentage Change in QSBL between the ninth (9th) Dividend Period and the Baseline, multiplied by (y) the Qualifying Portion Percentage, calculated as of the last day of the ninth (9th) Dividend Period; plus
- (B) (x) five percent (5%) multiplied by (y) the Non- Qualifying Portion Percentage, calculated as of the last day of the ninth (9th) Dividend Period.

In such case, the Applicable Dividend Rate shall be determined at the time the Issuer delivers a complete and accurate Supplemental Report to Treasury with respect to the ninth (9th) Dividend Period.

(4) With respect to (A) that portion of the nineteenth (19th) Dividend Period beginning on the four and one half (4 ½) year anniversary of the Original Issue Date and (B) all Dividend Periods thereafter, the Applicable Dividend Rate shall be nine percent (9%).

(5) Notwithstanding anything herein to the contrary, if the Issuer fails to submit a Supplemental Report that is due during any of the second (2nd) through tenth (10th) Dividend Periods on or before the sixtieth (60th) day of such Dividend Period, the Issuer’s QSBL for the Dividend Period that would have been covered by such Supplemental Report shall be zero (0) for purposes hereof.

(6) Notwithstanding anything herein to the contrary, but subject to Section 3(a)(i)(5) above, if the Issuer fails to submit the Supplemental Report that is due during the tenth (10th) Dividend Period, the Issuer’s QSBL for the shall be zero (0) for purposes of calculating the Applicable Dividend Rate pursuant to Section 3(a)(i)(3) and (4). The Applicable Dividend Rate shall be re-determined effective as of the first day of the calendar quarter following the date such failure is remedied, provided it is remedied prior to the four and one half (4 ½) anniversary of the Original Issue Date.

(7) Notwithstanding anything herein to the contrary, if the Issuer fails to submit any of the certificates required by Sections 3.1(d)(ii) or 3.1(d)(iii) of the Definitive Agreement when and as required thereby, the Issuer’s QSBL for the shall be zero (0) for purposes of calculating the Applicable Dividend Rate pursuant to Section 3(a)(i)(2) or (3) above until such failure is remedied.

(ii) The “Percentage Change in Qualified Lending” between any given Dividend Period and the Baseline shall be the result of the following formula, expressed as a percentage:

$$\left(\frac{(\text{QSBL for the Dividend Period} - \text{Baseline})}{\text{Baseline}} \right) \times 100$$

(iii) The following table shall be used for determining the Applicable Dividend Rate:

<i>If the Percentage Change in Qualified Lending is:</i>	<i>The Applicable Dividend Rate Shall be:</i>	
	Column "A" <i>(each of the 2nd - 10th Dividend Period')</i>	Column "B" <i>(11th - 18th, and the first part of the 19th, Dividend Periods)</i>
<i>0% or less</i>	5%	7%
<i>More than 0%, but less than 2.5%</i>	5%	5%
<i>2.5% or more, but less than 5%</i>	4%	4%
<i>5% or more, but less than 7.5%</i>	3%	3%
<i>7.5% or more, but less than 10%</i>		
<i>10% or more</i>		

(iv) If the Issuer consummates a Business Combination, a purchase of loans or a purchase of participations in loans and the Designated Preferred Stock remains outstanding thereafter, then the Baseline shall thereafter be the "Quarter-End Adjusted Small Business Lending Baseline" set forth on the Quarterly Supplemental Report (as defined in the Definitive Agreement).

(b) **Payment.** Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, non-cumulative cash dividends with respect to:

(i) each Dividend Period (other than the Initial Dividend Period) at a rate equal to one-fourth ($\frac{1}{4}$) of the Applicable Dividend Rate with respect to each Dividend Period on the Liquidation Amount per share of Designated Preferred Stock, and no more, payable quarterly in arrears on each Dividend Payment Date; and

(ii) the Initial Dividend Period, on the first such Dividend Payment Date to occur at least twenty (20) calendar days after the Original Issue Date, an amount equal to (A) the Applicable Dividend Rate with respect to the Initial Dividend Period multiplied by (B) the number of days from the Original Issue Date to the last day of the Initial Dividend Period (inclusive) divided by 360.

In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. For avoidance of doubt, "payable quarterly in arrears" means that, with respect to any particular Dividend Period, dividends begin accruing on the first day of such Dividend Period and are payable on the first day of the next Dividend Period.

The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of four 90-day quarters, and actual days elapsed over a 90-day quarter.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Issuer on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a "Dividend Record Date"). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Statement of Designation).

(c) Non-Cumulative. Dividends on shares of Designated Preferred Stock shall be non-cumulative. If the Board of Directors or any duly authorized committee of the Board of Directors does not declare a dividend on the Designated Preferred Stock in respect of any Dividend Period:

(i) the holders of Designated Preferred Stock shall have no right to receive any dividend for such Dividend Period, and the Issuer shall have no obligation to pay a dividend for such Dividend Period, whether or not dividends are declared for any subsequent Dividend Period with respect to the Designated Preferred Stock; and

(ii) the Issuer shall, within five (5) calendar days, deliver to the holders of the Designated Preferred Stock a written notice executed by the Chief Executive Officer and the Chief Financial Officer of the Issuer stating the Board of Directors' rationale for not declaring dividends.

(d) Priority of Dividends; Restrictions on Dividends.

(i) Subject to Sections 3(d)(ii), (iii) and (v) and any restrictions imposed by the Appropriate Federal Banking Agency or, if applicable, the Issuer's state bank supervisor (as defined in Section 3(r) of the Federal Deposit Insurance Act (12 U.S.C. § 1813(q)), so long as any share of Designated Preferred Stock remains outstanding, the Issuer may declare and pay dividends on the Common Stock, any other shares of Junior Stock, or Parity Stock, in each case only if (A) after giving effect to such dividend the Issuer's Tier I capital would be at least equal to the Tier I Dividend Threshold, and (B) full dividends on all outstanding shares of Designated Preferred Stock for the most recently completed Dividend Period have been or are contemporaneously declared and paid.

(ii) If a dividend is not declared and paid in full on the Designated Preferred Stock in respect of any Dividend Period, then from the last day of such Dividend Period until the last day of the third (3rd) Dividend Period immediately following it, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock; *provided, however*, that in any such Dividend Period in which a dividend is declared and paid on the Designated Preferred Stock, dividends may be paid on Parity Stock to the extent necessary to avoid any material breach of a covenant by which the Issuer is bound.

(iii) When dividends have not been declared and paid in full for an aggregate of four (4) Dividend Periods or more, and during such time the Issuer was not subject to a regulatory determination that prohibits the declaration and payment of dividends, the Issuer shall, within five (5) calendar days of each missed payment, deliver to the holders of the Designated Preferred Stock a certificate executed by at least a majority of the Board of Directors stating that the Board of Directors used its best efforts to declare and pay such dividends in a manner consistent with (A) safe and sound banking practices and (B) the directors' fiduciary obligations.

(iv) Subject to the foregoing and Section 3(e) below and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

(v) If the Issuer is not Publicly-Traded, then after the tenth (10th) anniversary of the Signing Date, so long as any share of Designated Preferred Stock remains outstanding, no dividend

or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock.

(e) Special Lending Incentive Fee Related to CPP. If Treasury held Previously Acquired Preferred Shares immediately prior to the Original Issue Date and the Issuer did not apply to Treasury to redeem such Previously Acquired Preferred Shares prior to December 16, 2010, and if the Issuer's Supplemental Report with respect to the ninth (9th) Dividend Period reflects an amount of Qualified Small Business Lending that is less than or equal to the Baseline (or if the Issuer fails to timely file a Supplemental Report with respect to the ninth (9th) Dividend Period), then beginning on May 15, 2014 and on all Dividend Payment Dates thereafter ending on April 1, 2016, the Issuer shall pay to the Holders of Designated Preferred Stock, on each share of Designated Preferred Stock, but only out of assets legally available therefor, a fee equal to 0.5% of the Liquidation Amount per share of Designated Preferred Stock ("CPP Lending Incentive Fee"). All references in Section 3(d) to "dividends" on the Designated Preferred Stock shall be deemed to include the CPP Lending Incentive Fee.

Section 4. Liquidation Rights.

(a) Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Issuer, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Issuer or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Issuer, subject to the rights of any creditors of the Issuer, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Issuer ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends on each such share (such amounts collectively, the "Liquidation Preference").

(b) Partial Payment. If in any distribution described in Section 4(a) above the assets of the Issuer or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

(c) Residual Distributions. If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution has been paid in full, the holders of other stock of the Issuer shall be entitled to receive all remaining assets of the Issuer (or proceeds thereof) according to their respective rights and preferences.

(d) Merger, Consolidation and Sale of Assets Is Not Liquidation. For purposes of this Section 4, the merger or consolidation of the Issuer with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Issuer, shall not constitute a liquidation, dissolution or winding up of the Issuer.

Section 5. Redemption.

(a) Optional Redemption.

(i) Subject to the other provisions of this Section 5:

(1) The Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of

funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding; and

(2) If, after the Signing Date, there is a change in law that modifies the terms of Treasury's investment in the Designated Preferred Stock or the terms of Treasury's Small Business Lending Fund program in a materially adverse respect for the Issuer, the Issuer may, after consultation with the Appropriate Federal Banking Agency, redeem all of the shares of Designated Preferred Stock at the time outstanding.

(ii) The per-share redemption price for shares of Designated Preferred Stock shall be equal to the sum of:

(1) the Liquidation Amount per share,

(2) the per-share amount of any unpaid dividends for the then current Dividend Period at the Applicable Dividend Rate to, but excluding, the date fixed for redemption (regardless of whether any dividends are actually declared for that Dividend Period; and

(3) the pro rata amount of CPP Lending Incentive Fees for the current Dividend Period.

The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Issuer or its agent. Any declared but unpaid dividends for the then current Dividend Period payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above.

(b) No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(c) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Issuer. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(d) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either *pro rata* or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable, but in any event the shares to be redeemed shall not be less than the Minimum Amount. Subject to the provisions hereof, the Board of Directors or a duly authorized committee thereof shall have full power and authority to

prescribe the terms and conditions upon which shares of Designated Preferred Stock shall be redeemed from time to time, subject to the approval of the Appropriate Federal Banking Agency. If fewer than all the shares represented by any certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without charge to the holder thereof.

(e) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption have been deposited by the Issuer, in trust for the *pro rata* benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of Manhattan, The City of New York, and having a capital and surplus of at least \$500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Issuer, after which time the holders of the shares so called for redemption shall look only to the Issuer for payment of the redemption price of such shares.

(f) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Issuer shall revert to authorized but unissued shares of Preferred Stock (*provided* that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

Section 6. Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

Section 7. Voting Rights.

(a) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

(b) Board Observation Rights. Whenever, at any time or times, dividends on the shares of Designated Preferred Stock have not been declared and paid in full within five (5) Business Days after each Dividend Payment Date for an aggregate of five (5) Dividend Periods or more, whether or not consecutive, the Issuer shall invite a representative selected by the holders of a majority of the outstanding shares of Designated Preferred Stock, voting as a single class, to attend all meetings of its Board of Directors in a nonvoting observer capacity and, in this respect, shall give such representative copies of all notices, minutes, consents, and other materials that it provides to its directors in connection with such meetings; *provided*, that the holders of the Designated Preferred Stock shall not be obligated to select such a representative, nor shall such representative, if selected, be obligated to attend any meeting to which he/she is invited. The rights of the holders of the Designated Preferred Stock set forth in this Section 7(b) shall terminate when full dividends have been timely paid on the Designated Preferred Stock for at least four consecutive Dividend Periods, subject to revesting in the event of each and every subsequent default of the character above mentioned.

(c) Preferred Stock Directors. Whenever, at any time or times, (i) dividends on the shares of Designated Preferred Stock have not been declared and paid in full within five (5) Business Days after each Dividend Payment Date for an aggregate of six (6) Dividend Periods or more, whether or not consecutive, and (ii) the aggregate liquidation preference of the then-outstanding shares of Designated Preferred Stock is greater than or equal to \$25,000,000, the authorized number of directors of the Issuer shall automatically be increased by two and the holders of the Designated Preferred Stock, voting as a single class, shall have the right, but not the obligation, to elect two directors (hereinafter the "Preferred Directors" and each a "Preferred Director") to fill such newly created directorships at the Issuer's next annual meeting of stockholders (or, if the next annual meeting is not yet scheduled or is scheduled to occur more than thirty days later, the President of the

Company shall promptly call a special meeting for that purpose) and at each subsequent annual meeting of stockholders until full dividends have been timely paid on the Designated Preferred Stock for at least four consecutive Dividend Periods, at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to revesting in the event of each and every subsequent default of the character above mentioned; *provided* that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Issuer to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Issuer may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any termination of the right of the holders of shares of Designated Preferred Stock to vote for directors as provided above, the Preferred Directors shall cease to be qualified as directors, the term of office of all Preferred Directors then in office shall terminate immediately and the authorized number of directors shall be reduced by the number of Preferred Directors elected pursuant hereto. Any Preferred Director may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by the affirmative vote of the holders a majority of the shares of Designated Preferred Stock at the time outstanding voting separately as a class. If the office of any Preferred Director becomes vacant for any reason other than removal from office as aforesaid, the holders of a majority of the outstanding shares of Designated Preferred Stock, voting as a single class, may choose a successor who shall hold office for the unexpired term in respect of which such vacancy occurred.

(d) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the written consent of (x) Treasury if Treasury holds any shares of Designated Preferred Stock, or (y) the holders of a majority of the outstanding shares of Designated Preferred Stock, voting as a single class, if Treasury does not hold any shares of Designated Preferred Stock, shall be necessary for effecting or validating:

(i) Authorization of Senior Stock. Any amendment or alteration of the Statement of Designation for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Issuer ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Issuer;

(ii) Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Statement of Designation for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(d)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock;

(iii) Share Exchanges, Reclassifications, Mergers and Consolidations. Subject to Section 7(d)(v) below, any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Issuer with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Issuer is not the surviving or resulting entity, are converted into or exchanged for preference securities of the surviving or resulting entity or its ultimate parent, and (y) such shares remaining outstanding or such preference securities, as the case may be, have such rights, preferences, privileges and voting powers, and limitations and restrictions thereof that are the same as the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such consummation, taken as a whole; provided, that in all cases, the obligations of the Issuer are assumed (by operation of law or by express written assumption) by the resulting entity or its ultimate parent;

(iv) Certain Asset Sales. Any sale of all, substantially all, or any material portion of, the assets of the Company, if the Designated Preferred Stock will not be redeemed in full contemporaneously with the consummation of such sale; and

(v) Holding Company Transactions. Any consummation of a Holding Company Transaction, unless as a result of the Holding Company Transaction each share of Designated Preferred Stock shall be converted into or exchanged for one share with an equal liquidation preference of preference securities of the Issuer or the Acquiror (the “Holding Company Preferred Stock”). Any such Holding Company Preferred Stock shall entitle holders thereof to dividends from the date of issuance of such Holding Company Preferred Stock on terms that are equivalent to the terms set forth herein, and shall have such other rights, preferences, privileges and voting powers, and limitations and restrictions thereof that are the same as the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such conversion or exchange, taken as a whole;

provided, however, that for all purposes of this Section 7(d), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Issuer to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Issuer will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(e) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(d) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(f) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

Section 8. Restriction on Redemptions and Repurchases.

(a) Subject to Sections 8(b) and (c), so long as any share of Designated Preferred Stock remains outstanding, the Issuer may repurchase or redeem any shares of Capital Stock (as defined below), in each case only if (i) after giving effect to such dividend, repurchase or redemption, the Issuer’s Tier I capital would be at least equal to the Tier I Dividend Threshold and (ii) dividends on all outstanding shares of Designated Preferred Stock for the most recently completed Dividend Period have been or are contemporaneously declared and paid (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date).

(b) If a dividend is not declared and paid on the Designated Preferred Stock in respect of any Dividend Period, then from the last day of such Dividend Period until the last day of the third (3rd) Dividend Period immediately following it, neither the Issuer nor any Issuer Subsidiary shall, redeem, purchase or acquire any shares of Common Stock, Junior Stock, Parity Stock or other capital stock or other equity securities of any kind of the Issuer or any Issuer Subsidiary, or any trust preferred securities issued by the Issuer or any Affiliate of the Issuer (“Capital Stock”), (other than (i) redemptions, purchases, repurchases or other

acquisitions of the Designated Preferred Stock and (ii) repurchases of Junior Stock or Common Stock in connection with the administration of any employee benefit plan in the ordinary course of business (including purchases to offset any Share Dilution Amount pursuant to a publicly announced repurchase plan) and consistent with past practice; *provided*, that any purchases to offset the Share Dilution Amount shall in no event exceed the Share Dilution Amount, (iii) the acquisition by the Issuer or any of the Issuer Subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Issuer or any other Issuer Subsidiary), including as trustees or custodians, (iv) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock or trust preferred securities for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case set forth in this clause (iv), solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock, (v) redemptions of securities held by the Issuer or any wholly-owned Issuer Subsidiary or (vi) redemptions, purchases or other acquisitions of capital stock or other equity securities of any kind of any Issuer Subsidiary required pursuant to binding contractual agreements entered into prior to (x) if Treasury held Previously Acquired Preferred Shares immediately prior to the Original Issue Date, the original issue date of such Previously Acquired Preferred Shares, or (y) otherwise, the Signing Date).

(c) If the Issuer is not Publicly-Traded, then after the tenth (10th) anniversary of the Signing Date, so long as any share of Designated Preferred Stock remains outstanding, no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Issuer or any of its subsidiaries.

Section 9. No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Issuer, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

Section 10. References to Line Items of Supplemental Reports. If Treasury modifies the form of Supplemental Report, pursuant to its rights under the Definitive Agreement, and any such modification includes a change to the caption or number of any line item on the Supplemental Report, then any reference herein to such line item shall thereafter be a reference to such re-captioned or re-numbered line item.

Section 11. Record Holders. To the fullest extent permitted by applicable law, the Issuer and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Issuer nor such transfer agent shall be affected by any notice to the contrary.

Section 12. Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in this Statement of Designation, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

Section 13. Replacement Certificates. The Issuer shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Issuer. The Issuer shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Issuer of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Issuer.

Section 14. Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law.

ASSIGNMENT AND ASSUMPTION AGREEMENT

This Assignment and Assumption Agreement (the “Assumption Agreement”) is made and entered as of the 1st day of August, 2017, by and among Veritex Holdings, Inc., a Texas corporation and registered bank holding company with its principal offices in Dallas, Texas (“Buyer”), Spartan Merger Sub, Inc., a Texas corporation and wholly-owned subsidiary of Buyer (“Merger Sub”), and Sovereign Bancshares, Inc., a Texas corporation and registered bank holding company with its principal offices in Dallas, Texas (“Seller”).

WHEREAS, Buyer, Merger Sub and Seller entered into that certain Agreement and Plan of Reorganization dated as of December 14, 2016 (the “Merger Agreement”), pursuant to which Merger Sub will merge with and into Seller, with Seller surviving as the wholly-owned subsidiary of Buyer (the “Merger”), and, immediately thereafter, Seller will merge with and into Buyer, with Buyer being the surviving corporation (the “Second-Step Merger”, and together with the Merger, the “Integrated Mergers”); and

WHEREAS, in conjunction with the Integrated Mergers, Buyer will acquire all of the assets and assume all of the liabilities of Seller, including the obligations in respect of the 24,500 issued and outstanding shares of Seller’s Senior Non-Cumulative Perpetual Preferred Stock, Series C (the “SBLF Preferred Shares”), that were issued to United States Department of the Treasury (the “Treasury Department”), pursuant to that certain Securities Purchase Agreement dated effective as of September 22, 2011, by and between the Treasury Department and Seller (the “Securities Purchase Agreement”).

NOW, THEREFORE, in consideration of the consummation of the transactions contemplated by the Merger Agreement, and to effectuate the agreements of Seller, Merger Sub and Buyer set forth therein, the parties hereto hereby agree as follows:

1. Assignment and Assumption of Liabilities. Subject to the consummation of the Integrated Mergers, Seller hereby assigns to Buyer, and Buyer hereby assumes the liabilities and obligations of Seller to be discharged, performed, satisfied or paid, including the due and punctual performance of each and every covenant, agreement and condition of the Securities Purchase Agreement to be performed by Seller with respect the SBLF Preferred Shares and all terms, conditions and agreements relating thereto (collectively, the “Assumed Liabilities”). Such assignment and assumption will be effective as of the effective time of the Second-Step Merger as specified in the Certificate of Merger filed with and certified by the Texas Secretary of State (the “Effective Time”).

2. Definitions. As of the Effective Time, each reference in the Securities Purchase Agreement to the “Company” shall mean Buyer and each reference to the “Preferred Shares” shall mean the Senior Non-Cumulative Perpetual Preferred Stock, Series D of Buyer issued to the Secretary of the Treasury at the Effective Time. Notwithstanding the Effective Time, all references in the Securities Purchase Agreement to the “Closing Date” shall continue to mean September 22, 2011. All capitalized terms used herein that are defined in the Securities Purchase Agreement, either directly or by reference therein, shall have the respective meanings assigned them in the Securities Purchase Agreement except as otherwise provided herein or unless the context otherwise requires.

3. Governing Law. This Assumption Agreement shall be governed by and construed in accordance with federal law of the United States if and to the extent such law is applicable, and otherwise in accordance with the laws of the State of New York applicable to contracts made and to be performed entirely within such state and shall be binding upon the parties hereto and their respective successors and assigns.

4. Successors and Assigns. This Assumption Agreement and all of the provisions hereof shall be binding upon, and shall inure to the benefit of, the parties hereto and their respective successors and assigns.

5. Counterparts. This Assumption Agreement may be executed simultaneously in multiple counterparts, each of which shall be deemed to be an original but all of which together shall constitute one and the same instrument.

6. Binding Effect. The Securities Purchase Agreement as so amended shall remain in full force and effect and shall be deemed binding upon the parties thereto and hereto until further amended in accordance with its terms.

7. Representations and Warranties. Buyer hereby represents and warrants to the Treasury that the representations and warranties of Buyer set forth in Article II of the Securities Purchase Agreement, as amended by this Assumption Agreement and the updated Disclosure Schedule attached hereto, are true and correct as of the Effective Time.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have caused this Assumption Agreement to be duly executed by their duly authorized officers as of the 1st day of August, 2017.

BUYER:

VERITEX HOLDINGS, INC.

By: /s/ C. Malcolm Holland, III
Name: C. Malcolm Holland, III
Title: Chairman and Chief Executive Officer

MERGER SUB:

SPARTAN MERGER SUB, INC.

By: /s/ C. Malcolm Holland, III
Name: C. Malcolm Holland, III
Title: Chairman and Chief Executive Officer

SELLER:

SOVEREIGN BANCSHARES, INC.

By: /s/ Thomas J. Mastor
Name: Thomas J. Mastor
Title: President and Chief Executive Officer

[Signature Page to Assignment and Assumption Agreement]

SMALL BUSINESS LENDING FUND — SECURITIES PURCHASE AGREEMENT

Sovereign Bancshares, Inc.

0062

Name of Company

SBLF No.

17950 Preston Road, Suite 500

Corporation

Street Address for Notices

Organizational Form (e.g., corporation, national bank)

Dallas Texas 75252

Texas

City State Zip Code

Jurisdiction of Organization

R. Michael Russell, CFO

Federal Reserve

Name of Contact Person to Receive Notices

Appropriate Federal Banking Agency

214-234-1862 214-242-1903

September 22, 2011

Fax Number for Notices

Phone Number for Notices

Effective Date

THIS SECURITIES PURCHASE AGREEMENT (the “*Agreement*”) is made as of the Effective Date set forth above (the “*Signing Date*”) between the Secretary of the Treasury (“*Treasury*”) and the Company named above (the “*Company*”), an entity existing under the laws of the Jurisdiction of Organization stated above in the Organizational Form stated above. The Company has elected to participate in Treasury’s Small Business Lending Fund program (“*SBLF*”). This Agreement contains the terms and conditions on which the Company intends to issue preferred stock to Treasury, which Treasury will purchase using funds appropriated under SBLF.

This Agreement consists of the following attached parts, all of which together constitute the entire agreement of Treasury and the Company (the “*Parties*”) with respect to the subject matter hereof, superseding all prior written and oral agreements and understandings between the Parties with respect to such subject matter:

- Annex A:* Information Specific to the Company and the Investment
- Annex B:* Definitions
- Annex C:* General Terms and Conditions
- Annex D:* Disclosure Schedule
- Annex E:* Registration Rights
- Annex F:* Form of Certificate of Designation

- Annex G:* Form of Officer’s Certificate
- Annex H:* Form of Supplemental Reports
- Annex I:* Form of Annual Certification
- Annex J:* Form of Opinion
- Annex K:* Form of Repayment Document

This Agreement may be executed in any number of counterparts, each being deemed to be an original instrument, and all of which will together constitute the same agreement. Executed signature pages to this Agreement may be delivered by facsimile or electronic mail attachment.

[Signatures follow]

IN WITNESS WHEREOF, this Agreement has been duly executed and delivered by the duly authorized representatives of the parties hereto as of the Effective Date.

THE SECRETARY OF THE TREASURY

VERITEX HOLDINGS, INC.

By: /s/ Don Graves
Name: Don Graves
Title: Deputy Assistant Secretary

By: /s/ Tom Mastor
Name: Tom Mastor
Title: President and Chairman of the Board

[Signature Page- SBLF Securities Purchase Agreement – Sovereign Bancshares, Inc.]

ANNEX A
INFORMATION SPECIFIC TO THE COMPANY AND THE INVESTMENT

Purchase Information

Terms of the Purchase:

Series of Preferred Stock Purchased:	Senior Non-Cumulative Perpetual Preferred Stock, Series C, no par value per share
Per Share Liquidation Preference of Preferred Stock:	\$1,000 per share
Number of Shares of Preferred Stock Purchased:	24,500
Dividend Payment Dates on the Preferred Stock:	Payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year.
Purchase Price:	\$24,500,000

Closing:

Location of Closing:	Virtual
Time of Closing:	10:00 a.m. (EST)
Date of Closing:	September 22, 2011

Redemption Information

(Only complete if the Company was a CPP or CDCI participant; leave blank otherwise.)

Prior Program:	<input checked="" type="checkbox"/> CPP
	<input type="checkbox"/> CDCI
Series of Previously Acquired Preferred Stock:	Fixed Rate Cumulative Perpetual Preferred Stock, Series A and Fixed Rate Cumulative Perpetual Preferred Stock, Series B
Number of Shares of Previously Acquired Preferred Stock:	18,215 shares of Series A and 911 shares of Series B
Repayment Amount ⁽¹⁾ :	\$19,228,031.61

(1) The Repayment Amount is the aggregate amount of principal and dividends due by the Company with respect to the CPP repurchase obligation.

Residual Amount⁽²⁾: \$0

(2) If the Repayment Amount is greater than the SBLF funding amount, insert the difference. If the Repurchase Amount is less than the SBLF funding amount, insert -0-.

Matching Private Investment Information

Treasury investment is contingent on the Company raising Matching Private Investment (check one):

<input type="radio"/>	Yes
<input checked="" type="checkbox"/>	No

If Yes, complete the following (leave blank otherwise):

Aggregate Dollar Amount of Matching Private Investment Required:

Aggregate Dollar Amount of Matching Private Investment Received:

Class of securities representing Matching Private Investment:

Date of issuance of Matching Private Investment:

ANNEX B
DEFINITIONS

1. Definitions. Except as otherwise specified herein or as the context may otherwise require, the following terms have the respective meanings set forth below for all purposes of this Agreement.

“*Affiliate*” means, with respect to any person, any person directly or indirectly controlling, controlled by or under common control with, such other person. For purposes of this definition, “*control*” (including, with correlative meanings, the terms “*controlled by*” and “*under common control with*”) when used with respect to any person, means the possession, directly or indirectly through one or more intermediaries, of the power to cause the direction of management and/or policies of such person, whether through the ownership of voting securities by contract or otherwise.

“*Application Date*” means the date of the Company’s completed application to participate in SBLF.

“*Appropriate Federal Banking Agency*” means the “appropriate Federal banking agency” with respect to the Company or such Company Subsidiaries, as applicable, as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)). The Appropriate Federal Banking Agency is identified on the cover page of this Agreement.

“*Appropriate State Banking Agency*” means, if the Company is a State-chartered bank, the Company’s State bank supervisor (as defined in Section 3(r) of the Federal Deposit Insurance Act, 12 U.S.C. § 1813(q)).

“*Bank Holding Company*” means a company registered as such with the Federal Reserve pursuant to 12 U.S.C. §1842 and the regulations of the Federal Reserve promulgated thereunder.

“*Call Report*” has the meaning assigned thereto in Section 4102(4) of the SBJA. If the Company is a Bank Holding Company or a Savings and Loan Holding Company, unless the context clearly indicates otherwise: (a) the term “Call Report” shall mean the Call Report(s) (as defined in Section 4102(4) of the SBJA) of the IDI Subsidiary(ies); and (b) if there are multiple IDI Subsidiaries, all references herein or in any document executed or delivered in connection herewith (including the Certificate of Designation, the Initial Supplemental Report and all Quarterly Supplemental Reports) to any data reported in a Call Report shall refer to the aggregate of such data across the Call Reports for all such IDI Subsidiaries.

“*CDCI*” means the Community Development Capital Initiative, as authorized under the Emergency Economic Stabilization Act of 2008.

“*Company Material Adverse Effect*” means a material adverse effect on (i) the business, results of operation or condition (financial or otherwise) of the Company and its consolidated subsidiaries taken as a whole; *provided, however,* that Company Material Adverse Effect shall not be deemed to include the effects of (A) changes after the Signing Date in general

business, economic or market conditions (including changes generally in prevailing interest rates, credit availability and liquidity, currency exchange rates and price levels or trading volumes in the United States or foreign securities or credit markets), or any outbreak or escalation of hostilities, declared or undeclared acts of war or terrorism, in each case generally affecting the industries in which the Company and its subsidiaries operate, (B) changes or proposed changes after the Signing Date in GAAP, or authoritative interpretations thereof, or (C) changes or proposed changes after the Signing Date in securities, banking and other laws of general applicability or related policies or interpretations of Governmental Entities (in the case of each of these clauses (A), (B) and (C), other than changes or occurrences to the extent that such changes or occurrences have or would reasonably be expected to have a materially disproportionate adverse effect on the Company and its consolidated subsidiaries taken as a whole relative to comparable U.S. banking or financial services organizations); or (ii) the ability of the Company to consummate the Purchase and other transactions contemplated by this Agreement and perform its obligations hereunder and under the Certificate of Designation on a timely basis and declare and pay dividends on the Dividend Payment Dates set forth in the Certificate of Designation.

“*CPP*” means the Capital Purchase Program, as authorized under the Emergency Economic Stabilization Act of 2008.

“*Disclosure Schedule*” means that certain schedule to this Agreement delivered to Treasury on or prior to the Signing Date, setting forth, among other things, items the disclosure of which is necessary or appropriate in response to an express disclosure requirement contained in a provision hereof. The Disclosure Schedule is contained in Annex D of this Agreement.

“*Executive Officers*” means the Company’s “executive officers” as defined in 12 C.F.R. § 215.2(e)(1) (regardless of whether or not such regulation is applicable to the Company).

“*Federal Reserve*” means the Board of Governors of the Federal Reserve System.

“*GAAP*” means generally accepted accounting principles in the United States.

“*General Terms and Conditions*” and “*General T&C*” each mean Annex C of this Agreement.

“*IDI Subsidiary*” means any Company Subsidiary that is an insured depository institution.

“*Junior Stock*” means Common Stock and any other class or series of stock of the Company the terms of which expressly provide that it ranks junior to the Preferred Shares as to dividend and redemption rights and/or as to rights on liquidation, dissolution or winding up of the Company.

“*knowledge of the Company*” or “*Company’s knowledge*” means the actual knowledge after reasonable and due inquiry of the “*officers*” (as such term is defined in Rule 3b-2 under the Exchange Act) of the Company.

“*Matching Private Investment-Supported*,” when used to describe the Company (if applicable), means the Company’s eligibility for participation in the SBLF program is conditioned upon the Company or an Affiliate of the Company acceptable to Treasury receiving Matching Private Investment, as contemplated by Section 4103(d)(3)(B) of the SBJA.

“*Original Letter Agreement*” means, if applicable, the Letter Agreement (and all terms incorporated therein) pursuant to which Treasury purchased from the Company, and the Company issued to Treasury, the Previously Acquired Preferred Shares (or warrants exercised to acquire the Previously Acquired Preferred Shares or the securities exchanged for the Previously Acquired Preferred Stock).

“*Oversight Officials*” means, interchangeably and collectively as context requires, the Special Deputy Inspector General for SBLF Program Oversight, the Inspector General of the Department of the Treasury, and the Comptroller General of the United States.

“*Parity Stock*” means any class or series of stock of the Company the terms of which do not expressly provide that such class or series will rank senior or junior to the Preferred Shares as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Company (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).

“*Preferred Shares*” means the number of shares of Preferred Stock identified in the “Purchase Information” section of Annex A opposite “Number of Shares of Preferred Stock Purchased.”

“*Preferred Stock*” means the series of the Company’s preferred stock identified in the “Purchase Information” section of Annex A opposite “Series of Preferred Stock Purchased.”

“*Previously Acquired Preferred Shares*” means, if the Company participated in CPP or CDCI, the number of shares of Previously Acquired Preferred Stock identified in the “Redemption Information” section of Annex A opposite “Number of Shares of Previously Acquired Preferred Stock.”

“*Previously Acquired Preferred Stock*” means, if the Company participated in CPP or CDCI, the series of the Company’s preferred stock identified in the “Redemption Information” section of Annex A opposite “Series of Previously Acquired Preferred Stock.”

“*Previously Disclosed*” means information set forth on the Disclosure Schedule or the Disclosure Update, as applicable; *provided, however*, that disclosure in any section of such Disclosure Schedule or Disclosure Update, as applicable, shall apply only to the indicated section of this Agreement; *provided, further*, that the existence of Previously Disclosed information, pursuant to a Disclosure Update, shall neither obligate Treasury to consummate the Purchase nor limit or affect any rights of or remedies available to Treasury.

“*Prior Program*” means (a) CPP, if the Company is a participant in CPP immediately prior to the Closing, or (b) CDCI, if the Company is a participant in CDCI immediately prior to the Closing.

“*Publicly-traded*” means a company that (i) has a class of securities that is traded on a national securities exchange and (ii) is required to file periodic reports with either the Securities and Exchange Commission or its primary federal bank regulator.

“*Purchase*” means the purchase of the Preferred Shares by Treasury from the Company pursuant to this Agreement.

“*Repayment*” has the meaning set forth in the Repayment Document.

“*Repayment Amount*” means, if the Company participated in CPP or CDCI, the aggregate amount payable by the Company as of the Closing Date to redeem the Previously Acquired Preferred Stock in accordance with its terms, which amount is set forth in the “Redemption Information” section of Annex A.

“*Savings and Loan Holding Company*” means a company registered as such with the Office of Thrift Supervision or any successor thereto pursuant to 12 U.S.C. §1467(a) and the regulations of the Office of Thrift Supervision promulgated thereunder.

“*SBJA*” means the Small Business Jobs Act of 2010, as it may be amended from time to time.

“*Subsidiary*” means any corporation, partnership, joint venture, limited liability company or other entity (A) of which such person or a subsidiary of such person is a general partner or (B) of which a majority of the voting securities or other voting interests, or a majority of the securities or other interests of which having by their terms ordinary voting power to elect a majority of the board of directors or persons performing similar functions with respect to such entity, is directly or indirectly owned by such person and/or one or more subsidiaries thereof.

“*Tax*” or “*Taxes*” means any federal, state, local or foreign income, gross receipts, property, sales, use, license, excise, franchise, employment, payroll, withholding, alternative or add-on minimum, *ad valorem*, transfer or excise tax, or any other tax, custom, duty, governmental fee or other like assessment or charge of any kind whatsoever, together with any interest, penalty or addition imposed by any Governmental Entity.

“*Total Assets*” means, with respect to an insured depository institution, the total assets of such insured depository institution.

“*Total Risk-Weighted Assets*” means, with respect to an insured depository institution, the risk-weighted assets of such insured depository institution.

“*Warrant*” has the meaning set forth in the Repayment Document.

2. Index of Definitions. The following table, which is provided solely for convenience of reference and shall not affect the interpretation of this Agreement, identifies the location where capitalized terms are defined in this Agreement:

Term	Location of Definition
Affiliate	Annex B, §1
Agreement	Cover Page
Appropriate Federal Banking Agency	Annex B, §1
Appropriate State Banking Agency	Annex B, §1
Bank Holding Company	Annex B, §1
Bankruptcy Exceptions	General T&C, §2.5(a)
Board of Directors	General T&C, §2.6
Business Combination	General T&C, §5.8
business day	General T&C, §5.12
Call Report	Annex B, §1
Capitalization Date	General T&C, §2.2
CDCI	Annex B, §1
Certificate of Designation	General T&C, §1.3(d)
Charter	General T&C, §1.3(d)
Closing	General T&C, §1.2(a)
Closing Date	General T&C, §1.2(a)
Closing Deadline	General T&C, §5.1(a)(i)
Code	General T&C, §2.14
Common Stock	General T&C, §2.2
Company	Cover Page
Company Financial Statements	General T&C, §1.3(i)
Company Material Adverse Effect	Annex B, §1
Company Reports	General T&C, §2.9
Company Subsidiary; Company Subsidiaries	General T&C, §2.5(b)
control; controlled by; under common control with	Annex B, §1
CPP	Annex B, §1
Disclosure Schedule	Annex B, §1
Disclosure Update	General T&C, §1.3(h)
ERISA	General T&C, §2.14
Exchange Act	General T&C, §4.3
Executive Officers	Annex B, §1
Federal Reserve	Annex B, §1
GAAP	Annex B, §1
Governmental Entities	General T&C, §1.3(a)
Holders	General T&C, §4.4(a)
Indemnitee	General T&C, §4.4(b)
Information	General T&C, §3.1(c)(iii)
Initial Supplemental Report	General T&C, §1.3(j)
Junior Stock	Annex B, §1
knowledge of the Company; Company's knowledge	Annex B, §1
Matching Private Investment	General T&C, §1.3(l)
Matching Private Investment-Supported	Annex B, §1
Matching Private Investors	General T&C, §1.3(l)

officers	Annex B, §1
Oversight Officials	Annex B, §1
Parity Stock	Annex B, §1
Parties	Cover Page
Plan	General T&C, §2.14
Preferred Shares	Annex B, §1
Preferred Stock	Annex B, §1
Previously Acquired Preferred Shares	Annex B, §1
Previously Acquired Preferred Stock	Annex B, §1
Previously Disclosed	Annex B, §1
Prior Program	General T&C, §1.2(c)
Proprietary Rights	General T&C, §2.21
Publicly-traded	Annex B, §1
Purchase	Annex B, §1
Purchase Price	General T&C, §1.1(a)
Regulatory Agreement	General T&C, §2.19
Related Party	General T&C, §2.25
Repayment Document	General T&C, §1.2(b)(ii)(E)
Residual Amount	General T&C, §1.2(b)(ii)(B)
Savings and Loan Holding Company	Annex B, §1
SBJA	Annex B, §1
SBLF	Cover Page
SEC	General T&C, §2.11
Securities Act	General T&C, §2.1
Signing Date	Cover Page
Subsidiary	Annex B, §1
Quarterly Supplemental Report	General T&C, §3.1(d)(i)
Tax; Taxes	Annex B, §1
Transfer	General T&C, §4.3
Treasury	Cover Page

3. Defined Terms in Annex K. Except for defined terms in Annex K that are expressly cross-referenced in another part of this Agreement, terms defined in Annex K are defined therein solely for purposes of Annex K and are not applicable to other parts of this Agreement.

ANNEX C
GENERAL TERMS AND CONDITIONS

CONTENTS OF GENERAL TERMS AND CONDITIONS

		Page
ARTICLE I	PURCHASE; CLOSING	3
	1.1 Purchase	3
	1.2 Closing	3
	1.3 Closing Conditions	4
ARTICLE II	REPRESENTATIONS AND WARRANTIES	6
	2.1 Organization, Authority and Significant Subsidiaries	6
	2.2 Capitalization	6
	2.3 Preferred Shares	7
	2.4 Compliance With Identity Verification Requirements	7
	2.5 Authorization; Enforceability	7
	2.6 Anti-takeover Provisions and Rights Plan	8
	2.7 No Company Material Adverse Effect	8
	2.8 Company Financial Statements	9
	2.9 Reports	9
	2.10 No Undisclosed Liabilities	9
	2.11 Offering of Securities	10
	2.12 Litigation and Other Proceedings	10
	2.13 Compliance with Laws	10
	2.14 Employee Benefit Matters	10
	2.15 Taxes	11
	2.16 Properties and Leases	11
	2.17 Environmental Liability	12
	2.18 Risk Management Instruments	12
	2.19 Agreements with Regulatory Agencies	12
	2.20 Insurance	13
	2.21 Intellectual Property	13
	2.22 Brokers and Finders	13
	2.23 Disclosure Schedule	13
	2.24 Previously Acquired Preferred Shares	14
	2.25 Related Party Transactions	14
	2.26 Ability to Pay Dividends	14
ARTICLE III	COVENANTS	14
	3.1 Affirmative Covenants	14
	3.2 Negative Covenants	20

ARTICLE IV	ADDITIONAL AGREEMENTS	21
	4.1 Purchase for Investment	21
	4.2 Legends	21
	4.3 Transfer of Preferred Shares	22
	4.4 Rule 144; Rule 144A; 4(1½) Transactions	22
	4.5 Depositary Shares	24
	4.6 Expenses and Further Assurances	24
ARTICLE V	MISCELLANEOUS	24
	5.1 Termination	24
	5.2 Survival	25
	5.3 Amendment	25
	5.4 Waiver of Conditions	26
	5.5 Governing Law; Submission to Jurisdiction; etc.	26
	5.6 No Relationship to TARP	26
	5.7 Notices	26
	5.8 Assignment	27
	5.9 Severability	27
	5.10 No Third Party Beneficiaries	27
	5.11 Specific Performance	27
	5.12 Interpretation	27

**ARTICLE I
PURCHASE; CLOSING**

1.1 Purchase. On the terms and subject to the conditions set forth in this Agreement, the Company agrees to sell to Treasury, and Treasury agrees to purchase from the Company, at the Closing, the Preferred Shares for the aggregate price set forth on Annex A (the “*Purchase Price*”).

1.2 Closing. (a) On the terms and subject to the conditions set forth in this Agreement, the closing of the Purchase (the “*Closing*”) will take place at the location specified in Annex A, at the time and on the date set forth in Annex A or as soon as practicable thereafter, or at such other place, time and date as shall be agreed between the Company and Treasury. The time and date on which the Closing occurs is referred to in this Agreement as the “*Closing Date*”.

(b) Subject to the fulfillment or waiver of the conditions to the Closing in Section 1.3, at the Closing:

(i) if Treasury holds Previously Acquired Preferred Shares:

(A) the Purchase Price shall first be applied to pay the Repayment Amount;

(B) if the Purchase Price is less than the Repayment Amount, the Company shall pay the positive difference (if any) between the Repayment Amount and the Purchase Price (a “*Residual Amount*”) to Treasury’s Office of Financial Stability by wire transfer of immediately available United States funds to an account designated in writing by Treasury; and

(C) upon receipt of the full Repayment Amount (by application of the Purchase Price and, if applicable, the Company’s payment of the Residual Amount), Treasury and the Company will consummate the Repayment;

(D) the Company will deliver to Treasury a statement of adjustment as contemplated by Section 13(J) of the Warrant; and

(E) the Company and Treasury will execute and deliver a properly completed repurchase document in the form attached hereto as Annex K, (the “*Repayment Document*”).

(ii) the Company will deliver the Preferred Shares as evidenced by one or more certificates dated the Closing Date and bearing appropriate legends as hereinafter provided for, in exchange for payment in full of the Purchase Price by application of the Purchase Price to the Repayment and by wire transfer of immediately available United States funds to a bank account designated by the Company in the Initial Supplemental Report.

1.3 Closing Conditions. The obligation of Treasury to consummate the Purchase is subject to the fulfillment (or waiver by Treasury) at or prior to the Closing of each of the following conditions:

(a) (i) any approvals or authorizations of all United States federal, state, local, foreign and other governmental, regulatory or judicial authorities (collectively, “*Governmental Entities*”) required for the consummation of the Purchase shall have been obtained or made in form and substance reasonably satisfactory to each party and shall be in full force and effect and all waiting periods required by United States and other applicable law, if any, shall have expired and (ii) no provision of any applicable United States or other law and no judgment, injunction, order or decree of any Governmental Entity shall prohibit the purchase and sale of the Preferred Shares as contemplated by this Agreement;

(b) (i) the representations and warranties of the Company set forth in (A) Sections 2.7 and 2.26 shall be true and correct in all respects as though made on and as of the Closing Date; (B) Sections 2.1, 2.2, 2.3, 2.4, 2.5, 2.6, 2.19, 2.22, 2.23, 2.24 and 2.25 shall be true and correct in all material respects as though made on and as of the Closing Date (other than representations and warranties that by their terms speak as of another date, which representations and warranties shall be true and correct in all material respects as of such other date); and (C) Sections 2.8 through 2.18 and Sections 2.20 through 2.21 (disregarding all qualifications or limitations set forth in such representations and warranties as to “materiality”, “Company Material Adverse Effect” and words of similar import) shall be true and correct as though made on and as of the Closing Date (other than representations and warranties that by their terms speak as of another date, which representations and warranties shall be true and correct as of such other date), except to the extent that the failure of such representations and warranties referred to in this Section 1.3(b)(i)(C) to be so true and correct, individually or in the aggregate, does not have and would not reasonably be expected to have a Company Material Adverse Effect; and (ii) the Company shall have performed in all respects all obligations required to be performed by it under this Agreement at or prior to the Closing;

(c) the Company shall have delivered to Treasury a certificate signed on behalf of the Company by an Executive Officer certifying to the effect that the conditions set forth in Section 1.3(b) have been satisfied, in substantially the form of Annex G;

(d) the Company shall have duly adopted and filed with the Secretary of State of its jurisdiction of organization or other applicable Governmental Entity an amendment to its certificate or articles of incorporation, articles of association, or similar organizational document (“*Charter*”) in substantially the form of Annex F (the “*Certificate of Designation*”) and the Company shall have delivered to Treasury a copy of the filed Certificate of Designation with appropriate evidence from the Secretary of State or other applicable Governmental Entity that the filing has been accepted, or if a filed copy is unavailable, a certificate signed on behalf of the Company by an Executive Officer certifying to the effect that the filing of the Certificate of Designation has been accepted, in substantially the form attached hereto as Annex E;

(e) the Company shall have delivered to Treasury true, complete and correct certified copies of the Charter and bylaws of the Company;

- (f) the Company shall have delivered to Treasury a written opinion from counsel to the Company (which may be internal counsel), addressed to Treasury and dated as of the Closing Date, in substantially the form of Annex J;
- (g) the Company shall have delivered certificates in proper form or, with the prior consent of Treasury, evidence of shares in book-entry form, evidencing the Preferred Shares to Treasury or its designee(s);
- (h) the Company shall have delivered to Treasury a copy of the Disclosure Schedule on or prior to the Signing Date and, to the extent that any information set forth on the Disclosure Schedule needs to be updated or supplemented to make it true, complete and correct as of the Closing Date, (i) the Company shall have delivered to Treasury an update to the Disclosure Schedule (the “*Disclosure Update*”), setting forth any information necessary to make the Disclosure Schedule true, correct and complete as of the Closing Date and (ii) Treasury, in its sole discretion, shall have approved the Disclosure Update, *provided, however*, that the delivery and acceptance of the Disclosure Update shall not limit or affect any rights of or remedies available to Treasury;
- (i) the Company shall have delivered to Treasury on or prior to the Signing Date each of the consolidated financial statements of the Company and its consolidated subsidiaries for each of the last three completed fiscal years of the Company (which shall be audited to the extent audited financial statements are available prior to the Signing Date) (together with the Call Reports filed by the Company or the IDI Subsidiary(ies) for each completed quarterly period since the last completed fiscal year, the “*Company Financial Statements*”);
- (j) the Company shall have delivered to Treasury, not later than five (5) business days prior to the Closing Date, a certificate (the “*Initial Supplemental Report*”) in substantially the form attached hereto as Annex H setting forth a complete and accurate statement of loans held by the Company (or if the Company is a Bank Holding Company or a Savings and Loan Holding Company, by the IDI Subsidiary(ies)) in each of the categories described therein, for the time periods specified therein, (A) including a signed certification of the Chief Executive Officer, the Chief Financial Officer and all directors or trustees of the Company or the IDI Subsidiary(ies) who attested to the Call Reports for the quarters covered by such certificate, that such certificate (x) has been prepared in conformance with the instructions issued by Treasury and (y) is true and correct to the best of their knowledge and belief; and (B) completed for the last full calendar quarter prior to the Closing Date and the four (4) quarters ended September 30, 2009, December 31, 2009, March 31, 2010 and June 30, 2010;
- (k) prior to the Signing Date, the Company shall have delivered to Treasury, the Appropriate Federal Banking Agency and, if the Company is a State-chartered bank, the Appropriate State Banking Agency, a small business lending plan describing how the Company’s business strategy and operating goals will allow it to address the needs of small businesses in the area it serves, as well as a plan to provide linguistically and culturally appropriate outreach, where appropriate; and

(l) if the Company is Matching Private Investment-Supported, on or after September 27, 2010 the Company or an Affiliate of the Company acceptable to Treasury shall (i) have received equity capital (“*Matching Private Investment*”) from one or more non-governmental investors (“*Matching Private Investors*”) (A) in an amount equal to or greater than the Aggregate Dollar Amount of Matching Private Investment Required set forth on Annex A (net of all dividends paid with respect to, and all repurchases and redemptions of, the Company’s equity securities), (B) that is subordinate in right of payment of dividends, liquidation preference and redemption rights to the Preferred Shares and (C) that is acceptable in form and substance to Treasury, in its sole discretion and (ii) have satisfied the following requirements reasonably in advance of the Closing Date: (A) delivery of copies of the definitive documentation for the Matching Private Investment to Treasury, (B) delivery of the organizational charts of such non-governmental investors to Treasury, each certified by the applicable non-governmental investor and demonstrating that such non-governmental investor is not an Affiliate of the Company, (C) delivery of any other documents or information as Treasury may reasonably request, in its sole discretion and (D) any other terms and conditions imposed by Treasury or the Appropriate Federal Banking Agency, in their sole discretion.

ARTICLE II REPRESENTATIONS AND WARRANTIES

The Company represents and warrants to Treasury that as of the Signing Date and as of the Closing Date (or such other date specified herein):

2.1 Organization, Authority and Significant Subsidiaries. The Company has been duly incorporated and is validly existing and in good standing under the laws of its jurisdiction of organization, with the necessary power and authority to own, operate and lease its properties and conduct its business as it is being currently conducted, and except as has not, individually or in the aggregate, had and would not reasonably be expected to have a Company Material Adverse Effect, has been duly qualified as a foreign corporation for the transaction of business and is in good standing under the laws of each other jurisdiction in which it owns or leases properties or conducts any business so as to require such qualification; each subsidiary of the Company that would be considered a “significant subsidiary” within the meaning of Rule 1-02(w) of Regulation S-X under the Securities Act of 1933 (the “*Securities Act*”), has been duly organized and is validly existing in good standing under the laws of its jurisdiction of organization. The Charter and bylaws of the Company, copies of which have been provided to Treasury prior to the Signing Date, are true, complete and correct copies of such documents as in full force and effect as of the Signing Date and as of the Closing Date.

2.2 Capitalization. The outstanding shares of capital stock of the Company have been duly authorized and are validly issued and outstanding, fully paid and nonassessable, and subject to no preemptive or similar rights (and were not issued in violation of any preemptive rights). As of the Signing Date, the Company does not have outstanding any securities or other obligations providing the holder the right to acquire its common stock (“*Common Stock*”) or other capital stock that is not reserved for issuance as specified in Part 2.2 of the Disclosure Schedule, and the Company has not made any other commitment to authorize, issue or sell any Common Stock or other capital stock. Since the last day of the fiscal period covered by the last Call Report filed by

the Company or the IDI Subsidiary(ies) prior to the Application Date (the “*Capitalization Date*”), the Company has not (a) declared, and has no present intention of declaring, any dividends on its Common Stock in a per-share amount greater than the per-share amount of declared dividends that are reflected in such Call Report; (b) declared, and has no present intention of declaring (except as contemplated by the Certificate of Designation) any dividends on any of its preferred stock in a per-share amount greater than the per-share amount of declared dividends that are reflected in such Call Report; or (c) issued any shares of Common Stock or other capital stock, other than (i) shares issued upon the exercise of stock options or delivered under other equity-based awards or other convertible securities or warrants which were issued and outstanding on the Capitalization Date and disclosed in Part 2.2 of the Disclosure Schedule, (ii) shares disclosed in Part 2.2 of the Disclosure Schedule, and (iii) if the Company is Matching Private Investment-Supported, shares or other capital stock representing Matching Private Investment disclosed in the “Matching Private Investment” section of Annex A. Except as disclosed in Part 2.2 of the Disclosure Schedule, the Company has no agreements providing for the accelerated exercise, settlement or exchange of any capital stock of the Company for Common Stock. Each holder of 5% or more of any class of capital stock of the Company and such holder’s primary address are set forth in Part 2.2 of the Disclosure Schedule. The Company has received a representation from each Matching Private Investor that such Matching Private Investor has not received or applied for any investment from the SBLF, and the Company has no reason to believe that any such representation is inaccurate. If the Company is a Bank Holding Company or a Savings and Loan Holding Company, (x) the percentage of each IDI Subsidiary’s issued and outstanding capital stock that is owned by the Company is set forth on Part 2.2 of the Disclosure Schedule; and (y) all shares of issued and outstanding capital stock of the IDI Subsidiary(ies) owned by the Company are free and clear of all liens, security interests, charges or encumbrances. Since the Application Date, there has been no change in the organizational hierarchy information regarding the Company that was available on the Application Date from the National Information Center of the Federal Reserve System.

2.3 Preferred Shares. The Preferred Shares have been duly and validly authorized, and, when issued and delivered pursuant to this Agreement, such Preferred Shares will be duly and validly issued and fully paid and non-assessable, will not be issued in violation of any preemptive rights, and will rank *pari passu* with or senior to all other series or classes of preferred stock, whether or not designated, issued or outstanding, with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

2.4 Compliance with Identity Verification Requirements. The Company and the Company Subsidiaries (to the extent such regulations are applicable to the Company Subsidiaries) are in compliance with the requirements of Section 1020.220 of title 31, Code of Federal Regulations.

2.5 Authorization, Enforceability.

(a) The Company has the corporate power and authority to execute and deliver this Agreement and to carry out its obligations hereunder (which includes the issuance of the Preferred Shares). The execution, delivery and performance by the Company of this Agreement and the consummation of the transactions contemplated hereby have been duly

authorized by all necessary corporate action on the part of the Company and its stockholders, and no further approval or authorization is required on the part of the Company. This Agreement is a valid and binding obligation of the Company enforceable against the Company in accordance with its terms, subject to any limitations of applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles, regardless of whether such enforceability is considered in a proceeding at law or in equity ("*Bankruptcy Exceptions*").

(b) The execution, delivery and performance by the Company of this Agreement and the consummation of the transactions contemplated hereby and compliance by the Company with the provisions hereof, will not (i) violate, conflict with, or result in a breach of any provision of, or constitute a default (or an event which, with notice or lapse of time or both, would constitute a default) under, or result in the termination of, or accelerate the performance required by, or result in a right of termination or acceleration of, or result in the creation of, any lien, security interest, charge or encumbrance upon any of the properties or assets of the Company or any subsidiary of the Company (each subsidiary, a "*Company Subsidiary*" and, collectively, the "*Company Subsidiaries*") under any of the terms, conditions or provisions of (A) its organizational documents or (B) any note, bond, mortgage, indenture, deed of trust, license, lease, agreement or other instrument or obligation to which the Company or any Company Subsidiary is a party or by which it or any Company Subsidiary may be bound, or to which the Company or any Company Subsidiary or any of the properties or assets of the Company or any Company Subsidiary may be subject, or (ii) subject to compliance with the statutes and regulations referred to in the next paragraph, violate any statute, rule or regulation or any judgment, ruling, order, writ, injunction or decree applicable to the Company or any Company Subsidiary or any of their respective properties or assets except, in the case of clauses (i)(B) and (ii), for those occurrences that, individually or in the aggregate, have not had and would not reasonably be expected to have a Company Material Adverse Effect.

(c) Other than the filing of the Certificate of Designation with the Secretary of State of its jurisdiction of organization or other applicable Governmental Entity, such filings and approvals as are required to be made or obtained under any state "blue sky" laws and such as have been made or obtained, no notice to, filing with, exemption or review by, or authorization, consent or approval of, any Governmental Entity is required to be made or obtained by the Company in connection with the consummation by the Company of the Purchase except for any such notices, filings, exemptions, reviews, authorizations, consents and approvals the failure of which to make or obtain would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

2.6 Anti-takeover Provisions and Rights Plan. The Board of Directors of the Company (the "*Board of Directors*") has taken all necessary action to ensure that the transactions contemplated by this Agreement and the consummation of the transactions contemplated hereby will be exempt from any anti-takeover or similar provisions of the Company's Charter and bylaws, and any other provisions of any applicable "moratorium", "control share", "fair price", "interested stockholder" or other anti-takeover laws and regulations of any jurisdiction.

2.7 No Company Material Adverse Effect. Since the last day of the fiscal period covered by the last Call Report filed by the Company or the IDI Subsidiary(ies) prior to the

Application Date, no fact, circumstance, event, change, occurrence, condition or development has occurred that, individually or in the aggregate, has had or would reasonably be expected to have a Company Material Adverse Effect.

2.8 Company Financial Statements. The Company Financial Statements present fairly in all material respects the consolidated financial position of the Company and its consolidated subsidiaries as of the dates indicated therein and the consolidated results of their operations for the periods specified therein; and except as stated therein, such financial statements (a) were prepared in conformity with GAAP applied on a consistent basis (except as may be noted therein) and (b) have been prepared from, and are in accordance with, the books and records of the Company and the Company Subsidiaries.

2.9 Reports.

(a) Since December 31, 2007, the Company and each Company Subsidiary has filed all reports, registrations, documents, filings, statements and submissions, together with any amendments thereto, that it was required to file with any Governmental Entity (the foregoing, collectively, the “*Company Reports*”) and has paid all fees and assessments due and payable in connection therewith, except, in each case, as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect. As of their respective dates of filing, the Company Reports complied in all material respects with all statutes and applicable rules and regulations of the applicable Governmental Entities.

(b) The records, systems, controls, data and information of the Company and the Company Subsidiaries are recorded, stored, maintained and operated under means (including any electronic, mechanical or photographic process, whether computerized or not) that are under the exclusive ownership and direct control of the Company or the Company Subsidiaries or their accountants (including all means of access thereto and therefrom), except for any non-exclusive ownership and non-direct control that would not reasonably be expected to have a material adverse effect on the system of internal accounting controls described below in this Section 2.9(b). The Company (i) has implemented and maintains adequate disclosure controls and procedures to ensure that material information relating to the Company, including the consolidated Company Subsidiaries, is made known to the chief executive officer and the chief financial officer of the Company by others within those entities, and (ii) has disclosed, based on its most recent evaluation prior to the Signing Date, to the Company’s outside auditors and the audit committee of the Board of Directors (A) any significant deficiencies and material weaknesses in the design or operation of internal controls that are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information and (B) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal controls over financial reporting.

2.10 No Undisclosed Liabilities. Neither the Company nor any of the Company Subsidiaries has any liabilities or obligations of any nature (absolute, accrued, contingent or otherwise) which are not properly reflected in the Company Financial Statements to the extent required to be so reflected and, if applicable, reserved against in accordance with GAAP applied on a consistent basis, except for (a) liabilities that have arisen since the last fiscal year end in the ordinary and usual course of business and consistent with past practice and (b) liabilities that,

individually or in the aggregate, have not had and would not reasonably be expected to have a Company Material Adverse Effect.

2.11 Offering of Securities. Neither the Company nor any person acting on its behalf has taken any action (including any offering of any securities of the Company under circumstances which would require the integration of such offering with the offering of any of the Preferred Shares under the Securities Act, and the rules and regulations of the Securities and Exchange Commission (the “SEC”) promulgated thereunder), which might subject the offering, issuance or sale of any of the Preferred Shares to Treasury pursuant to this Agreement to the registration requirements of the Securities Act.

2.12 Litigation and Other Proceedings. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, there is no (a) pending or, to the knowledge of the Company, threatened, claim, action, suit, investigation or proceeding, against the Company or any Company Subsidiary or to which any of their assets are subject nor is the Company or any Company Subsidiary subject to any order, judgment or decree or (b) unresolved violation, criticism or exception by any Governmental Entity with respect to any report or relating to any examinations or inspections of the Company or any Company Subsidiaries. There is no claim, action, suit, investigation or proceeding pending or, to the Company’s knowledge, threatened against any institution-affiliated party (as defined in 12 U.S.C. §1813(u)) of the Company or any of the IDI Subsidiaries that, if determined or resolved in a manner adverse to such institution-affiliated party, could result in such institution-affiliated party being prohibited from participation in the conduct of the affairs of any financial institution or holding company of any financial institution and, to the Company’s knowledge, there are no facts or circumstances could reasonably be expected to provide a basis for any such claim, action, suit, investigation or proceeding.

2.13 Compliance with Laws. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries have all permits, licenses, franchises, authorizations, orders and approvals of, and have made all filings, applications and registrations with, Governmental Entities that are required in order to permit them to own or lease their properties and assets and to carry on their business as presently conducted and that are material to the business of the Company or such Company Subsidiary. Except as set forth in Part 2.13 of the Disclosure Schedule, the Company and the Company Subsidiaries have complied in all respects and are not in default or violation of, and none of them is, to the knowledge of the Company, under investigation with respect to or, to the knowledge of the Company, have been threatened to be charged with or given notice of any violation of, any applicable domestic (federal, state or local) or foreign law, statute, ordinance, license, rule, regulation, policy or guideline, order, demand, writ, injunction, decree or judgment of any Governmental Entity, other than such noncompliance, defaults or violations that would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect. Except for statutory or regulatory restrictions of general application, no Governmental Entity has placed any restriction on the business or properties of the Company or any Company Subsidiary that would, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

2.14 Employee Benefit Matters. Except as would not reasonably be expected to have, either individually or in the aggregate, a Company Material Adverse Effect: (a) each “employee benefit plan” (within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”)) providing benefits to any current or former employee, officer or director of the Company or any member of its “Controlled Group” (defined as any organization which is a member of a controlled group of corporations within the meaning of Section 414 of the Internal Revenue Code of 1986, as amended (the “Code”)) that is sponsored, maintained or contributed to by the Company or any member of its Controlled Group and for which the Company or any member of its Controlled Group would have any liability, whether actual or contingent (each, a “Plan”) has been maintained in compliance with its terms and with the requirements of all applicable statutes, rules and regulations, including ERISA and the Code; (b) with respect to each Plan subject to Title IV of ERISA (including, for purposes of this clause (b), any plan subject to Title IV of ERISA that the Company or any member of its Controlled Group previously maintained or contributed to in the six years prior to the Signing Date), (1) no “reportable event” (within the meaning of Section 4043(c) of ERISA), other than a reportable event for which the notice period referred to in Section 4043(c) of ERISA has been waived, has occurred in the three years prior to the Signing Date or is reasonably expected to occur, (2) no “accumulated funding deficiency” (within the meaning of Section 302 of ERISA or Section 412 of the Code), whether or not waived, has occurred in the three years prior to the Signing Date or is reasonably expected to occur, (3) the fair market value of the assets under each Plan exceeds the present value of all benefits accrued under such Plan (determined based on the assumptions used to fund such Plan) and (4) neither the Company nor any member of its Controlled Group has incurred in the six years prior to the Signing Date, or reasonably expects to incur, any liability under Title IV of ERISA (other than contributions to the Plan or premiums to the Pension Benefit Guaranty Corporation in the ordinary course and without default) in respect of a Plan (including any Plan that is a “multiemployer plan”, within the meaning of Section 4001(c)(3) of ERISA); and (c) each Plan that is intended to be qualified under Section 401(a) of the Code has received a favorable determination letter from the Internal Revenue Service with respect to its qualified status that has not been revoked, or such a determination letter has been timely applied for but not received by the Signing Date, and nothing has occurred, whether by action or by failure to act, which could reasonably be expected to cause the loss, revocation or denial of such qualified status or favorable determination letter.

2.15 Taxes. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, (a) the Company and the Company Subsidiaries have filed all federal, state, local and foreign income and franchise Tax returns (together with any schedules and attached thereto) required to be filed through the Signing Date, subject to permitted extensions, and have paid all Taxes due thereon, (b) all such Tax returns (together with any schedules and attached thereto) are true, complete and correct in all material respects and were prepared in compliance with all applicable laws and (c) no Tax deficiency has been determined adversely to the Company or any of the Company Subsidiaries, nor does the Company have any knowledge of any Tax deficiencies.

2.16 Properties and Leases. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries have good and marketable title to all real properties and all other properties and assets owned by them, in each case free from liens (including, without limitation,

liens for Taxes), encumbrances, claims and defects that would affect the value thereof or interfere with the use made or to be made thereof by them. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries hold all leased real or personal property under valid and enforceable leases with no exceptions that would interfere with the use made or to be made thereof by them.

2.17 Environmental Liability. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect:

(a) there is no legal, administrative, or other proceeding, claim or action of any nature seeking to impose, or that would reasonably be expected to result in the imposition of, on the Company or any Company Subsidiary, any liability relating to the release of hazardous substances as defined under any local, state or federal environmental statute, regulation or ordinance, including the Comprehensive Environmental Response, Compensation and Liability Act of 1980, pending or, to the Company's knowledge, threatened against the Company or any Company Subsidiary;

(b) to the Company's knowledge, there is no reasonable basis for any such proceeding, claim or action; and

(c) neither the Company nor any Company Subsidiary is subject to any agreement, order, judgment or decree by or with any court, Governmental Entity or third party imposing any such environmental liability.

2.18 Risk Management Instruments. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, all derivative instruments, including, swaps, caps, floors and option agreements, whether entered into for the Company's own account, or for the account of one or more of the Company Subsidiaries or its or their customers, were entered into (i) only in the ordinary course of business, (ii) in accordance with prudent practices and in all material respects with all applicable laws, rules, regulations and regulatory policies and (iii) with counterparties believed to be financially responsible at the time; and each of such instruments constitutes the valid and legally binding obligation of the Company or one of the Company Subsidiaries, enforceable in accordance with its terms, except as may be limited by the Bankruptcy Exceptions. Neither the Company or the Company Subsidiaries, nor, to the knowledge of the Company, any other party thereto, is in breach of any of its obligations under any such agreement or arrangement other than such breaches that would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

2.19 Agreements with Regulatory Agencies. Except as set forth in Part 2.19 of the Disclosure Schedule, neither the Company nor any Company Subsidiary is subject to any cease-and-desist or other similar order or enforcement action issued by, or is a party to any written agreement, consent agreement or memorandum of understanding with, or is a party to any commitment letter or similar undertaking to, or is subject to any capital directive by, or since December 31, 2007, has adopted any board resolutions at the request of, any Governmental Entity that currently restricts the conduct of its business or that in any material manner relates to its capital adequacy, its liquidity and funding policies and practices, its ability to pay dividends,

its credit, risk management or compliance policies or procedures, its internal controls, its management or its operations or business (each item in this sentence, a “*Regulatory Agreement*”), nor has the Company or any Company Subsidiary been advised since December 31, 2007, by any such Governmental Entity that it is considering issuing, initiating, ordering, or requesting any such Regulatory Agreement. The Company and each Company Subsidiary is in compliance with each Regulatory Agreement to which it is party or subject, and neither the Company nor any Company Subsidiary has received any notice from any Governmental Entity indicating that either the Company or any Company Subsidiary is not in compliance with any such Regulatory Agreement.

2.20 Insurance. The Company and the Company Subsidiaries are insured with reputable insurers against such risks and in such amounts as the management of the Company reasonably has determined to be prudent and consistent with industry practice. The Company and the Company Subsidiaries are in material compliance with their insurance policies and are not in default under any of the material terms thereof, each such policy is outstanding and in full force and effect, all premiums and other payments due under any material policy have been paid, and all claims thereunder have been filed in due and timely fashion, except, in each case, as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

2.21 Intellectual Property. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, (i) the Company and each Company Subsidiary owns or otherwise has the right to use, all intellectual property rights, including all trademarks, trade dress, trade names, service marks, domain names, patents, inventions, trade secrets, know-how, works of authorship and copyrights therein, that are used in the conduct of their existing businesses and all rights relating to the plans, design and specifications of any of its branch facilities (“*Proprietary Rights*”) free and clear of all liens and any claims of ownership by current or former employees, contractors, designers or others and (ii) neither the Company nor any of the Company Subsidiaries is materially infringing, diluting, misappropriating or violating, nor has the Company or any of the Company Subsidiaries received any written (or, to the knowledge of the Company, oral) communications alleging that any of them has materially infringed, diluted, misappropriated or violated, any of the Proprietary Rights owned by any other person. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, to the Company’s knowledge, no other person is infringing, diluting, misappropriating or violating, nor has the Company or any of the Company Subsidiaries sent any written communications since December 31, 2007, alleging that any person has infringed, diluted, misappropriated or violated, any of the Proprietary Rights owned by the Company and the Company Subsidiaries.

2.22 Brokers and Finders. Treasury has no liability for any amounts that any broker, finder or investment banker is entitled to for any financial advisory, brokerage, finder’s or other fee or commission in connection with this Agreement or the transactions contemplated hereby based upon arrangements made by or on behalf of the Company or any Company Subsidiary.

2.23 Disclosure Schedule. The Company has delivered the Disclosure Schedule and, if applicable, the Disclosure Update to Treasury and the information contained in the Disclosure

Schedule, as modified by the information contained in the Disclosure Update, if applicable, is true, complete and correct.

2.24 Previously Acquired Preferred Shares. If Treasury holds Previously Acquired Preferred Shares:

(a) The Company has not breached any representation, warranty or covenant set forth in the Original Letter Agreement or any of the other documents governing the Previously Acquired Preferred Stock.

(b) The Company has paid to Treasury: (i) if the Previously Acquired Preferred Stock is cumulative, all accrued and unpaid dividends and/or interest then due on the Previously Acquired Preferred Stock; or (ii) if the Previously Acquired Preferred Stock is non-cumulative, all unpaid dividends and/or interest due on the Previously Acquired Preferred Shares for the fiscal quarter prior to the Closing Date plus the accrued and unpaid dividends and/or interest due on the Previously Acquired Preferred Shares as of the Closing Date for the fiscal quarter in which the Closing shall occur.

2.25 Related Party Transactions. Neither the Company nor any Company Subsidiary has made any extension of credit to any director or Executive Officer of the Company or any Company Subsidiary, any holder of 5% or more of the Company's issued and outstanding capital stock, or any of their respective spouses or children or to any Affiliate of any of the foregoing (each, a "*Related Party*"), other than in compliance with 12 C.F.R Part 215 (Regulation O). Except as set forth in Part 2.25 of the Disclosure Schedule, to the Company's knowledge, no Related Party has any (i) material commercial, industrial, banking, consulting, legal, accounting, charitable or familial relationship with any vendor or material customer of the Company or any Company Subsidiary that is not on arms-length terms, or (ii) direct or indirect ownership interest in any person or entity with which the Company or any Company Subsidiary has a material business relationship that is not on arms-length terms (not including Publicly-traded entities in which such person owns less than two percent (2%) of the outstanding capital stock).

2.26 Ability to Pay Dividends. The Company has all permits, licenses, franchises, authorizations, orders and approvals of, and has made all filings, applications and registrations with, Governmental Entities and third parties that are required in order to permit the Company to declare and pay dividends on the Preferred Shares on the Dividend Payment Dates set forth in the Certificate of Designation.

ARTICLE III COVENANTS

3.1 Affirmative Covenants. The Company hereby covenants and agrees with Treasury that:

(a) Commercially Reasonable Efforts. Subject to the terms and conditions of this Agreement, each of the parties will use its commercially reasonable efforts in good faith to take, or cause to be taken, all actions, and to do, or cause to be done, all things necessary, proper

or desirable, or advisable under applicable laws, so as to permit consummation of the Purchase as promptly as practicable and otherwise to enable consummation of the transactions contemplated hereby and shall use commercially reasonable efforts to cooperate with the other party to that end.

(b) Certain Notifications until Closing. From the Signing Date until the Closing, the Company shall promptly notify Treasury of

(i) any fact, event or circumstance of which it is aware and which would reasonably be expected to cause any representation or warranty of the Company contained in this Agreement to be untrue or inaccurate in any material respect or to cause any covenant or agreement of the Company contained in this Agreement not to be complied with or satisfied in any material respect and (ii) except as Previously Disclosed, any fact, circumstance, event, change, occurrence, condition or development of which the Company is aware and which, individually or in the aggregate, has had or would reasonably be expected to have a Company Material Adverse Effect; *provided, however*, that delivery of any notice pursuant to this Section 3.1(b) shall not limit or affect any rights of or remedies available to Treasury.

(c) Access, Information and Confidentiality.

(i) From the Signing Date until the date on which all of the Preferred Shares have been redeemed in whole, the Company will permit, and shall cause each of the Company's Subsidiaries to permit, Treasury, the Oversight Officials and their respective agents, consultants, contractors and advisors to (x) examine any books, papers, records, Tax returns (including all schedules attached thereto), data and other information; (y) make copies thereof; and (z) discuss the affairs, finances and accounts of the Company and the Company Subsidiaries with the personnel of the Company and the Company Subsidiaries, all upon reasonable notice; *provided*, that:

- (A) any examinations and discussions pursuant to this Section 3.1(c)(i) shall be conducted during normal business hours and in such manner as not to interfere unreasonably with the conduct of the business of the Company;
- (B) neither the Company nor any Company Subsidiary shall be required by this Section 3.1(c)(i) to disclose any information to the extent (x) prohibited by applicable law or regulation, or (y) that such disclosure would reasonably be expected to cause a violation of any agreement to which the Company or any Company Subsidiary is a party or would cause a risk of a loss of privilege to the Company or any Company Subsidiary (provided that the Company shall use commercially reasonable efforts to make appropriate substitute disclosure arrangements under circumstances where the restrictions in this clause (B) apply);
- (C) the obligations of the Company and the Company Subsidiaries to disclose information pursuant to this Section 3.1(c)(i) to any Oversight Official or any agent, consultant, contractor and

advisor thereof, such Oversight Official shall have agreed, with respect to documents obtained under this Section 3.1(c)(i), to follow applicable law and regulation (and the applicable customary policies and procedures) regarding the dissemination of confidential materials, including redacting confidential information from the public version of its reports and soliciting input from the Company as to information that should be afforded confidentiality, as appropriate; and

(D) for avoidance of doubt, such examinations and discussions may, at Treasury's option, be conducted on site at any office of the Company or any Company Subsidiary.

(ii) From the Signing Date until the date on which all of the Preferred Shares have been redeemed in whole, the Company will deliver, or will cause to be delivered, to Treasury:

(A) as soon as available after the end of each fiscal year of the Company, and in any event within 90 days thereafter, a consolidated balance sheet of the Company as of the end of such fiscal year, and consolidated statements of income, retained earnings and cash flows of the Company for such year, in each case prepared in accordance with GAAP applied on a consistent basis and setting forth in each case in comparative form the figures for the previous fiscal year of the Company and which shall be audited to the extent audited financial statements are available;³

(B) as soon as available after the end of the first, second and third quarterly periods in each fiscal year of the Company, a copy of any quarterly reports provided to other stockholders of the Company or Company management by the Company;

(C) as soon as available after the Company receives any assessment of the Company's internal controls, a copy of such assessment (other than assessments provided by the Appropriate Federal Banking Agency or the Appropriate State Banking Agency that the Company is prohibited by applicable law or regulation from disclosing to Treasury);

(D) annually on a date specified by Treasury, a completed survey, in a form specified by Treasury, providing, among other things, a description of how the Company has utilized the funds the

³ To the extent that the Company informed the Treasury on the Signing Date that it does not prepare financial statements in accordance with GAAP in the ordinary course, the Treasury may consider other annual financial reporting packages acceptable to it in its sole discretion.

Company received hereunder in connection with the sale of the Preferred Shares and the effects of such funds on the operations and status of the Company;

- (E) as soon as such items become effective, any amendments to the Charter, bylaws or other organizational documents of the Company; and
- (F) at the same time as such items are sent to any stockholders of the Company, copies of any information or documents sent by the Company to its stockholders.

(iii) Treasury will use reasonable best efforts to hold, and will use reasonable best efforts to cause its agents, consultants, contractors and advisors and United States executive branch officials and employees, to hold, in confidence all non-public records, books, contracts, instruments, computer data and other data and information (collectively, "*Information*") concerning the Company furnished or made available to it by the Company or its representatives pursuant to this Agreement (except to the extent that such information can be shown to have been (A) previously known by such party on a non-confidential basis, (B) in the public domain through no fault of such party or (C) later lawfully acquired from other sources by the party to which it was furnished (and without violation of any other confidentiality obligation)); *provided* that nothing herein shall prevent Treasury from disclosing any Information to the extent required by applicable laws or regulations or by any subpoena or similar legal process. Treasury understands that the Information may contain commercially sensitive confidential information entitled to an exception from a Freedom of Information Act request.

(iv) Treasury's information rights pursuant to Section 3.1(c)(ii)(A), (B), (C), (E) and (F) and Treasury's right to receive certifications from the Company pursuant to Section 3.1(d) may be assigned by Treasury to a transferee or assignee of the Preferred Shares with a liquidation preference of no less than an amount equal to 2% of the initial aggregate liquidation preference of the Preferred Shares.

(v) Nothing in this Section shall be construed to limit the authority that any Oversight Official or any other applicable regulatory authority has under law.

(vi) The Company shall provide to Treasury all such information as Treasury may request from time to time for the purpose of carrying out the study required by Section 4112 of the SBJA.

(d) Quarterly Supplemental Reports and Annual Certifications.

(i) Concurrently with the submission of Call Reports by the Company or the IDI Subsidiary(ies) (as the case may be) for each quarter ending after the Closing Date, the Company shall deliver to Treasury a certificate in substantially the form attached hereto as Annex H setting forth a complete and accurate statement of loans held by the Company in each of the categories described therein, for the time periods specified therein, (A) including a signed certification of the Chief Executive Officer, the Chief Financial Officer and all directors or

trustees of the Company or the IDI Subsidiary(ies) who attested to the Call Report for the quarter covered by such certificate, that such certificate (x) has been prepared in conformance with the instructions issued by Treasury and (y) is true and correct to the best of their knowledge and belief; (B) completed for such quarter (each, a “Quarterly Supplemental Report”).

(ii) Within ninety (90) days after the end of each fiscal year of the Company during which the Initial Supplemental Report is submitted pursuant to Section 1.3(j) or the first ten (10) Quarterly Supplemental Reports are submitted pursuant to Section 3.1(d)(i), the Company shall deliver to Treasury a certification from the Company’s independent auditors that the Initial Supplemental Report and/or Quarterly Supplemental Reports during such fiscal year are complete and accurate with respect to accounting matters, including policies and procedures and controls over such.

(iii) Until the date on which the Preferred Shares are redeemed pursuant to Section 5 of the Certificate of Designation, within ninety (90) days after the end of each fiscal year of the Company, the Company shall deliver to Treasury a certificate in substantially the form attached hereto as Annex I, signed on behalf of the Company by an Executive Officer.

(iv) If any Initial Supplemental Report or Quarterly Supplemental Report is inaccurate, Treasury shall be entitled to recover from the Company, upon demand, the amount of any difference between (x) the amount of the dividend payment(s) actually made to Treasury based on such inaccurate report and (y) the correct amount of the dividend payment(s) that should have been made, but for such inaccuracy. The Company shall provide Treasury with a written description of any such inaccuracy within three (3) business days after the Company’s discovery thereof.

(v) Treasury shall have the right from time to time to modify Annex H, by posting an amended and restated version of Annex H on Treasury’s web site, to conform Annex H to (A) reflect changes in GAAP, (B) reflect changes in the form or content of, or definitions used in, Call Reports, or (C) to make clarifications and/or technical corrections as Treasury determines to be reasonably necessary. Notwithstanding anything herein to the contrary, upon posting by Treasury on its web site, Annex H shall be deemed to be amended and restated as so posted, without the need for any further act on the part of any person or entity. If any such modification includes a change to the caption or number of any line item of Annex H, any reference herein to such line item shall thereafter be a reference to such re-captioned or re-numbered line item.

(e) Bank and Thrift Holding Company Status. If the Company is a Bank Holding Company or a Savings and Loan Holding Company on the Signing Date, then the Company shall maintain its status as a Bank Holding Company or Savings and Loan Holding Company for as long as Treasury owns any Preferred Shares. The Company shall redeem all Preferred Shares held by Treasury prior to terminating its status as a Bank Holding Company or Savings and Loan Holding Company.

(f) Predominantly Financial. For as long as Treasury owns any Preferred Shares, the Company, to the extent it is not itself an insured depository institution, agrees to

remain predominantly engaged in financial activities. A company is predominantly engaged in financial activities if the annual gross revenues derived by the company and all subsidiaries of the company (excluding revenues derived from subsidiary depository institutions), on a consolidated basis, from engaging in activities that are financial in nature or are incidental to a financial activity under subsection (k) of Section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)) represent at least 85 percent of the consolidated annual gross revenues of the company.

(g) Capital Covenant. From the Signing Date until the date on which all of the Preferred Shares have been redeemed in whole, the Company and the Company Subsidiaries shall maintain such capital as may be necessary to meet the minimum capital requirements of the Appropriate Federal Banking Agency, as in effect from time to time.

(h) Reporting Requirements. Prior to the date on which all of the Preferred Shares have been redeemed in whole, the Company covenants and agrees that, at all times on or after the Closing Date, (i) to the extent it is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, it shall comply with the terms and conditions set forth in Annex E or (ii) as soon as practicable after the date that the Company becomes subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, it shall comply with the terms and conditions set forth in Annex E.

(i) Transfer of Proceeds to Depository Institutions. If the Company is a Bank Holding Company or a Savings and Loan Holding Company, the Company shall immediately transfer to the IDI Subsidiaries, as equity capital contributions (in a manner that will cause such equity capital contributions to qualify for inclusion in the Tier 1 capital of the IDI Subsidiaries), not less than ninety percent (90%) of the proceeds it receives in connection with the sale of Preferred Shares; *provided, however*, that:

- (A) no IDI Subsidiary shall receive any amount pursuant to this Section 3.1(i) in excess of (A) three percent (3%) of the insured depository institution's Total Risk-Weighted Assets as reported in its Call Report filed immediately prior to the Application Date, if the insured depository institution has Total Assets of more than \$1,000,000,000 and less than \$10,000,000,000 as of December 31, 2009 or (B) five percent (5%) of the IDI Subsidiary's Total Risk-Weighted Assets as reported in its Call Report filed immediately prior to the Application Date, if the IDI Subsidiary has Total Assets of \$1,000,000,000 or less as of December 31, 2009; and
- (B) if Treasury held Previously Acquired Preferred Shares immediately prior to the Closing Date, the amount required to be transferred pursuant this Section 3.1(i) shall be ninety percent (90%) of the difference obtained by subtracting the Repayment Amount from the Purchase Price (unless the Purchase Price is less than the Repayment Amount, in which case no amount shall be required to be transferred pursuant to this Section 3.1(i)).

(j) Outreach to Minorities, Women and Veterans. The Company shall comply with Section 4103(d)(8) of the SBJA.

(k) Certification Related to Sex Offender Registration and Notification Act. The Company shall obtain from any business to which it makes a loan that is funded in whole or in part using funds from the Purchase Price a written certification that no principal of such business has been convicted of a sex offense against a minor (as such terms are defined in section 111 of the Sex Offender Registration and Notification Act, 42 U.S.C. §16911). The Company shall retain all such certifications in accordance with standard recordkeeping practices established by the Appropriate Federal Banking Agency.

3.2 Negative Covenants. The Company hereby covenants and agrees with Treasury that:

(a) Certain Transactions.

(i) The Company shall not merge or consolidate with, or sell, transfer or lease all or substantially all of its property or assets to, any other party unless the successor, transferee or lessee party (or its ultimate parent entity), as the case may be (if not the Company), expressly assumes the due and punctual performance and observance of each and every covenant, agreement and condition of this Agreement to be performed and observed by the Company.

(ii) Without the prior written consent of Treasury, until such time as Treasury shall cease to own any Preferred Shares, the Company shall not permit any of its “significant subsidiaries” (as such term is defined in Rule 12b-2 promulgated under the Exchange Act) to (A) engage in any merger, consolidation, statutory share exchange or similar transaction following the consummation of which such significant subsidiary is not wholly-owned by the Company, (B) dissolve or sell all or substantially all of its assets or property other than in connection with an internal reorganization or consolidation involving wholly-owned subsidiaries of the Company or (C) issue or sell any shares of its capital stock or any securities convertible or exercisable for any such shares, other than issuances or sales in connection with an internal reorganization or consolidation involving wholly-owned subsidiaries of the Company.

(b) Restriction on Dividends and Repurchases. The Company covenants and agrees that it shall not violate any of the restrictions on dividends, distributions, redemptions, repurchases, acquisitions and related actions set forth in the Certificate of Designation, which are incorporated by reference herein as if set forth in full.

(c) Related Party Transactions. Until such time as Treasury ceases to own any debt or equity securities of the Company, including the Preferred Shares, the Company and the Company Subsidiaries shall not enter into transactions with Affiliates or related persons (within the meaning of Item 404 under the SEC’s Regulation S-K) unless (A) such transactions are on terms no less favorable to the Company and the Company Subsidiaries than could be obtained from an unaffiliated third party, and (B) have been approved by the audit committee of the Board of Directors or comparable body of independent directors of the Company, or if there are no independent directors, the Board of Directors, *provided* that the Board of Directors shall maintain written documentation which supports its determination that the transaction meets the requirements of clause (A) of this Section 3.2(c).

**ARTICLE IV
ADDITIONAL AGREEMENTS**

4.1 Purchase for Investment. Treasury acknowledges that the Preferred Shares have not been registered under the Securities Act or under any state securities laws. Treasury (a) is acquiring the Preferred Shares pursuant to an exemption from registration under the Securities Act solely for investment with no present intention to distribute them to any person in violation of the Securities Act or any applicable U.S. state securities laws, (b) will not sell or otherwise dispose of any of the Preferred Shares, except in compliance with the registration requirements or exemption provisions of the Securities Act and any applicable U.S. state securities laws, and (c) has such knowledge and experience in financial and business matters and in investments of this type that it is capable of evaluating the merits and risks of the Purchase and of making an informed investment decision.

4.2 Legends. (a) Treasury agrees that all certificates or other instruments representing the Preferred Shares will bear a legend substantially to the following effect:

“THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE NOT SAVINGS ACCOUNTS, DEPOSITS OR OTHER OBLIGATIONS OF A BANK AND ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION OR ANY OTHER GOVERNMENTAL AGENCY.

THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE TRANSFERRED, SOLD OR OTHERWISE DISPOSED OF EXCEPT WHILE A REGISTRATION STATEMENT RELATING THERETO IS IN EFFECT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT OR SUCH LAWS. EACH PURCHASER OF THE SECURITIES REPRESENTED BY THIS INSTRUMENT IS NOTIFIED THAT THE SELLER MAY BE RELYING ON THE EXEMPTION FROM SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A THEREUNDER (THE “144A EXEMPTION”). IF ANY TRANSFEREE OF THE SECURITIES REPRESENTED BY THIS INSTRUMENT IS ADVISED BY THE TRANSFEROR THAT SUCH TRANSFEROR IS RELYING ON THE 144A EXEMPTION, SUCH TRANSFEREE BY ITS ACCEPTANCE HEREOF (1) REPRESENTS THAT IT IS A “QUALIFIED INSTITUTIONAL BUYER” (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT), (2) AGREES THAT IT WILL NOT OFFER, SELL OR OTHERWISE TRANSFER THE SECURITIES REPRESENTED BY THIS INSTRUMENT EXCEPT (A) PURSUANT TO A REGISTRATION STATEMENT WHICH IS THEN EFFECTIVE UNDER THE SECURITIES ACT, (B) FOR SO LONG AS THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, TO A PERSON IT REASONABLY BELIEVES IS A “QUALIFIED INSTITUTIONAL BUYER” AS DEFINED IN RULE 144A UNDER THE

SECURITIES ACT THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (C) TO THE ISSUER OR (D) PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND (3) AGREES THAT IT WILL GIVE TO EACH PERSON TO WHOM THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

THIS INSTRUMENT IS ISSUED SUBJECT TO THE RESTRICTIONS ON TRANSFER AND OTHER PROVISIONS OF A SECURITIES PURCHASE AGREEMENT BETWEEN THE ISSUER OF THESE SECURITIES AND TREASURY, A COPY OF WHICH IS ON FILE WITH THE ISSUER. THE SECURITIES REPRESENTED BY THIS INSTRUMENT MAY NOT BE SOLD OR OTHERWISE TRANSFERRED EXCEPT IN COMPLIANCE WITH SAID AGREEMENT. ANY SALE OR OTHER TRANSFER NOT IN COMPLIANCE WITH SAID AGREEMENT WILL BE VOID.”

(b) In the event that any Preferred Shares (i) become registered under the Securities Act or (ii) are eligible to be transferred without restriction in accordance with Rule 144 or another exemption from registration under the Securities Act (other than Rule 144A), the Company shall issue new certificates or other instruments representing such Preferred Shares, which shall not contain the applicable legends in Section 4.2(a) above; *provided that* Treasury surrenders to the Company the previously issued certificates or other instruments.

4.3 Transfer of Preferred Shares. Subject to compliance with applicable securities laws, Treasury shall be permitted to transfer, sell, assign or otherwise dispose of (“*Transfer*”) all or a portion of the Preferred Shares at any time, and the Company shall take all steps as may be reasonably requested by Treasury to facilitate the Transfer of the Preferred Shares, including without limitation, as set forth in Section 4.4, *provided that* Treasury shall not Transfer any Preferred Shares if such transfer would require the Company to be subject to the periodic reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (the “*Exchange Act*”) and the Company was not already subject to such requirements. In furtherance of the foregoing, the Company shall provide reasonable cooperation to facilitate any Transfers of the Preferred Shares, including, as is reasonable under the circumstances, by furnishing such information concerning the Company and its business as a proposed transferee may reasonably request and making management of the Company reasonably available to respond to questions of a proposed transferee in accordance with customary practice, subject in all cases to the proposed transferee agreeing to a customary confidentiality agreement.

4.4 Rule 144; Rule 144A; 4(1½) Transactions. (a) At all times after the Signing Date, the Company covenants that (1) it will, upon the request of Treasury or any subsequent holders of the Preferred Shares (“*Holder*”), use its reasonable best efforts to (x), to the extent any Holder is relying on Rule 144 under the Securities Act to sell any of the Preferred Shares, make “current public information” available, as provided in Section (c)(1) of Rule 144 (if the Company is a “Reporting Issuer” within the meaning of Rule 144) or in Section (c)(2) of Rule

144 (if the Company is a “Non-Reporting Issuer” within the meaning of Rule 144), in either case for such time period as necessary to permit sales pursuant to Rule 144, (y), to the extent any Holder is relying on the so-called “Section 4(1½)” exemption to sell any of its Preferred Shares, prepare and provide to such Holder such information, including the preparation of private offering memoranda or circulars or financial information, as the Holder may reasonably request to enable the sale of the Preferred Shares pursuant to such exemption, or (z) to the extent any Holder is relying on Rule 144A under the Securities Act to sell any of its Preferred Shares, prepare and provide to such Holder the information required pursuant to Rule 144A(d)(4), and (2) it will take such further action as any Holder may reasonably request from time to time to enable such Holder to sell Preferred Shares without registration under the Securities Act within the limitations of the exemptions provided by (i) the provisions of the Securities Act or any interpretations thereof or related thereto by the SEC, including transactions based on the so-called “Section 4(1½)” and other similar transactions, (ii) Rule 144 or 144A under the Securities Act, as such rules may be amended from time to time, or (iii) any similar rule or regulation hereafter adopted by the SEC; *provided* that the Company shall not be required to take any action described in this Section 4.4(a) that would cause the Company to become subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act if the Company was not subject to such requirements prior to taking such action. Upon the request of any Holder, the Company will deliver to such Holder a written statement as to whether it has complied with such requirements and, if not, the specifics thereof.

(b) The Company agrees to indemnify Treasury, Treasury’s officials, officers, employees, agents, representatives and Affiliates, and each person, if any, that controls Treasury within the meaning of the Securities Act (each, an “*Indemnitee*”), against any and all losses, claims, damages, actions, liabilities, costs and expenses (including reasonable fees, expenses and disbursements of attorneys and other professionals incurred in connection with investigating, defending, settling, compromising or paying any such losses, claims, damages, actions, liabilities, costs and expenses), joint or several, arising out of or based upon any untrue statement or alleged untrue statement of material fact contained in any document or report provided by the Company pursuant to this Section 4.4 or any omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.

(c) If the indemnification provided for in Section 4.4(b) is unavailable to an Indemnitee with respect to any losses, claims, damages, actions, liabilities, costs or expenses referred to therein or is insufficient to hold the Indemnitee harmless as contemplated therein, then the Company, in lieu of indemnifying such Indemnitee, shall contribute to the amount paid or payable by such Indemnitee as a result of such losses, claims, damages, actions, liabilities, costs or expenses in such proportion as is appropriate to reflect the relative fault of the Indemnitee, on the one hand, and the Company, on the other hand, in connection with the statements or omissions which resulted in such losses, claims, damages, actions, liabilities, costs or expenses as well as any other relevant equitable considerations. The relative fault of the Company, on the one hand, and of the Indemnitee, on the other hand, shall be determined by reference to, among other factors, whether the untrue statement of a material fact or omission to state a material fact relates to information supplied by the Company or by the Indemnitee and the parties’ relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission; the Company and Treasury agree that it would not be just and

equitable if contribution pursuant to this Section 4.4(c) were determined by *pro rata* allocation or by any other method of allocation that does not take account of the equitable considerations referred to in Section 4.4(b). No Indemnitee guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from the Company if the Company was not guilty of such fraudulent misrepresentation.

4.5 Depository Shares. Upon request by Treasury at any time following the Closing Date, the Company shall promptly enter into a depository arrangement, pursuant to customary agreements reasonably satisfactory to Treasury and with a depository reasonably acceptable to Treasury, pursuant to which the Preferred Shares may be deposited and depository shares, each representing a fraction of a Preferred Share, as specified by Treasury, may be issued. From and after the execution of any such depository arrangement, and the deposit of any Preferred Shares, as applicable, pursuant thereto, the depository shares issued pursuant thereto shall be deemed "Preferred Shares" and, as applicable, "Registrable Securities" for purposes of this Agreement.

4.6 Expenses and Further Assurances. (a) Unless otherwise provided in this Agreement, each of the parties hereto will bear and pay all costs and expenses incurred by it or on its behalf in connection with the transactions contemplated under this Agreement, including fees and expenses of its own financial or other consultants, investment bankers, accountants and counsel.

(b) The Company shall, at the Company's sole cost and expense, (i) furnish to Treasury all instruments, documents and other agreements required to be furnished by the Company pursuant to the terms of this Agreement, including, without limitation, any documents required to be delivered pursuant to Section 4.4 above, or which are reasonably requested by Treasury in connection therewith; (ii) execute and deliver to Treasury such documents, instruments, certificates, assignments and other writings, and do such other acts necessary or desirable, to evidence, preserve and/or protect the Preferred Shares purchased by Treasury, as Treasury may reasonably require; and (iii) do and execute all and such further lawful and reasonable acts, conveyances and assurances for the better and more effective carrying out of the intents and purposes of this Agreement, as Treasury shall reasonably require from time to time.

ARTICLE V MISCELLANEOUS

5.1 Termination. This Agreement shall terminate upon the earliest to occur of:

(a) termination at any time prior to the Closing:

(i) by either Treasury or the Company if the Closing shall not have occurred on or before the 30th calendar day following the date on which Treasury issued its preliminary approval of the Company's application to participate in SBLF (the "Closing Deadline"); *provided, however*, that in the event the Closing has not occurred by the Closing Deadline, the parties will consult in good faith to determine whether to extend the term of this Agreement, it being understood that the parties shall be required to consult only until the fifth calendar day after the Closing Deadline and not be under any obligation to extend the term of

this Agreement thereafter; *provided, further*, that the right to terminate this Agreement under this Section 5.1(a)(i) shall not be available to any party whose breach of any representation or warranty or failure to perform any obligation under this Agreement shall have caused or resulted in the failure of the Closing to occur on or prior to such date; or

(ii) by either Treasury or the Company in the event that any Governmental Entity shall have issued an order, decree or ruling or taken any other action restraining, enjoining or otherwise prohibiting the transactions contemplated by this Agreement, and such order, decree, ruling or other action shall have become final and nonappealable; or

(iii) by the mutual written consent of Treasury and the Company; or

(b) the date on which all of the Preferred Shares have been redeemed in whole; or

(c) the date on which Treasury has transferred all of the Preferred Shares to third parties which are not Affiliates of Treasury.

In the event of termination of this Agreement as provided in this Section 5.1, this Agreement shall forthwith become void and there shall be no liability on the part of either party hereto except that nothing herein shall relieve either party from liability for any breach of this Agreement.

5.2 Survival.

(a) This Agreement and all representations, warranties, covenants and agreements made herein shall survive the Closing without limitation.

(b) The covenants set forth in Article III and Annex E and the agreements set forth in Article IV shall, to the extent such covenants do not explicitly terminate at such time as Treasury no longer owns any Preferred Shares, survive the termination of this Agreement pursuant to Section 5.1(c) without limitation until the date on which all of the Preferred Shares have been redeemed in whole.

(c) The rights and remedies of Treasury with respect to the representations, warranties, covenants and obligations of the Company herein shall not be affected by any investigation conducted with respect to, or any knowledge acquired (or capable of being acquired) at any time by Treasury or any of its personnel or agents with respect to the accuracy or inaccuracy of, or compliance with, any such representation, warranty, covenant or obligation.

5.3 Amendment. No amendment of any provision of this Agreement will be effective unless made in writing and signed by an officer or a duly authorized representative of each party, except as set forth in Section 3.1(d)(v). No failure or delay by any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof nor shall any single or partial exercise thereof preclude any other or further exercise of any other right, power or privilege. The rights and remedies herein provided shall be cumulative of any rights or remedies provided by law.

5.4 Waiver of Conditions. The conditions to each party's obligation to consummate the Purchase are for the sole benefit of such party and may be waived by such party in whole or in part to the extent permitted by applicable law. No waiver will be effective unless it is in a writing signed by a duly authorized officer of the waiving party that makes express reference to the provision or provisions subject to such waiver.

5.5 Governing Law; Submission to Jurisdiction, etc. This Agreement and any claim, controversy or dispute arising under or related to this Agreement, the relationship of the parties, and/or the interpretation and enforcement of the rights and duties of the parties shall be enforced, governed, and construed in all respects (whether in contract or in tort) in accordance with the federal law of the United States if and to the extent such law is applicable, and otherwise in accordance with the laws of the State of New York applicable to contracts made and to be performed entirely within such State. Each of the parties hereto agrees (a) to submit to the exclusive jurisdiction and venue of the United States District Court for the District of Columbia and the United States Court of Federal Claims for any and all civil actions, suits or proceedings arising out of or relating to this Agreement or the Purchase contemplated hereby and (b) that notice may be served upon (i) the Company at the address and in the manner set forth for notices to the Company in Section 5.7 and (ii) Treasury at the address and in the manner set forth for notices to the Company in Section 5.7, but otherwise in accordance with federal law. **TO THE EXTENT PERMITTED BY APPLICABLE LAW, EACH OF THE PARTIES HERETO HEREBY UNCONDITIONALLY WAIVES TRIAL BY JURY IN ANY CIVIL LEGAL ACTION OR PROCEEDING RELATING TO THIS AGREEMENT OR THE PURCHASE CONTEMPLATED HEREBY.**

5.6 No Relationship to TARP. The parties acknowledge and agree that (i) the SBLF program is separate and distinct from the Troubled Asset Relief Program established by the Emergency Economic Stabilization Act of 2008; and (ii) the Company shall not, by virtue of the investment contemplated hereby, be considered a recipient under the Troubled Asset Relief Program.

5.7 Notices. Any notice, request, instruction or other document to be given hereunder by any party to the other will be in writing and will be deemed to have been duly given (a) on the date of delivery if delivered personally, or by facsimile, upon confirmation of receipt, or (b) on the second business day following the date of dispatch if delivered by a recognized next day courier service. All notices to the Company shall be delivered as set forth on the cover page of this Agreement, or pursuant to such other instruction as may be designated in writing by the Company to Treasury. All notices to Treasury shall be delivered as set forth below, or pursuant to such other instructions as may be designated in writing by Treasury to the Company.

If to Treasury:

The Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220
Attention: Small Business Lending Fund, Office of Domestic Finance

E-mail: SBLFComplSubmissions@treasury.gov

5.8 Assignment. Neither this Agreement nor any right, remedy, obligation nor liability arising hereunder or by reason hereof shall be assignable by any party hereto without the prior written consent of the other party, and any attempt to assign any right, remedy, obligation or liability hereunder without such consent shall be void, except (a) an assignment, in the case of a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Company's stockholders (a "*Business Combination*") where such party is not the surviving entity, or a sale of substantially all of its assets, to the entity which is the survivor of such Business Combination or the purchaser in such sale, (b) an assignment of certain rights as provided in Sections 3.1(c) or 3.1(h) or Annex E or (c) an assignment by Treasury of this Agreement to an Affiliate of Treasury; *provided* that if Treasury assigns this Agreement to an Affiliate, Treasury shall be relieved of its obligations under this Agreement but (i) all rights, remedies and obligations of Treasury hereunder shall continue and be enforceable by such Affiliate, (ii) the Company's obligations and liabilities hereunder shall continue to be outstanding and (iii) all references to Treasury herein shall be deemed to be references to such Affiliate.

5.9 Severability. If any provision of this Agreement, or the application thereof to any person or circumstance, is determined by a court of competent jurisdiction to be invalid, void or unenforceable, the remaining provisions hereof, or the application of such provision to persons or circumstances other than those as to which it has been held invalid or unenforceable, will remain in full force and effect and shall in no way be affected, impaired or invalidated thereby, so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Upon such determination, the parties shall negotiate in good faith in an effort to agree upon a suitable and equitable substitute provision to effect the original intent of the parties.

5.10 No Third Party Beneficiaries. Other than as expressly provided herein, nothing contained in this Agreement, expressed or implied, is intended to confer upon any person or entity other than the Company and Treasury (and any Indemnitee) any benefit, right or remedies.

5.11 Specific Performance. The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms. It is accordingly agreed that the parties shall be entitled (without the necessity of posting a bond) to specific performance of the terms hereof, this being in addition to any other remedies to which they are entitled at law or equity.

5.12 Interpretation. When a reference is made in this Agreement to "Articles" or "Sections" such reference shall be to an Article or Section of the Annex of this Agreement in which such reference is contained, unless otherwise indicated. When a reference is made in this Agreement to an "Annex", such reference shall be to an Annex to this Agreement, unless otherwise indicated. The terms defined in the singular have a comparable meaning when used in the plural, and vice versa. References to "herein", "hereof", "hereunder" and the like refer to this Agreement as a whole and not to any particular section or provision, unless the context requires otherwise. The table of contents and headings contained in this Agreement are for reference purposes only and are not part of this Agreement. Whenever the words "include", "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words

“without limitation”. No rule of construction against the draftsman shall be applied in connection with the interpretation or enforcement of this Agreement, as this Agreement is entered into between sophisticated parties advised by counsel. All references to “\$” or “dollars” mean the lawful currency of the United States of America. Except as expressly stated in this Agreement, all references to any statute, rule or regulation are to the statute, rule or regulation as amended, modified, supplemented or replaced from time to time (and, in the case of statutes, include any rules and regulations promulgated under the statute) and to any section of any statute, rule or regulation include any successor to the section. References to a “business day” shall mean any day except Saturday, Sunday and any day on which banking institutions in the State of New York or the District of Columbia generally are authorized or required by law or other governmental actions to close.

**ANNEX D
DISCLOSURE SCHEDULE**

[OMITTED]

ANNEX E
REGISTRATION RIGHTS

1. Definitions. Terms not defined in this Annex shall have the meaning ascribed to such terms in the Agreement. As used in this Annex E, the following terms shall have the following respective meanings:

(a) “*Holder*” means Treasury and any other holder of Registrable Securities to whom the registration rights conferred by this Agreement have been transferred in compliance with Section 9 of this Annex E.

(b) “*Holders’ Counsel*” means one counsel for the selling Holders chosen by Holders holding a majority interest in the Registrable Securities being registered.

(c) “*Pending Underwritten Offering*” means, with respect to any Holder forfeiting its rights pursuant to Section 11 of this Annex E, any underwritten offering of Registrable Securities in which such Holder has advised the Company of its intent to register its Registrable Securities either pursuant to Section 2(b) or 2(d) of this Annex E prior to the date of such Holder’s forfeiture.

(d) “*Register*”, “*registered*”, and “*registration*” shall refer to a registration effected by preparing and (A) filing a registration statement or amendment thereto in compliance with the Securities Act and applicable rules and regulations thereunder, and the declaration or ordering of effectiveness of such registration statement or amendment thereto or (B) filing a prospectus and/or prospectus supplement in respect of an appropriate effective registration statement on Form S-3.

(e) “*Registrable Securities*” means (A) all Preferred Shares and (B) any equity securities issued or issuable directly or indirectly with respect to the securities referred to in the foregoing clause (A) by way of conversion, exercise or exchange thereof, or share dividend or share split or in connection with a combination of shares, recapitalization, reclassification, merger, amalgamation, arrangement, consolidation or other reorganization, *provided* that, once issued, such securities will not be Registrable Securities when (1) they are sold pursuant to an effective registration statement under the Securities Act, (2) they shall have ceased to be outstanding or (3) they have been sold in any transaction in which the transferor’s rights under this Agreement are not assigned to the transferee of the securities. No Registrable Securities may be registered under more than one registration statement at any one time.

(f) “*Registration Expenses*” mean all expenses incurred by the Company in effecting any registration pursuant to this Agreement (whether or not any registration or prospectus becomes effective or final) or otherwise complying with its obligations under this Annex E, including all registration, filing and listing fees, printing expenses, fees and disbursements of counsel for the Company, blue sky fees and expenses, expenses incurred in connection with any “road show”, the reasonable fees and disbursements of Holders’ Counsel, and expenses of the Company’s independent accountants in connection with any regular or

special reviews or audits incident to or required by any such registration, but shall not include Selling Expenses.

(g) “Rule 144”, “Rule 144A”, “Rule 159A”, “Rule 405” and “Rule 415” mean, in each case, such rule promulgated under the Securities Act (or any successor provision), as the same shall be amended from time to time.

(h) “Selling Expenses” mean all discounts, selling commissions and stock transfer taxes applicable to the sale of Registrable Securities and fees and disbursements of counsel for any Holder (other than the fees and disbursements of Holders’ Counsel included in Registration Expenses).

(i) “Special Registration” means the registration of (A) equity securities and/or options or other rights in respect thereof solely registered on Form S-4 or Form S-8 (or successor form) or (B) shares of equity securities and/or options or other rights in respect thereof to be offered to directors, members of management, employees, consultants, customers, lenders or vendors of the Company or Company Subsidiaries or in connection with dividend reinvestment plans.

2. Registration.

(a) The Company covenants and agrees that as promptly as practicable after the date that the Company becomes subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act (and in any event no later than 30 days thereafter), the Company shall prepare and file with the SEC a Shelf Registration Statement covering all Registrable Securities (or otherwise designate an existing shelf registration on an appropriate form under Rule 415 under the Securities Act (a “Shelf Registration Statement”) filed with the SEC to cover the Registrable Securities), and, to the extent the Shelf Registration Statement has not theretofore been declared effective or is not automatically effective upon such filing, the Company shall use reasonable best efforts to cause such Shelf Registration Statement to be declared or become effective and to keep such Shelf Registration Statement continuously effective and in compliance with the Securities Act and usable for resale of such Registrable Securities for a period from the date of its initial effectiveness until such time as there are no Registrable Securities remaining (including by refiling such Shelf Registration Statement (or a new Shelf Registration Statement) if the initial Shelf Registration Statement expires). Notwithstanding the foregoing, if the Company is not eligible to file a registration statement on Form S-3, then the Company shall not be obligated to file a Shelf Registration Statement unless and until requested to do so in writing by Treasury.

(b) Any registration pursuant to Section 2(a) of this Annex E shall be effected by means of a Shelf Registration Statement on an appropriate form under Rule 415 under the Securities Act (a “Shelf Registration Statement”). If any Holder intends to distribute any Registrable Securities by means of an underwritten offering it shall promptly so advise the Company and the Company shall take all reasonable steps to facilitate such distribution, including the actions required pursuant to Section 2(d) of this Annex E; *provided* that the Company shall not be required to facilitate an underwritten offering of Registrable Securities unless (i) the expected gross proceeds from such offering exceed \$200,000 or (ii) such underwritten offering includes all of the outstanding Registrable Securities held by such Holder.

The lead underwriters in any such distribution shall be selected by the Holders of a majority of the Registrable Securities to be distributed.

(c) The Company shall not be required to effect a registration (including a resale of Registrable Securities from an effective Shelf Registration Statement) or an underwritten offering pursuant to Section 2 of this Annex E: (A) with respect to securities that are not Registrable Securities; or (B) if the Company has notified all Holders that in the good faith judgment of the Board of Directors, it would be materially detrimental to the Company or its security holders for such registration or underwritten offering to be effected at such time, in which event the Company shall have the right to defer such registration for a period of not more than 45 days after receipt of the request of any Holder; *provided* that such right to delay a registration or underwritten offering shall be exercised by the Company (1) only if the Company has generally exercised (or is concurrently exercising) similar black-out rights against holders of similar securities that have registration rights and (2) not more than three times in any 12-month period and not more than 90 days in the aggregate in any 12-month period.

(d) If during any period when an effective Shelf Registration Statement is not available, the Company proposes to register any of its equity securities, other than a registration pursuant to Section 2(a) of this Annex E or a Special Registration, and the registration form to be filed may be used for the registration or qualification for distribution of Registrable Securities, the Company will give prompt written notice to all Holders of its intention to effect such a registration (but in no event less than ten days prior to the anticipated filing date) and will include in such registration all Registrable Securities with respect to which the Company has received written requests for inclusion therein within ten business days after the date of the Company's notice (a "*Piggyback Registration*"). Any such person that has made such a written request may withdraw its Registrable Securities from such Piggyback Registration by giving written notice to the Company and the managing underwriter, if any, on or before the fifth business day prior to the planned effective date of such Piggyback Registration. The Company may terminate or withdraw any registration under this Section 2(d) of this Annex E prior to the effectiveness of such registration, whether or not any Holders have elected to include Registrable Securities in such registration.

(e) If the registration referred to in Section 2(d) of this Annex E is proposed to be underwritten, the Company will so advise all Holders as a part of the written notice given pursuant to Section 2(d) of this Annex E. In such event, the right of all Holders to registration pursuant to Section 2 of this Annex E will be conditioned upon such persons' participation in such underwriting and the inclusion of such person's Registrable Securities in the underwriting if such securities are of the same class of securities as the securities to be offered in the underwritten offering, and each such person will (together with the Company and the other persons distributing their securities through such underwriting) enter into an underwriting agreement in customary form with the underwriter or underwriters selected for such underwriting by the Company; *provided* that Treasury (as opposed to other Holders) shall not be required to indemnify any person in connection with any registration. If any participating person disapproves of the terms of the underwriting, such person may elect to withdraw therefrom by written notice to the Company, the managing underwriters and Treasury (if Treasury is participating in the underwriting).

(f) If either (x) the Company grants “piggyback” registration rights to one or more third parties to include their securities in an underwritten offering under the Shelf Registration Statement pursuant to Section 2(b) of this Annex E or (y) a Piggyback Registration under Section 2(d) of this Annex E relates to an underwritten offering on behalf of the Company, and in either case the managing underwriters advise the Company that in their reasonable opinion the number of securities requested to be included in such offering exceeds the number which can be sold without adversely affecting the marketability of such offering (including an adverse effect on the per share offering price), the Company will include in such offering only such number of securities that in the reasonable opinion of such managing underwriters can be sold without adversely affecting the marketability of the offering (including an adverse effect on the per share offering price), which securities will be so included in the following order of priority: (A) first, in the case of a Piggyback Registration under Section 2(d) of this Annex E, the securities the Company proposes to sell, (B) then the Registrable Securities of all Holders who have requested inclusion of Registrable Securities pursuant to Section 2(b) or Section 2(d) of this Annex E, as applicable, *pro rata* on the basis of the aggregate number of such securities or shares owned by each such Holder and (C) lastly, any other securities of the Company that have been requested to be so included, subject to the terms of this Agreement; *provided, however*, that if the Company has, prior to the Signing Date, entered into an agreement with respect to its securities that is inconsistent with the order of priority contemplated hereby then it shall apply the order of priority in such conflicting agreement to the extent that it would otherwise result in a breach under such agreement.

3. Expenses of Registration. All Registration Expenses incurred in connection with any registration, qualification or compliance hereunder shall be borne by the Company. All Selling Expenses incurred in connection with any registrations hereunder shall be borne by the holders of the securities so registered *pro rata* on the basis of the aggregate offering or sale price of the securities so registered.

4. Obligations of the Company. Whenever required to effect the registration of any Registrable Securities or facilitate the distribution of Registrable Securities pursuant to an effective Shelf Registration Statement, the Company shall, as expeditiously as reasonably practicable:

(a) Prepare and file with the SEC a prospectus supplement or post-effective amendment with respect to a proposed offering of Registrable Securities pursuant to an effective registration statement, subject to Section 4 of this Annex E, keep such registration statement effective and keep such prospectus supplement current until the securities described therein are no longer Registrable Securities.

(b) Prepare and file with the SEC such amendments and supplements to the applicable registration statement and the prospectus or prospectus supplement used in connection with such registration statement as may be necessary to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such registration statement.

(c) Furnish to the Holders and any underwriters such number of copies of the applicable registration statement and each such amendment and supplement thereto (including in

each case all exhibits) and of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned or to be distributed by them.

(d) Use its reasonable best efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders or any managing underwriter(s), to keep such registration or qualification in effect for so long as such registration statement remains in effect, and to take any other action which may be reasonably necessary to enable such seller to consummate the disposition in such jurisdictions of the securities owned by such Holder; *provided* that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions.

(e) Notify each Holder of Registrable Securities at any time when a prospectus relating thereto is required to be delivered under the Securities Act of the happening of any event as a result of which the applicable prospectus, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing.

(f) Give written notice to the Holders:

(i) when any registration statement or any amendment thereto has been filed with the SEC (except for any amendment effected by the filing of a document with the SEC pursuant to the Exchange Act) and when such registration statement or any post-effective amendment thereto has become effective;

(ii) of any request by the SEC for amendments or supplements to any registration statement or the prospectus included therein or for additional information;

(iii) of the issuance by the SEC of any stop order suspending the effectiveness of any registration statement or the initiation of any proceedings for that purpose;

(iv) of the receipt by the Company or its legal counsel of any notification with respect to the suspension of the qualification of the applicable Registrable Securities for sale in any jurisdiction or the initiation or threatening of any proceeding for such purpose;

(v) of the happening of any event that requires the Company to make changes in any effective registration statement or the prospectus related to the registration statement in order to make the statements therein not misleading (which notice shall be accompanied by an instruction to suspend the use of the prospectus until the requisite changes have been made); and

(vi) if at any time the representations and warranties of the Company contained in any underwriting agreement contemplated by Section 4(j) of this Annex E cease to be true and correct.

(g) Use its reasonable best efforts to prevent the issuance or obtain the withdrawal of any order suspending the effectiveness of any registration statement referred to in Section 4(f)(iii) of this Annex E at the earliest practicable time.

(h) Upon the occurrence of any event contemplated by Section 4(e) or 4(f)(v) of this Annex E, promptly prepare a post-effective amendment to such registration statement or a supplement to the related prospectus or file any other required document so that, as thereafter delivered to the Holders and any underwriters, the prospectus will not contain an untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. If the Company notifies the Holders in accordance with Section 4(f)(v) to suspend the use of the prospectus until the requisite changes to the prospectus have been made, then the Holders and any underwriters shall suspend use of such prospectus and use their reasonable best efforts to return to the Company all copies of such prospectus (at the Company's expense) other than permanent file copies then in such Holders' or underwriters' possession. The total number of days that any such suspension may be in effect in any 12-month period shall not exceed 90 days.

(i) Use reasonable best efforts to procure the cooperation of the Company's transfer agent in settling any offering or sale of Registrable Securities, including with respect to the transfer of physical stock certificates into book-entry form in accordance with any procedures reasonably requested by the Holders or any managing underwriter(s).

(j) If an underwritten offering is requested pursuant to Section 2(b) of this Annex E, enter into an underwriting agreement in customary form, scope and substance and take all such other actions reasonably requested by the Holders of a majority of the Registrable Securities being sold in connection therewith or by the managing underwriter(s), if any, to expedite or facilitate the underwritten disposition of such Registrable Securities, and in connection therewith in any underwritten offering (including making members of management and executives of the Company available to participate in "road shows", similar sales events and other marketing activities), (A) make such representations and warranties to the Holders that are selling stockholders and the managing underwriter(s), if any, with respect to the business of the Company and its subsidiaries, and the Shelf Registration Statement, prospectus and documents, if any, incorporated or deemed to be incorporated by reference therein, in each case, in customary form, substance and scope, and, if true, confirm the same if and when requested, (B) use its reasonable best efforts to furnish the underwriters with opinions of counsel to the Company, addressed to the managing underwriter(s), if any, covering the matters customarily covered in such opinions requested in underwritten offerings, (C) use its reasonable best efforts to obtain "cold comfort" letters from the independent certified public accountants of the Company (and, if necessary, any other independent certified public accountants of any business acquired by the Company for which financial statements and financial data are included in the Shelf Registration Statement) who have certified the financial statements included in such Shelf Registration Statement, addressed to each of the managing underwriter(s), if any, such letters to be in customary form and covering matters of the type customarily covered in "cold comfort" letters, (D) if an underwriting agreement is entered into, the same shall contain indemnification provisions and procedures customary in underwritten offerings (*provided* that Treasury shall not be obligated to provide any indemnity), and (E) deliver such documents and certificates as may be reasonably requested by the Holders of a majority of the Registrable Securities being sold in

connection therewith, their counsel and the managing underwriter(s), if any, to evidence the continued validity of the representations and warranties made pursuant to clause (A) above and to evidence compliance with any customary conditions contained in the underwriting agreement or other agreement entered into by the Company.

(k) Make available for inspection by a representative of Holders that are selling stockholders, the managing underwriter(s), if any, and any attorneys or accountants retained by such Holders or managing underwriter(s), at the offices where normally kept, during reasonable business hours, financial and other records, pertinent corporate documents and properties of the Company, and cause the officers, directors and employees of the Company to supply all information in each case reasonably requested (and of the type customarily provided in connection with due diligence conducted in connection with a registered public offering of securities) by any such representative, managing underwriter(s), attorney or accountant in connection with such Shelf Registration Statement.

(l) Use reasonable best efforts to cause all such Registrable Securities to be listed on each national securities exchange on which similar securities issued by the Company are then listed or, if no similar securities issued by the Company are then listed on any national securities exchange, use its reasonable best efforts to cause all such Registrable Securities to be listed on such securities exchange as Treasury may designate.

(m) If requested by Holders of a majority of the Registrable Securities being registered and/or sold in connection therewith, or the managing underwriter(s), if any, promptly include in a prospectus supplement or amendment such information as the Holders of a majority of the Registrable Securities being registered and/or sold in connection therewith or managing underwriter(s), if any, may reasonably request in order to permit the intended method of distribution of such securities and make all required filings of such prospectus supplement or such amendment as soon as practicable after the Company has received such request.

(n) Timely provide to its security holders earning statements satisfying the provisions of Section 11(a) of the Securities Act and Rule 158 thereunder.

5. Suspension of Sales. Upon receipt of written notice from the Company that a registration statement, prospectus or prospectus supplement contains or may contain an untrue statement of a material fact or omits or may omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading or that circumstances exist that make inadvisable use of such registration statement, prospectus or prospectus supplement, each Holder of Registrable Securities shall forthwith discontinue disposition of Registrable Securities until such Holder has received copies of a supplemented or amended prospectus or prospectus supplement, or until such Holder is advised in writing by the Company that the use of the prospectus and, if applicable, prospectus supplement may be resumed, and, if so directed by the Company, such Holder shall deliver to the Company (at the Company's expense) all copies, other than permanent file copies then in such Holder's possession, of the prospectus and, if applicable, prospectus supplement covering such Registrable Securities current at the time of receipt of such notice. The total number of days that any such suspension may be in effect in any 12-month period shall not exceed 90 days.

6. Termination of Registration Rights. A Holder's registration rights as to any securities held by such Holder (and its Affiliates, partners, members and former members) shall not be available unless such securities are Registrable Securities.

7. Furnishing Information.

(a) No Holder shall use any free writing prospectus (as defined in Rule 405) in connection with the sale of Registrable Securities without the prior written consent of the Company.

(b) It shall be a condition precedent to the obligations of the Company to take any action pursuant to Section 4 of this Annex E that the selling Holders and the underwriters, if any, shall furnish to the Company such information regarding themselves, the Registrable Securities held by them and the intended method of disposition of such securities as shall be required to effect the registered offering of their Registrable Securities.

8. Indemnification.

(a) The Company agrees to indemnify each Holder and, if a Holder is a person other than an individual, such Holder's officers, directors, employees, agents, representatives and Affiliates, and in the case of Treasury, Treasury's officials, and each person, if any, that controls a Holder within the meaning of the Securities Act (each, an "*Indemnitee*"), against any and all losses, claims, damages, actions, liabilities, costs and expenses (including reasonable fees, expenses and disbursements of attorneys and other professionals incurred in connection with investigating, defending, settling, compromising or paying any such losses, claims, damages, actions, liabilities, costs and expenses), joint or several, arising out of or based upon any untrue statement or alleged untrue statement of material fact contained in any registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto or any documents incorporated therein by reference or contained in any free writing prospectus (as such term is defined in Rule 405) prepared by the Company or authorized by it in writing for use by such Holder (or any amendment or supplement thereto); or any omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading; *provided*, that the Company shall not be liable to such Indemnitee in any such case to the extent that any such loss, claim, damage, liability (or action or proceeding in respect thereof) or expense arises out of or is based upon (A) an untrue statement or omission made in such registration statement, including any such preliminary prospectus or final prospectus contained therein or any such amendments or supplements thereto or contained in any free writing prospectus (as such term is defined in Rule 405) prepared by the Company or authorized by it in writing for use by such Holder (or any amendment or supplement thereto), in reliance upon and in conformity with information regarding such Indemnitee or its plan of distribution or ownership interests which was furnished in writing to the Company by such Indemnitee for use in connection with such registration statement, including any such preliminary prospectus or final prospectus contained therein or any such amendments or supplements thereto, or (B) offers or sales effected by or on behalf of such Indemnitee "by means of" (as defined in Rule 159A) a "free writing prospectus" (as defined in Rule 405) that was not authorized in writing by the Company.

(b) If the indemnification provided for in Section 8(a) of this Annex E is unavailable to an Indemnitee with respect to any losses, claims, damages, actions, liabilities, costs or expenses referred to therein or is insufficient to hold the Indemnitee harmless as contemplated therein, then the Company, in lieu of indemnifying such Indemnitee, shall contribute to the amount paid or payable by such Indemnitee as a result of such losses, claims, damages, actions, liabilities, costs or expenses in such proportion as is appropriate to reflect the relative fault of the Indemnitee, on the one hand, and the Company, on the other hand, in connection with the statements or omissions which resulted in such losses, claims, damages, actions, liabilities, costs or expenses as well as any other relevant equitable considerations. The relative fault of the Company, on the one hand, and of the Indemnitee, on the other hand, shall be determined by reference to, among other factors, whether the untrue statement of a material fact or omission to state a material fact relates to information supplied by the Company or by the Indemnitee and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission; the Company and each Holder agree that it would not be just and equitable if contribution pursuant to this Section 8(b) of this Annex E were determined by *pro rata* allocation or by any other method of allocation that does not take account of the equitable considerations referred to in Section 8(a) of this Annex E. No Indemnitee guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from the Company if the Company was not guilty of such fraudulent misrepresentation.

9. Assignment of Registration Rights. The rights of Treasury to registration of Registrable Securities pursuant to Section 2 of this Annex E may be assigned by Treasury to a transferee or assignee of Registrable Securities; *provided, however*, the transferor shall, within ten days after such transfer, furnish to the Company written notice of the name and address of such transferee or assignee and the number and type of Registrable Securities that are being assigned.

10. Clear Market. With respect to any underwritten offering of Registrable Securities by Holders pursuant to this Annex E, the Company agrees not to effect (other than pursuant to such registration or pursuant to a Special Registration) any public sale or distribution, or to file any Shelf Registration Statement (other than such registration or a Special Registration) covering any preferred stock of the Company or any securities convertible into or exchangeable or exercisable for preferred stock of the Company, during the period not to exceed ten days prior and 60 days following the effective date of such offering or such longer period up to 90 days as may be requested by the managing underwriter for such underwritten offering. The Company also agrees to cause such of its directors and senior executive officers to execute and deliver customary lock-up agreements in such form and for such time period up to 90 days as may be requested by the managing underwriter.

11. Forfeiture of Rights. At any time, any holder of Registrable Securities (including any Holder) may elect to forfeit its rights set forth in this Annex E from that date forward; *provided*, that a Holder forfeiting such rights shall nonetheless be entitled to participate under Section 2(d) — (f) of this Annex E in any Pending Underwritten Offering to the same extent that such Holder would have been entitled to if the Holder had not withdrawn; and *provided, further*, that no such forfeiture shall terminate a Holder's rights or obligations under Section 7 of this Annex E with respect to any prior registration or Pending Underwritten Offering.

12. Specific Performance. The parties hereto acknowledge that there would be no adequate remedy at law if the Company fails to perform any of its obligations under this Annex E and that Holders from time to time may be irreparably harmed by any such failure, and accordingly agree that such Holders, in addition to any other remedy to which they may be entitled at law or in equity, to the fullest extent permitted and enforceable under applicable law shall be entitled to compel specific performance of the obligations of the Company under this Annex E in accordance with the terms and conditions of this Annex E.

13. No Inconsistent Agreements. The Company shall not, on or after the Signing Date, enter into any agreement with respect to its securities that may impair the rights granted to Holders under this Annex E or that otherwise conflicts with the provisions hereof in any manner that may impair the rights granted to Holders under this Annex E. In the event the Company has, prior to the Signing Date, entered into any agreement with respect to its securities that is inconsistent with the rights granted to Holders under this Annex E (including agreements that are inconsistent with the order of priority contemplated by Section 2(f) of Annex E) or that may otherwise conflict with the provisions hereof, the Company shall use its reasonable best efforts to amend such agreements to ensure they are consistent with the provisions of this Annex E.

14. Certain Offerings by Treasury. An “underwritten” offering or other disposition shall include any distribution of such securities on behalf of Treasury by one or more broker-dealers, an “underwriting agreement” shall include any purchase agreement entered into by such broker-dealers, and any “registration statement” or “prospectus” shall include any offering document approved by the Company and used in connection with such distribution.

ANNEX F
FORM OF CERTIFICATE OF DESIGNATION

[OMITTED. Please see Exhibit 3.1, Statement of Designation of Senior Non-Cumulative Perpetual Preferred Stock, Series D of Veritex Holdings, Inc., as filed with the Office of the Secretary of State of the State of Texas on July 28, 2017, to Veritex Holdings, Inc.'s Current Report on Form 8-K, dated August 1, 2017]

ANNEX G
FORM OF OFFICER'S CERTIFICATE

[OMITTED]

**ANNEX H
FORM OF SUPPLEMENTAL REPORTS**

[OMITTED]

**ANNEX I
FORM OF ANNUAL CERTIFICATION**

[OMITTED]

**ANNEX J
FORM OF OPINION**

[OMITTED]

**ANNEX K
FORM OF REPAYMENT DOCUMENT**

[OMITTED]

Consent of Independent Auditor

We consent to the incorporation by reference in the Prospectus Supplement to the Registration Statement (No. 333-207934) on Form S-3 of Veritex Holdings, Inc. of our report dated March 30, 2017, relating to the consolidated financial statements of Sovereign Bancshares, Inc., appearing in this Current Report on Form 8-K.

We also consent to the reference of our firm under the heading "Experts" in such Registration Statement.

/s/ RSM US LLP

Dallas, Texas
August 1, 2017

PRESS RELEASE**Veritex Holdings, Inc. Completes Acquisition of Sovereign Bancshares, Inc.**

DALLAS, TX- August 1, 2017-Veritex Holdings, Inc. (NASDAQ: VBTX)(“Veritex”), the parent holding company of Veritex Community Bank, announced the completion of the acquisition of Sovereign Bancshares, Inc. (“Sovereign”) effective August 1, 2017. Sovereign was the parent holding company of Sovereign Bank, a Texas state chartered full service commercial bank with total assets of \$1.0 billion, total loans of \$789.9 million, and total deposits of \$813.0 million at June 30, 2017. Sovereign Bank operates nine branches in Texas with six branches in Dallas-Fort Worth, two branches in Austin, and one branch in the Houston metropolitan area.

Under the terms of the definitive agreement, Veritex issued 5,117,647 shares of its common stock and paid approximately \$56.2 million in cash for the outstanding shares of Sovereign common stock in connection with the closing of the acquisition.

C. Malcolm Holland, Chairman and Chief Executive Officer of Veritex noted, “This is an exciting day for the employees, clients, and shareholders of both Sovereign and Veritex. The efforts made by the integration teams over the past several months have been critical to building the foundation needed to propel our combined company forward.” Mr. Holland continued, “This marks the fifth acquisition we have successfully completed in less than seven years, and we are poised to continue growing shareholder value as we execute our strategic plan.”

Veritex was advised by Stephens Inc. as financial advisor and Norton Rose Fulbright US LP as legal counsel. Sovereign was advised by Sandler + O’Neill & Partners, L.P. as financial advisor and Fenimore, Kay, Harrison & Ford, LLP as legal counsel.

About Veritex Holdings, Inc.

Headquartered in Dallas, Texas, Veritex Holdings, Inc. is a bank holding company that conducts banking activities through its wholly-owned subsidiary, Veritex Community Bank, with locations throughout the Dallas metropolitan area. Veritex Community Bank is a Texas state chartered bank regulated by the Texas Department of Banking and the Board of Governors of the Federal Reserve System. For more information, visit www.veritexbank.com.

Special Note Concerning Forward-Looking Statements

This press release contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements reflect the current views of Veritex’s management with respect to, among other things, future events and Veritex’s financial performance. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “project,” “forecast,” “goal,” “target,” “would” and “outlook,” or the negative variations of those words or other comparable words of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about Veritex’s industry, management’s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond Veritex’s control. Accordingly, Veritex cautions you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. Although Veritex believes that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements. Factors that could cause actual results to differ materially from Veritex expectations include successfully implementing its growth strategy, including identifying acquisition targets and consummating suitable acquisitions; continuing to sustain internal growth rate; providing competitive products and services that appeal to its customers and target market; continuing to have access to debt and equity capital markets and achieving its performance goals. The foregoing list of factors is not exhaustive.

For discussion of these and other risks that may cause actual results to differ from expectations, please refer to “Special Cautionary Note Regarding Forward-Looking Statements” and “Risk Factors” in Veritex’s Annual Report on Form 10-K filed with the SEC on March 10, 2017 and any updates to those risk factors set forth in Veritex’s subsequent Quarterly Reports on Form 10-Q or Current Reports on Form 8-K. If one or more events related to these or other risks or uncertainties materialize, or if Veritex’s underlying assumptions prove to be incorrect, actual results may differ materially from what Veritex anticipates. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and Veritex does not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New risks and uncertainties arise from time to time, and it is not possible for Veritex to predict those events or how they may affect it. In addition, Veritex cannot assess the impact of

each factor on Veritex's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. All forward-looking statements, expressed or implied, included in this press release are expressly qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that Veritex or persons acting on Veritex's behalf may issue.

Annualized, pro forma, projected and estimated numbers are used for illustrative purpose only, are not forecasts and may not reflect actual results.

Source: Veritex Holdings, Inc.

Media Contact:

LaVonda Renfro
972-349-6200
lrenfro@veritexbank.com

Investor Relations:

Susan Caudle
972-349-6200
scaudle@veritexbank.com

Sovereign Bancshares, Inc. and Subsidiaries

Consolidated Financial Report
December 31, 2016

Contents

Independent Auditor's Report	1
------------------------------	---

Financial Statements	
Consolidated balance sheets	2
Consolidated statements of income	3
Consolidated statements of comprehensive income	4
Consolidated statements of changes in stockholders' equity	5
Consolidated statements of cash flows	6
Notes to consolidated financial statements	7-34

Independent Auditor's Report on the Supplementary Information	35
---	----

Supplementary Information	
Consolidating balance sheet	36
Consolidating statement of income	37

Independent Auditor's Report

To the Board of Directors
Sovereign Bancshares, Inc. and Subsidiaries
Dallas, Texas

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Sovereign Bancshares, Inc. and Subsidiaries, which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of income, comprehensive income, changes in stockholder's equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sovereign Bancshares, Inc. and Subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter

We have also audited, in accordance with auditing standards generally accepted in the United States of America, Sovereign Bancshares, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 30, 2017 expressed an unqualified opinion on the effectiveness of Sovereign Bancshares, Inc. and Subsidiaries' internal control over financial reporting.

RSM US LLP

Dallas, Texas
March 30, 2017

Sovereign Bancshares, Inc. and Subsidiaries
Consolidated Balance Sheets
December 31, 2016 and 2015
(In thousands, except shares and per share values)

ASSETS	2016	2015
Cash and due from banks	\$ 5,496	\$ 4,553
Interest-bearing deposits	4,508	9,614
Federal funds sold	75	74
Cash and cash equivalents	10,079	14,241
Securities held to maturity	110,207	132,542
Securities available for sale	70,059	119,920
Loans, net	845,517	800,535
Premises and equipment, net	21,896	22,440
Other real estate owned	611	621
Accrued interest receivable	3,416	3,415
Federal Home Loan Bank Stock	7,028	9,446
Other assets	8,373	9,423
Total assets	\$ 1,077,186	\$ 1,112,583
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	\$ 163,587	\$ 173,985
Interest-bearing	693,667	624,467
Total deposits	857,254	798,452
Accrued interest payable	422	361
Trust preferred subordinated debentures	8,609	8,609
Other liabilities	2,420	1,894
Federal Home Loan Bank advances	90,000	190,000
Total liabilities	958,705	999,316
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, 2,000,000 total shares authorized:		
Series C cumulative perpetual preferred shares, \$1 par value, \$1,000 per share liquidation value; 24,500 shares issued and outstanding at December 31, 2016 and 2015	24,500	24,500
Common stock, par value \$1 per share, 10,000,000 shares authorized; 5,258,200 and 5,203,100 shares issued and outstanding at December 31, 2016 and 2015, respectively	5,258	5,203
Additional paid-in capital	57,676	57,366
Retained earnings	31,512	24,901
Accumulated other comprehensive income	(465)	1,297
Total stockholders' equity	118,481	113,267
Total liabilities and stockholders' equity	\$ 1,077,186	\$ 1,112,583

See Notes to Consolidated Financial Statements.

Sovereign Bancshares, Inc. and Subsidiaries
Consolidated Statements of Income
Years Ended December 31, 2016 and 2015
(In thousands)

	2016	2015
Interest income:		
Loans, including fees	\$ 37,988	\$ 35,417
Investment securities:		
Taxable	2,613	4,690
Nontaxable	2,340	2,608
Federal funds sold	93	33
Other	97	26
Total interest income	43,131	42,774
Interest expense:		
Deposits	5,175	4,595
Federal funds purchased	15	18
Trust preferred subordinated debentures	410	374
Federal Home Loan Bank advances	673	602
Total interest expense	6,273	5,589
Net interest income	36,858	37,185
Provision for loan losses	2,750	4,800
Net interest income after provision for loan losses	34,108	32,385
Noninterest income:		
Service charges and other fees	589	604
Net investment securities gains	1,052	55
Gain on sales of loans	868	3,194
Other	844	918
Total noninterest income	3,353	4,771
Noninterest expense:		
Salaries and employee benefits	15,685	16,157
Occupancy expense	3,252	3,514
Legal and professional fees	935	2,037
Deposit insurance assessment	857	853
Loan and repossessed asset expenses	804	308
Data processing	732	840
Telephone	597	701
Other	2,777	2,477
Total noninterest expense	25,639	26,887
Income before taxes	11,822	10,269
Income tax expense	3,386	2,649
Net income	\$ 8,436	\$ 7,620

See Notes to Consolidated Financial Statements.

Sovereign Bancshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income
 Years Ended December 31, 2016 and 2015
 (In thousands)

	2016	2015
Net income	\$ 8,436	\$ 7,620
Other comprehensive income (loss) before tax:		
Net unrealized (losses) gains on available for sale securities arising during the year	(972)	741
Reclassification adjustment for amortization of unrealized losses on investment securities transferred to held to maturity from available for sale	(646)	(710)
Reclassification adjustment for net gains on sales of securities available for sale included in net income	(1,052)	(55)
Other comprehensive loss, before tax	<u>(2,670)</u>	<u>(24)</u>
Income tax benefit	(908)	(8)
Other comprehensive loss, net of tax	<u>(1,762)</u>	<u>(16)</u>
 Comprehensive income	 <u>\$ 6,674</u>	 <u>\$ 7,604</u>

See Notes to Consolidated Financial Statements.

Sovereign Bancshares, Inc. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
Years Ended December 31, 2016 and 2015
(In thousands)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2015	\$ 24,500	\$ 5,162	\$ 56,887	\$ 17,526	\$ 1,313	\$ 105,388
Net Income	—	—	—	7,620	—	7,620
Other comprehensive income, net of tax	—	—	—	—	(16)	(16)
Stock-based compensation	—	—	304	—	—	304
Deferred stock vested (13,360 shares)	—	13	(13)	—	—	—
Stock options exercised (34,000 shares), net of shares acquired (5,703) in lieu of cash	—	28	188	—	—	216
Preferred Stock dividends	—	—	—	(245)	—	(245)
Balance at December 31, 2015	24,500	5,203	57,366	24,901	1,297	113,267
Net Income	—	—	—	8,436	—	8,436
Other comprehensive income, net of tax	—	—	—	—	(1,762)	(1,762)
Stock-based compensation	—	—	274	—	—	274
Deferred stock vested (49,100 shares)	—	49	(49)	—	—	—
Stock options exercised (6,000 shares)	—	6	85	—	—	91
Preferred stock dividends	—	—	—	(1,825)	—	(1,825)
Balance at December 31, 2016	\$ 24,500	\$ 5,258	\$ 57,676	\$ 31,512	\$ (465)	\$ 118,481

See Notes to Consolidated Financial Statements.

Sovereign Bancshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2016 and 2015
(In thousands)

	2016	2015
Cash flows from operating activities:		
Net income	\$ 8,436	\$ 7,620
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	720	877
Deferred income tax expense	413	1,563
Provision for loan losses	2,750	4,800
Net gain on sales of securities available for sale	(1,052)	(55)
Gain on sales of loans	(868)	(3,194)
Valuation adjustments on other real estate owned	10	90
Stock-based compensation expense	274	304
Net amortization of securities available for sale	2,001	2,181
Net amortization of securities held to maturity	506	1,386
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	732	8,616
Accrued interest payable and other liabilities	847	(16,306)
Net cash provided by operating activities	14,769	7,882
Cash flows from investing activities:		
Purchase of securities available for sale	(149,999)	(100,000)
Proceeds from sales of securities available for sale	41,121	29,420
Proceeds from calls, maturities and principal repayments of securities held to maturity	20,980	21,469
Proceeds from calls, maturities and principal repayments of securities available for sale	155,970	114,742
Net redemption (purchase) of FHLB stock	2,418	(2,874)
Net increase in loans	(46,864)	(130,332)
Purchases of premises and equipment	(176)	(44)
Net cash used in investing activities	23,450	(67,619)
Cash flows from financing activities:		
Net increase in deposits	58,802	5,117
Net (decrease) increase in Federal Home Loan Bank advances	(100,000)	60,000
Preferred stock dividend paid	(1,274)	(245)
Proceeds from exercise of stock options and stock warrants	91	216
Net cash (used in) provided by financing activities	(42,381)	65,088
Net (decrease) increase in cash and cash equivalents	(4,162)	5,351
Cash and cash equivalents at beginning of year	14,241	8,890
Cash and cash equivalents at end of year	\$ 10,079	\$ 14,241

See Notes to Consolidated Financial Statements.

Note 1. Summary of Significant Accounting Policies

Basis of presentation: The accompanying consolidated financial statements include the accounts of Sovereign Bancshares, Inc. ("SBI") and its wholly owned subsidiary, Sovereign Bank ("Bank"). They are collectively referred to as the Company. All significant intercompany transactions and balances have been eliminated in consolidation.

Nature of business: The Bank is a state banking organization headquartered in Dallas, Texas and began operations on July 29, 2004. The Bank provides a full range of banking services to individual and corporate customers primarily in Dallas, Austin, and Houston, Texas and the surrounding areas.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the period. Accordingly, actual results could differ significantly from those estimates.

A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses. A significant portion of the Company's loan portfolio is collateralized by real estate and related assets located in local markets. Accordingly, the ultimate collectability of this portion of the Company's loan portfolio and the recovery of the carrying amount of other real estate owned are susceptible to changes in local market conditions.

Cash flow reporting: For purposes of reporting cash flow, cash equivalents include cash items, amounts due from banks and federal funds sold. Federal funds sold are normally sold for one-day periods.

Concentrations on cash equivalents: The Company maintains deposits with other financial institutions in amounts that exceed federal deposit insurance coverage. Furthermore, federal funds sold are essentially uncollateralized loans to other financial institutions. Management regularly evaluates the credit risk associated with the counterparties to these transactions.

Investment securities: Securities classified as available for sale are those that the Company intends to hold for an indefinite period of time, but not necessarily to maturity and are carried at fair value. Unrealized gains and losses on investments classified as available for sale have been accounted for as accumulated other comprehensive income (loss). Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors.

Securities classified as held to maturity are debt securities for which the Company has the positive intent and ability to hold to maturity and are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. Transfers of debt securities into the held to maturity category from the available for sale category are made at fair value at the date of transfer. The unrealized holding gain or loss at the date of transfer is retained in other comprehensive income and in the carrying value of the held to maturity securities. Such amounts are amortized over the remaining life of the security.

Interest income includes amortization of purchase premiums and discounts. Realized gains and losses on sales of securities are recorded on the trade date and are determined using the specific identification method. Declines in the fair value of available for sale securities and held to maturity securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other than temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the

financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Federal home loan bank stock: As a member of the Federal Home Loan Bank of Dallas (FHLB), the Company is required to maintain an investment in capital stock of the FHLB. FHLB stock does not have readily determinable fair values as ownership is restricted and lacks a ready market. As a result, this stock is carried at cost and evaluated periodically by management for impairment. No impairment was recorded during the years ended December 31, 2016 and 2015.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge offs and the allowance for loan losses and deferred loan fees and deferred loan costs. Loan fees collected on loans with terms greater than twelve months are deferred, net of costs and recognized over the life of the loan. Interest income is accrued on the unpaid principal balance.

The accrual of interest is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. All interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reason for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify such loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Transfers of financial assets: Transfers of financial assets are accounted for as sales only when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company, (2) the transferee obtains the right to pledge or exchange the assets it received, and no condition both constrains the transferee from taking advantage of its right to pledge or exchange the assets it received, or provides more than a modest benefit to the transferor, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets. In addition, for transfers of a portion of financial assets (for example, participations of loan receivables), the transfer must meet the definition of a 'participating interest' in order to account for the transfer as a sale. Following are the characteristics of a 'participating interest':

- Pro-rata ownership in an entire financial asset.
- From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership.
- The rights of each participating interest holder have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder.
- No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

Allowance for loan losses: The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans.

The allowance, in the judgment of management, is necessary to reserve for estimated loan losses inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with ASC Topic 310, *Receivables* and allowance allocations calculated in accordance with ASC Topic 450, *Contingencies*. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions, and unidentified losses inherent in the current loan portfolio, as well as trends in the foregoing. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including but not limited to the performance of the loan portfolio, the economy, changes in interest rates, and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of two elements: (i) specific valuation allowances established for probable losses on impaired loans and (ii) historical valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted for general economic conditions and other qualitative risk factors both internal and external to the Company.

Premises and equipment: Land is carried at cost. Building and improvements, and furniture and equipment are carried at cost, less accumulated depreciation computed principally by the straight-line method based on the estimated useful lives of the related properties ranging from three to ten years. Leasehold improvements are generally depreciated over the lesser of the term of the respective leases or the estimated useful lives of the improvements.

Other real estate owned: Other real estate owned acquired through or instead of loan foreclosure is initially recorded at fair value when acquired, establishing a new cost basis. Costs after acquisition are expensed. If the fair value of the property declines, the value of the other real estate is reduced with a corresponding charge to earnings.

Income taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities (excluding deferred tax assets and liabilities related to components of other comprehensive income). Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and the tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years.

The Financial Accounting Standards Board (FASB) has issued guidance for how uncertain tax positions should be recognized, measured, disclosed and presented in the financial statements. This guidance requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company's federal and state tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained "when challenged" or "when examined" by the applicable tax authority. Tax positions deemed to meet the more-likely-than-not threshold would be recorded as a tax benefit or expense in the current year. The Company files income tax returns in U.S. federal jurisdiction and Texas. With few exceptions, the Company is no longer subject to U.S. federal or Texas state income tax examination by tax authorities for the years ended on or before December 31, 2013. For the years ended December 31, 2015 and 2014, management has determined there are no material uncertain tax positions. The Company classifies interest and, if applicable, penalties related to income tax liabilities as a component of income tax expense.

Fair value measurements: ASC Topic 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. In general, fair values are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that assets and liabilities are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Company's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time.

Share-based payment: Share-based payments to employees, including grants of employee stock options, warrants and restricted stock, are valued at fair value on the grant date and expensed over the applicable vesting period.

Comprehensive income (loss): Comprehensive income (loss) includes all changes in stockholders' equity during a period, except those resulting from transactions with stockholders. Besides net income, other components of the Company's comprehensive income include the after tax effect of changes in the net unrealized gain/loss on securities available for sale and amortization of unrealized losses on investment securities transferred to held to maturity from available for sale.

Contingencies: Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed.

Reclassification: Certain amounts previously reported have been reclassified to conform to current year presentation. These reclassifications had no effect on previously reported stockholders' equity or net income.

Subsequent events: The Company has evaluated subsequent events through March 30, 2017, the date on which the financial statements were available to be issued.

New authoritative accounting guidance:

ASU 2016-13 "Financial Instruments —Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13") amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, Topic 326 eliminates the probable initial recognition threshold in current GAAP and, instead, requires an entity to reflect its current estimate of all expected credit losses. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected. For available for sale debt securities, credit losses should be measured in a manner similar to current GAAP, however Topic 326 will require that credit losses be presented as an allowance rather than as a write-down. This Accounting Standards Update affects entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. For public business entities, this ASU is effective for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods therein. The Company is in process of evaluating the impact of this pronouncement.

ASU 2016-09 "Compensation —Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09") simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public business entities, this ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods therein. The Company is adopting this pronouncement as of January 1, 2017 and no material impact is expected.

ASU 2016-02 "Leases (Topic 842)" is intended to improve the reporting of leasing transactions to provide users of financial statements with more decision-useful information. ASU 2016-02 will require organizations that lease assets

to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is in process of evaluating the impact of this pronouncement, which is not expected to have a significant impact on the consolidated financial statements.

ASU 2016-01 “Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”) amends certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. This update will be effective for the Company on January 1, 2018. The Company is in process of evaluating the impact of this pronouncement, which is not expected to have a significant impact on the consolidated financial statements.

ASU 2014-09 “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”) implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 establishes a five-step model which entities must follow to recognize revenue and removes inconsistencies and weaknesses in existing guidance. The original effective date for ASU 2014-09 was for annual and interim periods beginning after December 15, 2016. However, in August 2015, the FASB issued ASU 2015-14, which deferred the effective date by one year, therefore it is now effective for interim and annual reporting periods beginning after December 15, 2017. The Company is continuing to evaluate the impact that ASU 2014-09 with the expectation to adopt the standard in the first quarter of 2018. This new standard would have an impact on components of non-interest income, however the Company’s preliminary analysis suggests that the adoption of this accounting guidance is not expected to have a material impact on the Company’s consolidated financial statements.

Note 2. Statements of Cash Flows

The Company reports on a net basis its cash receipts and cash payments for time deposits accepted and repayments of those deposits, loans made to customers and principal collections on those loans, interest-bearing deposits in other banks, and short-term borrowings. The Company uses the indirect method to present cash flows from operating activities. Other supplemental cash flow information for the years ended December 31, 2016 and 2015 is presented as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Cash paid for interest	<u>\$ 6,212</u>	<u>\$ 5,587</u>
Cash paid for taxes	<u>\$ 1,700</u>	<u>\$ 90</u>
Shares of common stock received in lieu of cash on exercise of stock options and warrants (0 and 5,703 in 2016 and 2015)	<u>\$ —</u>	<u>\$ 170</u>

Note 3. Restrictions on Cash and Due From Banks

The Bank is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. The total of those reserve balances was approximately \$12,273,000 and \$10,904,000 at December 31, 2016 and 2015, respectively.

Note 4. Securities

The amortized cost of securities and their approximate fair values at December 31, 2016 and 2015 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>Securities Held to Maturity</u>				
December 31, 2016:				
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	\$ 112,955	\$ 22	\$ (3,188)	\$ 109,789
	<u>\$ 112,955</u>	<u>\$ 22</u>	<u>\$ (3,188)</u>	<u>\$ 109,789</u>
<u>Securities Available for Sale</u>				
December 31, 2016:				
Municipal securities	\$ 62,979	\$ 2,103	\$ —	\$ 65,082
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	5,037	14	(74)	4,977
	<u>\$ 68,016</u>	<u>\$ 2,117</u>	<u>\$ (74)</u>	<u>\$ 70,059</u>
<u>Securities Held to Maturity</u>				
December 31, 2015:				
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	\$ 135,936	\$ 27	\$ (2,192)	\$ 133,771
	<u>\$ 135,936</u>	<u>\$ 27</u>	<u>\$ (2,192)</u>	<u>\$ 133,771</u>
<u>Securities Available for Sale</u>				
December 31, 2015:				
Municipal securities	\$ 71,611	\$ 4,946	\$ —	\$ 76,557
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	42,950	436	(23)	43,363
	<u>\$ 114,561</u>	<u>\$ 5,382</u>	<u>\$ (23)</u>	<u>\$ 119,920</u>

During June of 2014, the Company transferred investment securities with an amortized cost of approximately \$172,235,000 and unrealized losses of approximately \$4,453,000 from classification as available for sale to held to maturity. The unrealized loss at the time of transfer is amortized over the remaining life of the securities. The remaining unamortized balance of unrealized losses was \$2,748,000 and \$3,394,000 at December 31, 2016 and 2015, respectively.

Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2016 and 2015, are summarized as follows (in thousands):

Description of Securities	Continuous Unrealized Losses Existing for Less than 12 Months		Continuous Unrealized Losses Existing for Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2016:				
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC:				
Securities held to maturity	\$ 68,720	\$ 1,735	\$ 38,336	\$ 1,453
Securities available for sale	3,950	74	—	—
	\$ 72,670	\$ 1,809	\$ 38,336	\$ 1,453
December 31, 2015:				
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC:				
Securities held to maturity	\$ 60,143	\$ 749	\$ 67,294	\$ 1,443
Securities available for sale	3,017	23	—	—
	\$ 63,160	\$ 772	\$ 67,294	\$ 1,443

For all of the above investment securities, the unrealized losses are generally due to changes in interest rates and, as such, are considered by the Company to be temporary.

The scheduled contractual maturities of securities at December 31, 2016 are shown below (in thousands). Expected maturities of pass-through securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Therefore, the securities are not included in the maturity categories below.

	Held to Maturity	
	Amortized Cost	Estimated Fair Value
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	\$ 112,955	\$ 109,789
	<u>\$ 112,955</u>	<u>\$ 109,789</u>
	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due 3 months or less	\$ 1,290	\$ 1,296
Due after 3 months through 1 year	987	1,001
Due after one year through 5 years	16,314	17,029
Due after five years through 10 years	25,191	25,982
Due after ten years	19,197	19,774
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	5,037	4,977
	<u>\$ 68,016</u>	<u>\$ 70,059</u>

There were no pledged investment securities at December 31, 2016 or 2015

Proceeds from the sales of investment securities available for sale and gross realized gains and losses for the years ended December 31, 2016 and 2015 are as follows (in thousands):

	2016	2015
Proceeds from sales	<u>\$ 41,121</u>	<u>\$ 29,420</u>
Gross realized gains	<u>\$ 1,052</u>	<u>\$ 106</u>
Gross realized losses	<u>\$ —</u>	<u>\$ 51</u>

Note 5. Loans and Allowance for Loan Losses

Loans by portfolio segment and class at December 31, 2016 and 2015 consisted of the following (in thousands):

	<u>2016</u>	<u>2015</u>
Real estate:		
Construction	\$ 133,471	\$ 163,993
Residential	16,233	16,672
Owner occupied	137,298	110,352
Commercial and farmland	315,686	218,355
Commercial:		
Financial and agricultural	176,900	186,640
Energy	74,960	112,146
Consumer and other loans	5,129	6,890
	859,677	815,048
Unearned loan fees	(3,389)	(3,587)
Allowance for loan losses	(10,771)	(10,926)
	\$ 845,517	\$ 800,535

To determine an appropriate allowance, management separates loans into separate categories based on similar risk characteristics. These categories and their risk characteristics are described below:

- *Real estate – construction:* This category consists of loans secured by real estate under construction or land development, both commercial and residential. Construction and land development loans can carry additional risk of repayment from several different factors influencing the completion of the project on time and on budget. Other risks involved are market driven through real estate values and long-term financing options. As such, the Company takes additional steps to insure that sufficient equity is required, underwriting supports the project, and secondary sources of repayment are identified. This category also consists of loans secured by vacant land, which includes developed commercial land, undeveloped commercial land, rural land, single family residential lots, and lot development loans. These types of loans require larger down payments to help mitigate the risk.
- *Real estate – residential:* This category consists of loans secured by some form of both owner-occupied and non-owner occupied residential real estate. The category includes loans for 1-4 family home construction, home improvement, home equity lines of credit, closed-end financing for 1-4 family properties, and financing for multi-family residential properties. The overall credit risk in this segment of the loan portfolio is low given the nature of the collateral and the Company's strict underwriting standards for this type of financing. The Company does not originate sub-prime mortgage loans. The higher risk area of this category is the non-owner occupied portion of these loans, which are often reliant on rental income as the primary source of repayment.
- *Real estate – owner occupied:* This category consists of loans secured by commercial buildings that are occupied by companies that are run by the borrower or guarantors on the loan. These loans are lower risk than the non owner occupied loans because the borrower or guarantor has a personal interest in the success of the tenant company. In addition, more in-depth financial information can be obtained to help management evaluate the business and its profitability.
- *Real estate – commercial and farmland:* This category consists of loans secured by income-producing commercial buildings such as shopping centers, office buildings, office warehouse buildings, hotels, and multi-family properties. These loans carry a higher risk than owner-occupied properties because the repayment is based on the successful operations of the tenants and may be subject to adverse conditions in the real estate

market and/or general economy. A substantial majority of these loans have adequate secondary sources of repayment through financially strong guarantors that are well known to the Company.

- *Commercial – financial and agricultural:* This category consists of all business loans and leases secured by assets other than the business real estate. A substantial majority of these loans are secured by equipment, accounts receivable, and inventory. The primary risk involved with this category is that the loans and leases are typically secured by depreciable assets that may not provide an adequate source of repayment if the loan goes into default. However, the Company's very conservative underwriting standards and credit culture help mitigate risk.
- *Commercial – energy:* Energy loans are credits extended to businesses deriving a majority of their revenues from the sale of oil and gas related products or whose credit requires a technical evaluation of oil and gas reserves or where the forecasting and analysis of oil and gas prices directly impacts credit quality. The Energy Industry can be divided into three segments: Upstream (Oil and gas exploration and production or [E&P]); Midstream (refining, gathering, processing); and Downstream (selling product to end users). Integrated oil companies are generally involved in all three segments. The other oil and gas companies are involved in the upstream segment and may also be involved in midstream and downstream segments. Energy lending at Sovereign Bank focuses its efforts on upstream and midstream E&P companies. Loans are secured by proven, producing oil and gas reserves.
- *Consumer and other loans:* This category of loans includes all other forms of consumer debt, including automobiles, recreational vehicles, debt consolidation, household or personal use, education, taxes, and investments. A large majority of the loans in this category are relatively short-term loans secured by new and used automobiles, recreational vehicles, and bank certificates of deposit.

As part of the management of the loan portfolio, risk ratings are assigned to all loans. Through the loan review process, ratings are modified as believed to be appropriate to reflect changes in the credit. Lending is an important activity for the bank and represents a major asset commitment. The loan review function represents a significant self-monitoring process to ensure, across the organization, the quality of loans meets or exceeds corporate credit standards. The loan review team evaluates various related risks and management techniques involved with loan activities.

In order to manage credit risk, credit administration assigns a credit risk rating to each loan at the time of origination and reviews loans on a regular basis to determine each loan's credit risk rating on a scale of 1 through 10, with higher scores indicating higher risk. Creditworthiness of the borrower is the primary determinant in the assignment of risk ratings. In certain cases, however, risks inherent in the transaction itself may influence the final rating. The final rating should be the product of careful evaluation derived from an overall assessment of such factors as creditworthiness, structure and any unusual features.

- *1-6 – pass ratings:* Risk ratings from 1-6 are all "Pass" ratings and represent the loans considered acceptable to the bank. The ratings range from 1 being the Highest Quality to 6 being Minimum Acceptable Quality (including a 6 – pass/watch rating). All ratings reflect loans with a good primary and secondary source of repayment and/or well collateralized. While the availability varies within the Pass categories, borrowers typically have access to alternative financial markets.
- *7 – special mention:* A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the bank's credit position at some future date. Special Mention assets are not adversely classified and do not expose the bank to sufficient risk to warrant adverse classification.

The Special Mention category is not to be used to identify an asset that has as its sole weakness credit data exceptions, collateral documentation exceptions or other account management weaknesses where the exceptions/weaknesses are not material to the repayment of the loan.

- *8 – substandard:* The loan is inadequately protected by the current worth and paying capacity of the obligor or of the collateral pledged, if any. There are well-defined weaknesses that jeopardize the repayment of the debt.

Although loss may not be imminent, if the weaknesses are not corrected, there is a good possibility that the bank will sustain some loss. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified Substandard.

- *9 – doubtful:* The loan has the weaknesses of those in the classification of Substandard, one or more of which make collection or liquidation in full, on the basis of currently ascertainable facts, conditions and values, highly questionable or improbable. The possibility of loss is extremely high, but certain identifiable contingencies that are reasonably likely to materialize may work to the advantage and strengthening of the loan, such that it is reasonable to defer its classification as a loss until its more exact status may be determined. Contingencies that may call for deferral of loss classification include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on addition collateral and refinancing plans.

Loans in this classification are normally carried on interest non-accrual, and interest received is applied to reduce principal. Credits rated Doubtful are reviewed frequently to determine if events that might require a change in rating upward or downward have taken place.

- *10 – loss:* Loans in this classification are considered uncollectible and of such little value that their continued classification as bankable assets is not warranted. This classification does not mean the loan has absolutely no recovery or salvage value, but that it is neither practical nor desirable to defer writing off this basically worthless loan even though partial recovery may be affected in the future.

The following table presents the recorded investment in loans receivable (in thousands) by credit quality indicator as of December 31, 2016 and 2015:

	Pass (Rating 1-6)	Special Mention (Rating 7)	Substandard (Rating 8)	Doubtful (Rating 9)	Total
2016:					
Real estate:					
Construction	\$ 133,471	\$ —	\$ —	\$ —	\$ 133,471
Residential	16,233	—	—	—	16,233
Owner occupied	127,677	99	9,522	—	137,298
Commercial and farmland	310,363	—	5,323	—	315,686
Commercial:					
Financial and agricultural	164,538	9,712	2,650	—	176,900
Energy	35,160	19,869	19,931	—	74,960
Consumer and other loans	4,999	—	130	—	5,129
	<u>\$ 792,441</u>	<u>\$ 29,680</u>	<u>\$ 37,556</u>	<u>\$ —</u>	<u>\$ 859,677</u>
2015:					
Real estate:					
Construction	\$ 163,993	\$ —	\$ —	\$ —	\$ 163,993
Residential	16,672	—	—	—	16,672
Owner occupied	109,664	370	318	—	110,352
Commercial and farmland	215,485	—	2,870	—	218,355
Commercial:					
Financial and agricultural	182,760	1,820	2,060	—	186,640
Energy	65,929	9,792	36,425	—	112,146
Consumer and other loans	6,842	—	48	—	6,890
	<u>\$ 761,345</u>	<u>\$ 11,982</u>	<u>\$ 41,721</u>	<u>\$ —</u>	<u>\$ 815,048</u>

The Company's activity in the allowance for loan losses for the year ended December 31, 2016 and 2015 by portfolio segment and disaggregated on the basis of the Company's impairment methodology is as follows (in thousands):

	Real Estate			Commercial			Consumer and Other Loans	Total
	Construction	Residential	Owner Occupied	Commercial and Farmland	Financial and Agricultural	Energy		
2016:								
Beginning balance	\$ 1,761	\$ 134	\$ 793	\$ 1,558	\$ 1,962	\$ 4,655	\$ 63	\$ 10,926
Charge-offs	—	—	—	—	—	(2,955)	(3)	(2,958)
Recoveries	—	—	—	—	54	—	—	54
Provision	(225)	6	453	1,218	(50)	1,326	21	2,749
Ending balance	\$ 1,536	\$ 140	\$ 1,246	\$ 2,776	\$ 1,966	\$ 3,026	\$ 81	\$ 10,771
Period-end amount allocated to:								
Loans individually evaluated for impairment	\$ —	\$ —	\$ 3	\$ 27	\$ 14	\$ 2,181	\$ 34	\$ 2,259
Loans collectively evaluated for impairment	1,536	140	1,242	2,749	1,952	844	49	8,512
Ending balance	\$ 1,536	\$ 140	\$ 1,245	\$ 2,776	\$ 1,966	\$ 3,025	\$ 83	\$ 10,771
Loans:								
Loans individually evaluated for impairment	\$ —	\$ —	\$ 311	\$ 2,803	\$ 1,439	\$ 12,050	\$ 91	\$ 16,694
Loans collectively evaluated for impairment	133,471	16,233	136,987	312,833	175,461	62,910	5,038	842,933
Ending balance	\$ 133,471	\$ 16,233	\$ 137,298	\$ 315,636	\$ 176,900	\$ 74,960	\$ 5,129	\$ 859,627
2015:								
Beginning balance	\$ 1,512	\$ 303	\$ 783	\$ 1,046	\$ 2,330	\$ 2,158	\$ 120	\$ 8,252
Charge-offs	—	(359)	—	—	—	(1,779)	—	(2,138)
Recoveries	—	—	—	—	12	—	—	12
Provision	249	190	10	512	(380)	4,276	(57)	4,800
Ending balance	\$ 1,761	\$ 134	\$ 793	\$ 1,558	\$ 1,962	\$ 4,655	\$ 63	\$ 10,926
Period-end amount allocated to:								
Loans individually evaluated for impairment	\$ —	\$ —	\$ 3	\$ 26	\$ 53	\$ 2,385	\$ —	\$ 2,467
Loans collectively evaluated for impairment	1,761	134	790	1,532	1,909	2,270	63	8,459
Ending balance	\$ 1,761	\$ 134	\$ 793	\$ 1,558	\$ 1,962	\$ 4,655	\$ 63	\$ 10,926
Loans:								
Loans individually evaluated for impairment	\$ —	\$ —	\$ 318	\$ 2,870	\$ 1,695	\$ 14,295	\$ —	\$ 19,178
Loans collectively evaluated for impairment	163,992	16,672	110,034	215,486	184,945	97,851	6,890	795,870
Ending balance	\$ 163,992	\$ 16,672	\$ 110,352	\$ 218,356	\$ 186,640	\$ 112,146	\$ 6,890	\$ 815,048

The following table presents the past due aging of the recorded investment in loans and loans on nonaccrual status as of December 31, 2016 and 2015 (in thousands):

	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Past Due	Total Past Due Loans	Non-Accrual Loans
2016:					
Real estate:					
Construction	\$ —	\$ —	\$ —	\$ —	\$ —
Residential	—	—	—	—	—
Owner occupied	9,211	—	—	9,211	—
Commercial and farmland	—	2,520	—	2,520	—
Commercial:					
Financial and agricultural	3,256	99	—	3,355	—
Energy	—	—	9,569	9,569	9,569
Consumer and other loans	—	53	38	91	38
	\$ 12,467	\$ 2,672	\$ 9,607	\$ 24,746	\$ 9,607
2015:					
Real estate:					
Construction	\$ —	\$ —	\$ —	\$ —	\$ —
Residential	—	—	—	—	—
Owner occupied	318	—	—	318	—
Commercial and farmland	—	—	—	—	—
Commercial:					
Financial and agricultural	712	—	748	1,460	748
Energy	—	2,055	11,945	14,000	14,000
Consumer and other loans	4	—	—	4	—
	\$ 1,034	\$ 2,055	\$ 12,693	\$ 15,782	\$ 14,748

The following table presents loans identified as impaired by class of loans as of December 31, 2016 and 2015 (in thousands):

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized on Impaired Loans
2016:							
Real estate:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Residential	—	—	—	—	—	—	—
Owner occupied	311	—	311	311	3	315	78
Commercial and farmland	2,803	—	2,803	2,803	27	2,837	183
Commercial:							
Financial and agricultural	1,439	—	1,439	1,439	14	1,575	59
Energy	12,050	—	12,050	12,050	2,182	14,232	196
Consumer and other loans	91	—	91	91	33	18	1
	\$ 16,694	\$ —	\$ 16,694	\$ 16,694	\$ 2,259	\$ 18,977	\$ 517
2015:							
Real estate:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Residential	—	—	—	—	—	—	—
Owner occupied	318	—	318	318	3	64	24
Commercial and farmland	2,870	—	2,870	2,870	26	2,895	190
Commercial:							
Financial and agricultural	1,695	—	1,695	1,695	53	1,346	52
Energy	14,295	—	14,295	14,295	2,385	5,508	39
Consumer and other loans	—	—	—	—	—	—	—
	\$ 19,178	\$ —	\$ 19,178	\$ 19,178	\$ 2,467	\$ 9,813	\$ 305

A loan is considered a troubled debt restructuring (TDR) if the Company, for economic or legal reasons related to a debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Concessions granted under a TDR typically involve a temporary or permanent reduction in the interest rate at less than a current market rate of interest or an extension of a loan's stated maturity date. Loans classified as TDR's are designated as impaired.

Three impaired loans totaling approximately \$5,237,000 and three impaired loans totaling approximately \$3,504,000 were accounted for as troubled debt restructurings as of December 31, 2016 and 2015, respectively. There were no TDRs that defaulted during the years ended December 31, 2016 or 2015.

Note 6. Premises and Equipment

Premises and equipment at December 31, 2016 and 2015 consisted of the following (in thousands):

	2016		2015	
Land	\$	11,771	\$	11,771
Building and improvements		11,408		11,388
Leasehold improvements		2,460		2,917
Furniture, fixtures and equipment		6,566		6,512
		32,205		32,588
Less accumulated depreciation and amortization		(10,309)		(10,148)
	\$	21,896	\$	22,440

Note 7. Deposits

Deposits at December 31, 2016 and 2015 are summarized as follows (in thousands):

	2016		2015	
	Amount	Percent	Amount	Percent
Noninterest-bearing demand accounts	\$ 163,587	19.1%	\$ 173,985	21.8%
Interest-bearing checking accounts	50,358	5.9	30,520	3.8
Limited access money market accounts	210,008	24.5	224,537	28.0
Savings accounts	2,805	0.3	2,816	0.4
Certificates of deposit, \$250,000 and greater	131,024	15.3	86,008	10.8
Certificates of deposit, less than \$250,000	299,472	34.9	280,586	35.1
	\$ 857,254	100%	\$ 798,452	100%

At December 31 2016, scheduled maturities of certificates of deposit were as follows (in thousands):

2017	\$	417,075
2018		11,502
2019		1,540
2020		378
2021		—
	\$	430,495

Note 8. Federal Home Loan Bank Advances

The Company periodically borrows from the Federal Home Loan Bank (FHLB) of Dallas. These advances are collateralized by approximately \$342,286,000 of loans and \$109,295,000 of investment securities and FHLB stock at December 31, 2016 and \$347,902,000 of loans and \$217,837,000 of investment securities and FHLB stock at December 31, 2015. The advances may be prepaid at any time, but such prepayment may be subject to a penalty or benefit depending upon the movement in market interest rates. The maturities of FHLB advances are as follows (in thousands):

Maturity	Interest Rate	Principal Balance
January 4, 2017	0.58%	\$ 10,000
January 9, 2017	0.62%	10,000
January 23, 2017	0.80%	10,000
January 25, 2017	0.62%	10,000
February 7, 2017	0.80%	10,000
March 2, 2017	0.82%	10,000
March 14, 2017	0.64%	10,000
March 27, 2017	0.64%	10,000
April 10, 2017	0.79%	10,000
		\$ 90,000

Note 9. Trust Preferred Subordinated Debentures

In May 2008, the Company, in a private placement, issued \$8,350,000 (8,350 shares with a liquidation amount of \$1,000 per security) of Floating Rate Cumulative Trust Preferred Securities (TruPS) through a newly formed, unconsolidated, wholly-owned subsidiary, SovDallas Capital Trust I (the Trust). The Company has an investment in 100% of the common shares of the Trust totaling \$259,000. The Trust invested the total proceeds from the sale of the TruPS and the investment in common shares in floating rate Junior Subordinated Debentures (the Debentures) issued by the Company. The terms of the Debentures are such that they qualify as Tier I capital under the Federal Reserve Board's regulatory capital guidelines applicable to bank holding companies. Interest on the TruPS is payable quarterly at a rate equal to 3 month LIBOR plus 4.0% (4.85% at December 31, 2016). Principal payments are due at maturity in July 2038. The TruPS are guaranteed by the Company and are subject to redemption. The Company may redeem the debt securities, in whole or in part, at any time at an amount equal to the principal amount of the debt securities being redeemed plus any accrued and unpaid interest.

Note 10. Income Taxes

For the years ended December 31, 2016 and 2015, income tax expense (benefit) consisted of the following (in thousands):

	2016	2015
Current:		
Federal	\$ 2,955	\$ 1,055
State	18	31
	2,973	1,086
Deferred	413	1,563
	\$ 3,386	\$ 2,649

Actual tax expense differed from the amounts computed by applying the United States federal income tax rate of 34% to net income before taxes for the years ended December 31, 2016 and 2015 as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Federal income tax expense computed at statutory rate	\$ 4,020	\$ 3,491
State tax (net of federal benefit)	12	20
Meals, entertainment and nondeductible dues	77	72
Tax exempt interest	(795)	(887)
Tax credits	—	10
Other	72	(57)
	<hr/>	<hr/>
Income tax expense	\$ 3,386	\$ 2,649
	<hr/> <hr/>	<hr/> <hr/>

Significant components of the Company's deferred tax assets and liabilities as of December 31, 2016 and 2015 are as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Deferred tax assets:		
Allowance for loan losses	\$ 3,662	\$ 3,715
Deferred loan fees	414	478
Interest on non-accrual loans	425	362
Securities available for sale	240	—
Stock options/warrants	44	70
Other real estate owned	41	37
Premises and equipment	33	101
Other	—	21
Total deferred tax assets	4,859	4,784
	<hr/>	<hr/>
Deferred tax liability:		
Lone Star New Market Fund	(428)	(214)
Securities available for sale	—	(669)
Other	(35)	—
Total deferred tax liabilities	(463)	(883)
	<hr/>	<hr/>
Deferred tax asset	\$ 4,396	\$ 3,901
	<hr/> <hr/>	<hr/> <hr/>

Note 11. Commitments and Contingencies

The Company has entered into noncancelable operating leases related to its branch locations and corporate office. At December 31, 2016, future minimum annual rental commitments under noncancelable operating leases with initial or remaining terms of more than one year are as follows (in thousands):

2017	\$	1,463
2018		1,489
2019		1,519
2020		1,417
2021		975
Thereafter		6,972
		<hr/>
	\$	<u>13,835</u>

Total rent expense was \$1,537,000 and \$1,598,000 for the years ended December 31, 2016 and 2015, respectively.

Legal and professional fees consist of expenses related to previously outstanding litigation, other legal fees, accounting fees, placement fees and other professional fees.

Note 12. Financial Instruments

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. At December 31, 2016 and 2015, the approximate amounts of these financial instruments were as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 242,306	\$ 304,662
Standby letters of credit	3,258	3,689
	<hr/>	<hr/>
	\$ 245,564	\$ 308,351

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

Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. In the event the customer does not perform in accordance with the terms of the

agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount shown in the table above. If the commitment is funded, the Company would be entitled to seek recovery from the customer. As of December 31, 2016 and 2015, no amounts have been recorded as liabilities for the Company's potential obligations under these guarantees.

Note 13. Concentrations of Credit

The Company's loans, commitments and standby letters of credit have generally been granted to customers in the Company's market area. Such customers are normally also depositors of the Bank. The concentrations of credit by type of loan are set forth in Note 5. Generally these loans are collateralized and are expected to be repaid from cash flow or proceeds from sale of selected assets of the borrowers. Standby letters of credit are granted primarily to commercial borrowers.

Note 14. Related Party Transactions

In the ordinary course of business, the Company expects to have transactions, including borrowings, with its officers, directors and their affiliates. In the opinion of management, such transactions will be on the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unaffiliated persons. At December 31, 2016 and 2015, there were approximately \$2,635,000 and \$2,759,000 of related party loans.

Additionally, at December 31, 2016, the Company had unfunded commitments for such loans of approximately \$1,101,000.

Note 15. Stock Compensation

Stock options: Under the Company's Employee Stock Option Plan, the Company may grant options and warrants to its directors, officers and employees for up to 1,098,113 shares of common stock, of which 493,164 remain to be granted. Both incentive stock options and nonqualified stock options may be granted under the Plan. The exercise price of each option equals the market price of the Company's stock on the date of grant and an option's maximum term is 10 years. Vesting periods range from immediate to five years from the date of grant.

The summary of stock option activity for 2016 and 2015 follows:

	2016		2015	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	108,199	21.12	144,699	\$ 18.67
Exercised	(6,000)	15.00	(34,000)	11.35
Forfeited	(56,479)	21.48	(2,500)	12.00
Outstanding, end of year	<u>45,720</u>	<u>\$ 21.48</u>	<u>108,199</u>	<u>\$ 21.12</u>
Options exercisable	<u>45,720</u>	<u>\$ 21.48</u>	<u>108,199</u>	<u>\$ 21.12</u>
Weighted average remaining contractual life of options:				
Outstanding	1.02 years		1.92 years	
Exercisable	1.02 years		1.92 years	

The intrinsic value of options exercised during 2016 and 2015 was approximately \$89,000 and \$628,000, respectively. During 2015, 5,703 shares of common stock were accepted in lieu of cash on the exercise of stock options. The intrinsic value of options outstanding at December 31, 2016 was approximately \$675,000.

No options were granted in 2016 or 2015. At December 31, 2016, there was no unrecognized compensation cost related to option compensation arrangements.

Deferred stock: At December 31, 2016 and 2015, certain officers had outstanding deferred stock awards totaling 60,000 and 109,100 shares of common stock, respectively with values ranging from \$13.09 to \$29.82 per share at the date of grant. During 2015, 10,000 deferred stock awards were granted. The shares granted during 2015 had a weighted average fair value at the grant date of \$29.82 per share. The deferred stock awards have varying terms and vest various years from the date of grant. The grant of shares will take place following a "deferral period" or upon employee termination or change of control. Upon employee termination, shares will be granted based on the number of shares vested at the time of termination. Upon change in control, the shares vest immediately. The holders of the awards have no rights of a stockholder until shares are granted following the deferral period. During 2016 and 2015, 49,100 and 13,360 shares vested, respectively. The remaining 60,000 shares will vest over the next 2.51 years.

Total compensation expense related to these deferred stock awards totaled \$274,000 and \$304,000 during 2016 and 2015, respectively. At December 31, 2016, future compensation expense related to deferred stock awards is approximately \$535,000 and will be recognized over a remaining weighted average period of 2.51 years.

Note 16. Regulatory Matters

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. Regulatory approval would be required for any dividends or other distributions to be made by the Bank during the time an accumulated deficit exists.

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

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes as of December 31, 2016 and 2015, that the Bank met all capital adequacy requirements to which it is subject.

At December 31, 2016 and 2015, the Bank's capital ratios exceeded those levels necessary to be categorized as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bank must maintain minimum total risk based, Tier I risk based, and Tier I leverage ratios as set forth in the following table. At December 31, 2016 and 2015, the Company met all capital requirements under the regulatory framework specified by the Federal Reserve Board. Management is not aware of any conditions subsequent to December 31, 2016 that would change the Bank's capital category.

The Company's and the Bank's actual capital amounts and ratios are presented in the following table (dollar amounts in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2016:						
Total capital (to risk weighted assets):						
Consolidated	\$ 138,068	13.57%	\$ 81,373	8.00%	N/A	N/A
Bank	137,362	13.52%	81,308	8.00%	101,635	10.00%
Tier I capital (to risk weighted assets):						
Consolidated	\$ 127,296	12.51%	\$ 61,029	6.00%	N/A	N/A
Bank	126,591	12.46%	60,981	6.00%	81,308	8.00%
Common equity (to risk weighted assets):						
Consolidated	\$ 94,446	9.29%	\$ 45,772	4.50%	N/A	N/A
Bank	126,591	12.46%	45,736	4.50%	66,063	6.50%
Tier I capital (to average assets):						
Consolidated	\$ 127,296	11.55%	\$ 44,100	4.00%	N/A	N/A
Bank	126,591	11.49%	44,069	4.00%	55,087	5.00%
December 31, 2015:						
Total capital (to risk weighted assets):						
Consolidated	\$ 131,246	13.06%	\$ 80,423	8.00%	N/A	N/A
Bank	130,409	12.98%	80,380	8.00%	100,475	10.00%
Tier I capital (to risk weighted assets):						
Consolidated	\$ 120,320	11.97%	\$ 60,317	6.00%	N/A	N/A
Bank	119,483	11.89%	60,285	6.00%	80,380	8.00%
Common equity (to risk weighted assets):						
Consolidated	\$ 87,470	8.70%	\$ 45,238	4.50%	N/A	N/A
Bank	119,483	11.89%	45,214	4.50%	65,308	6.50%
Tier I capital (to average assets):						
Consolidated	\$ 120,320	10.69%	\$ 45,027	4.00%	N/A	N/A
Bank	119,483	10.62%	44,997	4.00%	56,247	5.00%

In July 2013, the FDIC and other regulatory bodies issued final rules consisting of minimum requirements that increased both the quantity and quality of capital held by banking organizations. The final rules are a result of the implementation of the BASEL III capital reforms and various Dodd-Frank Act related capital provisions and impact all U.S. banking organizations with more than \$500 million in assets. Consistent with the Basel international framework, the new rule includes a new minimum ratio of common equity tier 1 to risk-weighted assets of 4.5 percent and a common equity tier 1 capital conservation buffer of 2.5 percent of risk-weighted assets. The rule also raised the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent and includes a minimum leverage ratio of 4 percent for all banking organizations. Regarding the quality of capital, the new rule emphasizes common equity tier 1 capital and implements strict eligibility criteria for regulatory capital instruments. The new rule also improves the methodology for calculating risk-weighted assets to enhance risk sensitivity. The new rule is subject to a four year phase in period for mandatory compliance and the Company began to phase in the new rules beginning on January 1, 2015.

Note 17. Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

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

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

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

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

During 2016 there were no changes in valuation methodologies compared to 2015 and there were no transfers between levels.

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

	Fair Value Measurements at Reporting Date			
	Assets/ Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016:				
Measured on a recurring basis:				
Assets:				
Municipal securities	\$ 65,082	\$ —	\$ 65,082	\$ —
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA, and SBIC	4,977	—	4,977	—
December 31, 2015:				
Measured on a recurring basis:				
Assets:				
Municipal securities	\$ 76,557	\$ —	\$ 76,557	\$ —
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA, and SBIC	43,363	—	43,363	—

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

The Company has no nonfinancial assets or nonfinancial liabilities measured at fair value on a recurring basis.

The following table presents assets measured at fair value on a nonrecurring basis (in thousands):

	Fair Value Measurements at Reporting Date				Net Change During Period
	Assets/ Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
December 31, 2016:					
Measured on a nonrecurring basis:					
Assets:					
Impaired loans	\$ 15,691	\$ —	\$ —	\$ 15,691	(163)
December 31, 2015:					
Measured on a nonrecurring basis:					
Assets:					
Impaired loans	\$ 19,178	\$ —	\$ —	\$ 19,178	2,210

Certain impaired loans are reported at the fair value of underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on the fair value of the collateral discounted based on internal criteria. Impaired loans are primarily comprised of collateral-dependent commercial and real estate loans.

Other real estate owned is measured at fair value on a nonrecurring basis (subsequent to initial recognition). Other real estate owned is classified within Level 3 of the valuation hierarchy. When transferred from the loan portfolio, other real estate is adjusted to and subsequently carried at fair value less estimated selling costs. The fair value is determined using an external appraisal process, discounted based on internal criteria.

The methods and assumptions used by the Bank in estimating fair values of financial instruments other than those measured at fair value on a recurring and nonrecurring basis discussed above, are as follows:

Cash and cash equivalents: The carrying amounts of cash, due from banks, and federal funds sold approximate their fair value.

Loans: The fair value for all fixed-rate loans is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality. The estimated fair value for variable rate loans is the carrying amount.

Federal Home Loan Bank stock: The carrying amount of Federal Home Loan Bank stock approximates its fair value.

Deposits: The fair values disclosed for demand deposits with no defined maturities are equal to their carrying amounts which are payable on demand. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Trust preferred subordinated debentures: It is not practicable to estimate the fair value of trust preferred subordinated debentures as there are currently no transactions of similar instruments.

Federal Home Loan Bank advances and federal funds purchased: The carrying amounts of variable rate borrowings approximate their fair values. The fair value of fixed rate borrowings is estimated based on the present value of expected cash flows using current interest rates for similar financial instruments.

Accrued interest receivable and payable: The carrying amounts of accrued interest approximate their fair values.

Off-balance sheet instruments: Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and the counterparties' credit standings.

The estimated fair value of the Company's financial instruments were as follows at December 31, 2016 and 2015 (in thousands):

	2016		2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 10,079	\$ 10,079	\$ 14,241	\$ 14,241
Securities held to maturity	110,207	109,789	132,542	133,771
Securities available for sale	70,059	70,059	119,920	119,920
Loans, net	845,517	844,764	800,535	799,535
Federal Home Loan Bank stock	7,028	7,028	9,446	9,446
Accrued interest receivable	3,416	3,416	3,415	3,415
Financial liabilities:				
Deposits	857,254	857,421	798,452	798,810
Federal Home Loan Bank advances	90,000	90,003	190,000	190,029
Accrued interest payable	422	422	361	361
Off-balance sheet assets (liabilities):				
Commitments to extend credit	—	—	—	—
Standby letters of credit	—	—	—	—

Note 18. Capital Requirements

Small business lending fund preferred stock: On September 22, 2011, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with the Secretary of the United States Treasury (the "Secretary"), pursuant to which the Company issued 24,500 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series C (the "Series C Preferred Stock"), having a liquidation amount per share equal to \$1,000, for a total purchase price of \$24,500,000. The Purchase Agreement was entered into, and the Series C Preferred Stock was issued, as authorized by the Small Business Lending Fund program (SBLF).

The Series C Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, as a percentage of the liquidation amount, fluctuated on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock was outstanding, based upon changes in the level of "Qualified Small Business Lending" or "QSBL" by the Bank. Based upon the increase in the Bank's level of QSBL over the baseline level calculated under the terms of the Purchase Agreement, the dividend rate for the initial dividend period was set at 5%. For the second through tenth calendar quarters, the dividend rate fluctuated between 1% and 5% per annum, to reflect the amount of change in the Bank's level of QSBL. For the eleventh calendar quarter through four and one half years after issuance, the dividend rate is fixed at 1% based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to 9%. In addition, beginning on January 1, 2014, and on all Series C Preferred Stock dividend payment dates thereafter ending on April 1, 2016, the Company will be required to pay a fee equal to 0.5% of the liquidation amount per share of Series C Preferred Stock if the amount of eligible loans falls below the baseline.

The Series C Preferred Stock is non-voting, except in limited circumstances. The Series C Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of our federal banking regulator. The Company is permitted to repay its SBLF funding in increments of 25% or \$5.0 million, subject to the approval of the Company's federal banking regulator.

The Series C Preferred Stock was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Series C Preferred Stock is not subject to any contractual restrictions on transfer.

Note 19. Pending Merger with Veritex Holdings, Inc.

On December 14, 2016 the Company entered into a definitive agreement to merge with Veritex Holdings, Inc. (Veritex). Under the terms of the merger agreement, Veritex will acquire all outstanding shares of Sovereign Bancshares, Inc. (Sovereign) common stock and Sovereign will merge into Veritex with Veritex being the surviving corporation. The merger is subject to customary closing conditions including the receipt of regulatory approvals and the approval of the merger agreement by the Shareholders of Sovereign and Veritex. The transaction is expected to close during the second quarter of 2017. If the merger is not completed, Sovereign may be required to pay Veritex a termination fee of \$4.5 million under certain conditions. In connection with the merger, Sovereign will be obligated for payments of approximately \$11.3 million related to certain change in control and severance agreements.

Independent Auditor's Report on the Supplementary Information

To the Board of Directors
Sovereign Bancshares, Inc. and Subsidiaries
Dallas, Texas

We have audited the consolidated financial statements of Sovereign Bancshares, Inc. and Subsidiaries (the Company) as of and for the years ended December 31, 2016 and 2015, and have issued our report thereon, which contains an unqualified opinion on those consolidated financial statements. See page 1. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

RSM US LLP

Dallas, Texas
March 30, 2017

Sovereign Bancshares, Inc. and Subsidiaries
**Consolidating Balance Sheet
December 31, 2016
(In thousands)**

Assets	Sovereign		Eliminations	Consolidated
	Bancshares, Inc.	Sovereign Bank		
Cash and due from banks	\$ 588	\$ 5,496	\$ (588)	\$ 5,496
Interest-bearing deposits	—	4,508	—	4,508
Federal funds sold	—	75	—	75
Cash and cash equivalents	588	10,079	(588)	10,079
Securities held to maturity	—	110,207	—	110,207
Securities available for sale	—	70,059	—	70,059
Investment in subsidiary	126,126	—	(126,126)	—
Loans, net	—	845,517	—	845,517
Premises and equipment, net	—	21,896	—	21,896
Other real estate	—	611	—	611
Accrued interest receivable	—	3,416	—	3,416
Federal Home Loan Bank Stock	—	7,028	—	7,028
Other assets	1,065	7,308	—	8,373
Total assets	\$ 127,779	\$ 1,076,121	\$ (126,714)	\$ 1,077,186
Liabilities and Stockholders' Equity				
Deposits:				
Noninterest-bearing	\$ —	\$ 164,175	\$ (588)	\$ 163,587
Interest-bearing	—	693,667	—	693,667
Total deposits	—	857,842	(588)	857,254
Accrued interest payable	103	319	—	422
Trust preferred subordinated debentures	8,609	—	—	8,609
Other liabilities	586	1,834	—	2,420
Federal Home Loan Bank advances	—	90,000	—	90,000
Total liabilities	9,298	949,995	(588)	958,705
Commitments and contingencies				
Stockholders' equity:				
Series C preferred stock	24,500	—	—	24,500
Common stock	5,258	5,200	(5,200)	5,258
Additional paid-in capital	57,676	80,760	(80,760)	57,676
Retained earnings	31,512	40,631	(40,631)	31,512
Accumulated other comprehensive income	(465)	(465)	465	(465)
Total stockholders' equity	118,481	126,126	(126,126)	118,481
Total liabilities and stockholders' equity	\$ 127,779	\$ 1,076,121	\$ (126,714)	\$ 1,077,186

See Independent Auditor's Report on Supplementary Information.

Sovereign Bancshares, Inc. and Subsidiaries
Consolidating Statement of Income
Year Ended December 31, 2016
(In thousands)

	Sovereign Bancshares, Inc	Sovereign Bank	Eliminations	Consolidated
Interest income:				
Loans, including fees	\$ —	\$ 37,988	\$ —	\$ 37,988
Investment securities:				
Taxable	—	2,613	—	2,613
Nontaxable	—	2,340	—	2,340
Federal funds sold	—	93	—	93
Other	—	97	—	97
Total interest income	—	43,131	—	43,131
Interest expense:				
Deposits	—	5,175	—	5,175
Federal funds purchased	—	15	—	15
Trust preferred subordinated debentures	410	—	—	410
Federal Home Loan Bank advances	—	673	—	673
Total interest expense	410	5,863	—	6,273
Net interest income (expense)	(410)	37,268	—	36,858
Provision for loan losses	—	2,750	—	2,750
Net interest income (expense) after provision for loan losses	(410)	34,518	—	34,108
Noninterest income:				
Service charges and other fees	—	589	—	589
Net income from subsidiary	8,958	—	(8,958)	—
Net investment securities gains	—	1,052	—	1,052
Gain on sales of loans	—	868	—	868
Other	12	832	—	844
Total noninterest income	8,970	3,341	(8,958)	3,353
Noninterest expense:				
Salaries and employee benefits	274	15,411	—	15,685
Occupancy expense	—	3,252	—	3,252
Legal and professional fees	44	891	—	935
Deposit insurance assessment	—	857	—	857
Loan and repossessed asset expenses	—	804	—	804
Data processing	—	732	—	732
Telephone	—	597	—	597
Other	75	2,702	—	2,777
Total noninterest expense	393	25,246	—	25,639
Income before taxes	8,167	12,613	(8,958)	11,822
Income tax:				
Income tax expense (benefit)	(269)	3,655	—	3,386
Net income	\$ 8,436	\$ 8,958	\$ (8,958)	\$ 8,436

See Independent Auditor's Report on Supplementary Information.

Sovereign Bancshares, Inc. and Subsidiaries

Consolidated Financial Report
June 30, 2017

Contents

Financial Statements (unaudited)

Consolidated Balance Sheets	3
Consolidated Statements of Income	4
Consolidated Statements of Comprehensive Income	5
Consolidated Statements of Changes in Stockholders' Equity	6
Consolidated Statements of Cash Flows	7
Notes to Consolidated Financial Statements	8-32

Sovereign Bancshares, Inc. and Subsidiaries
**Consolidated Balance Sheets (unaudited)
 June 30, 2017 and December 31, 2016
 (In thousands, except shares and per share values)**

	<u>June 30,</u> 2017	<u>December 31,</u> 2016
Assets		
Cash and due from banks	\$ 4,663	\$ 5,496
Interest-bearing deposits	37,581	4,508
Federal funds sold	71	75
Cash and cash equivalents	42,315	10,079
Securites held to maturity	101,175	110,207
Securities available for sale	67,608	70,059
Loans, net	779,013	845,517
Premises and equipment, net	21,573	21,896
Other real estate owned	282	611
Accrued interest receivable	3,120	3,416
Federal Home Loan Bank Stock	4,964	7,028
Other assets	7,269	8,373
Total assets	\$ 1,027,319	\$ 1,077,186
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	\$ 166,888	\$ 163,587
Interest-bearing	646,064	693,667
Total deposits	812,952	857,254
Accrued interest payable	378	422
Trust preferred subordinated debentures	8,609	8,609
Other liabilities	2,865	2,420
Federal Home Loan Bank advances	80,000	90,000
Total liabilities	904,804	958,705
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, 2,000,000 total shares authorized:		
Series C cumulative perpetual preferred shares, \$1 par value, \$1,000 per share liquidation value; 24,500 shares issued and outstanding at June 30, 2017 and December 31, 2016	24,500	24,500
Common stock, par value \$1 per share, 10,000,000 shares authorized; 5,273,225 and 5,258,200 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	5,273	5,258
Additional paid-in capital	58,073	57,676
Retained earnings	34,655	31,512
Accumulated other comprehensive income (loss)	14	(465)
Total stockholders' equity	122,515	118,481
Total liabilities and stockholders' equity	\$ 1,027,319	\$ 1,077,186

See Notes to Consolidated Financial Statements

Sovereign Bancshares, Inc. and Subsidiaries

Consolidated Statements of Income (unaudited)
Six Months Ended June 30, 2017 and 2016
(In thousands)

	Six Months Ended June 30,	
	2017	2016
Interest income:		
Loans, including fees	\$ 19,022	\$ 18,767
Investment securities:		
Taxable	1,187	1,516
Nontaxable	1,108	1,197
Federal funds sold	86	46
Other	44	49
Total interest income	<u>21,447</u>	<u>21,575</u>
Interest expense:		
Deposits	2,800	2,405
Federal funds purchased	5	9
Trust preferred subordinated debentures	220	201
Federal Home Loan Bank advances	374	344
Total interest expense	<u>3,399</u>	<u>2,959</u>
Net interest income	18,048	18,616
Provision for loan losses	150	2,750
Net interest income after provision for loan losses	17,898	15,866
Noninterest income:		
Service charges and other fees	309	290
Net investment securities gains	—	1,048
Gain on sales of loans	95	576
Other	337	329
Total noninterest income	<u>741</u>	<u>2,243</u>
Noninterest expense:		
Salaries and employee benefits	7,569	7,581
Occupancy expense	1,574	1,658
Legal and professional fees	794	507
Deposit insurance assessment	364	448
Loan and repossessed asset expenses	178	442
Data processing	367	371
Telephone	328	317
Other	1,419	1,436
Total noninterest expense	<u>12,593</u>	<u>12,760</u>
Income before taxes	6,046	5,349
Income tax expense	1,801	1,544
Net income	\$ 4,245	\$ 3,805

See Notes to Consolidated Financial Statements.

Sovereign Bancshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (unaudited)
Six Months Ended June 30, 2017 and 2016
(In thousands)

	<u>Six Months Ended June 30,</u>	
	<u>2017</u>	<u>2016</u>
Net income	\$ 4,245	\$ 3,805
Other comprehensive income (loss) before tax:		
Net unrealized gains on available for sale securities arising during the year	988	844
Reclassification adjustment for amortization of unrealized losses on investment securities transferred to held to maturity from available for sale	(262)	(307)
Reclassification adjustment for net gains on sales of securities available for sale included in net income	—	(1,048)
Other comprehensive income (loss), before tax	726	(511)
Income tax expense (benefit)	247	(174)
Other comprehensive income (loss), net of tax	479	(337)
Comprehensive income	\$ 4,724	\$ 3,468

See Notes to Consolidated Financial Statements

Sovereign Bancshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity (unaudited)

Six Months Ended June 30, 2017

(In thousands, except shares)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2016	\$ 24,500	\$ 5,258	\$ 57,676	\$ 31,512	\$ (465)	\$ 118,481
Net Income	—	—	—	4,245	—	4,245
Other comprehensive income, net of tax	—	—	—	—	479	479
Stock-based compensation	—	—	106	—	—	106
Stock options exercised (15,025 shares)	—	15	291	—	—	306
Preferred Stock dividends	—	—	—	(1,102)	—	(1,102)
Balance at June 30, 2017	\$ 24,500	\$ 5,273	\$ 58,073	\$ 34,655	\$ 14	\$ 122,515

See Notes to Consolidated Financial Statements

Sovereign Bancshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (unaudited)
Six Months Ended June 30, 2017 and 2016
(In thousands)

	For the Six Months Ended	
	June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 4,245	\$ 3,805
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	336	366
Provision for loan losses	150	2,750
Net gain on sales of securities available for sale	—	(1,048)
Gain on sales of loans	(95)	(576)
Valuation adjustments on other real estate owned	329	—
Stock-based compensation expense	106	158
Net amortization of securities available for sale	179	275
Net amortization of securities held to maturity	778	963
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	1,400	1,852
Accrued interest payable and other liabilities	153	243
Net cash provided by operating activities	7,581	8,788
Cash flows from investing activities:		
Proceeds from sales of securities available for sale	—	41,121
Proceeds from calls, maturities and principal repayments of securities held to maturity	8,516	9,659
Proceeds from calls, maturities and principal repayments of securities available for sale	2,737	2,064
Net redemption (purchase) of FHLB stock	2,064	(48)
Net decrease (increase) in loans	66,449	(18,840)
Purchases of premises and equipment	(13)	(96)
Net cash provided by investing activities	79,753	33,860
Cash flows from financing activities:		
Net (decrease) increase in deposits	(44,302)	15,381
Net decrease in Federal Home Loan Bank advances	(10,000)	(40,000)
Preferred stock dividends paid	(1,102)	(172)
Proceeds from exercise of stock options and stock warrants	306	91
Net cash used in financing activities	(55,098)	(24,700)
Net increase in cash and cash equivalents	32,236	17,948
Cash and cash equivalents, beginning of period	10,079	14,241
Cash and cash equivalents, end of period	\$ 42,315	\$ 32,189

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Basis of presentation: The accompanying unaudited condensed consolidated financial statements include the accounts of Sovereign Bancshares, Inc. ("SBI") and its wholly owned subsidiary, Sovereign Bank ("Bank"). They are collectively referred to as the Company. All significant intercompany transactions and balances have been eliminated in consolidation.

Nature of business: The Bank is a state banking organization headquartered in Dallas, Texas and began operations on July 29, 2004. The Bank provides a full range of banking services to individual and corporate customers primarily in Dallas, Austin, and Houston, Texas and the surrounding areas.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the period. Accordingly, actual results could differ significantly from those estimates.

A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses. A significant portion of the Company's loan portfolio is collateralized by real estate and related assets located in local markets. Accordingly, the ultimate collectability of this portion of the Company's loan portfolio and the recovery of the carrying amount of other real estate owned are susceptible to changes in local market conditions.

Cash flow reporting: For purposes of reporting cash flow, cash equivalents include cash items, amounts due from banks and federal funds sold. Federal funds sold are normally sold for one-day periods.

Concentrations on cash equivalents: The Company maintains deposits with other financial institutions in amounts that exceed federal deposit insurance coverage. Furthermore, federal funds sold are essentially uncollateralized loans to other financial institutions. Management regularly evaluates the credit risk associated with the counterparties to these transactions.

Investment securities: Securities classified as available for sale are those that the Company intends to hold for an indefinite period of time, but not necessarily to maturity and are carried at fair value. Unrealized gains and losses on investments classified as available for sale have been accounted for as accumulated other comprehensive income (loss). Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors.

Securities classified as held to maturity are debt securities for which the Company has the positive intent and ability to hold to maturity and are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. Transfers of debt securities into the held to maturity category from the available for sale category are made at fair value at the date of transfer. The unrealized holding gain or loss at the date of transfer is retained in other comprehensive income and in the carrying value of the held to maturity securities. Such amounts are amortized over the remaining life of the security.

Interest income includes amortization of purchase premiums and discounts. Realized gains and losses on sales of securities are recorded on the trade date and are determined using the specific identification method. Declines in the fair value of available for sale securities and held to maturity securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other than temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Federal home loan bank stock: As a member of the Federal Home Loan Bank of Dallas (FHLB), the Company is required to maintain an investment in capital stock of the FHLB. FHLB stock does not have readily determinable fair values as ownership is restricted and lacks a ready market. As a result, this stock is carried at cost and evaluated periodically by management for impairment. No impairment was recorded during the periods.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge offs and the allowance for loan losses and deferred loan fees and deferred loan costs. Loan fees collected on loans with terms greater than twelve months are deferred, net of costs and recognized over the life of the loan. Interest income is accrued on the unpaid principal balance.

The accrual of interest is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. All interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reason for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify such loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Transfers of financial assets: Transfers of financial assets are accounted for as sales only when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company, (2) the transferee obtains the right to pledge or exchange the assets it received, and no condition both constrains the transferee from taking advantage of its right to pledge or exchange the assets it received, or provides more than a modest benefit to the transferor, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets. In addition, for transfers of a portion of financial assets (for example, participations of loan receivables), the transfer must meet the definition of a 'participating interest' in order to account for the transfer as a sale. Following are the characteristics of a 'participating interest':

- Pro-rata ownership in an entire financial asset.
- From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership.
- The rights of each participating interest holder have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder.
- No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

Allowance for loan losses: The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans.

The allowance, in the judgment of management, is necessary to reserve for estimated loan losses inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with ASC Topic 310, *Receivables* and allowance allocations calculated in accordance with ASC Topic 450, *Contingencies*. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions, and unidentified losses inherent in the current loan portfolio, as well as trends in the foregoing. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including but not limited to the performance of the loan portfolio, the economy, changes in interest rates, and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of two elements: (i) specific valuation allowances established for probable losses on impaired loans and (ii) historical valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted for general economic conditions and other qualitative risk factors both internal and external to the Company.

Premises and equipment: Land is carried at cost. Building and improvements, and furniture and equipment are carried at cost, less accumulated depreciation computed principally by the straight-line method based on the estimated useful lives of the related properties ranging from three to ten years. Leasehold improvements are generally depreciated over the lesser of the term of the respective leases or the estimated useful lives of the improvements.

Other real estate owned: Other real estate owned acquired through or instead of loan foreclosure is initially recorded at fair value when acquired, establishing a new cost basis. Costs after acquisition are expensed. If the fair value of the property declines, the value of the other real estate is reduced with a corresponding charge to earnings.

Income taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities (excluding deferred tax assets and liabilities related to components of other comprehensive income). Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and the tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years.

The Financial Accounting Standards Board (FASB) has issued guidance for how uncertain tax positions should be recognized, measured, disclosed and presented in the financial statements. This guidance requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company's federal and state tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained "when challenged" or "when examined" by the applicable tax authority. Tax positions deemed to meet the more-likely-than-not threshold would be recorded as a tax benefit or expense in the current year. The Company files income tax returns in U.S. federal jurisdiction and Texas. The Company classifies interest and, if applicable, penalties related to income tax liabilities as a component of income tax expense.

Fair value measurements: ASC Topic 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. In general, fair values are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that assets and liabilities are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Company's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time.

Share-based payment: Share-based payments to employees, including grants of employee stock options, warrants and restricted stock, are valued at fair value on the grant date and expensed over the applicable vesting period.

Comprehensive income (loss): Comprehensive income (loss) includes all changes in stockholders' equity during a period, except those resulting from transactions with stockholders. Besides net income, other components of the Company's comprehensive income include the after tax effect of changes in the net unrealized gain/loss on securities available for sale and amortization of unrealized losses on investment securities transferred to held to maturity from available for sale.

Contingencies: Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed.

Reclassification: Certain amounts previously reported have been reclassified to conform to current year presentation. These reclassifications had no effect on previously reported stockholders' equity or net income.

Subsequent events: The Company has evaluated subsequent events through July 28, 2017, the date on which the financial statements were available to be issued.

Pending Merger with Veritex Holdings, Inc.: On December 14, 2016, the Company entered into a definitive agreement ("the merger agreement") with Dallas-based Veritex Holdings, Inc. ("Veritex") and its wholly-owned subsidiary Veritex Community Bank. The merger agreement provides for the merger of Spartan Merger Sub, Inc., a wholly owned subsidiary of Veritex, with and into the Company. Following the merger, the Company will merge with and into Veritex with Veritex surviving and Sovereign Bank will merge with and into Veritex Community Bank with Veritex Community Bank surviving. Under the terms of the merger agreement, Veritex will issue 5,117,647 shares of its common stock and will pay approximately \$58.0 million in cash for all of the shares of the Company's common stock, subject to certain conditions and potential adjustments as described in the merger agreement.

Additionally, under the terms of the merger agreement, each of the Company's 24,500 shares of senior Non-Cumulative Perpetual Preferred Stock, Series C, no par value ("Sovereign SBLF Preferred Stock") issued and outstanding immediately prior to the effective time shall be converted into one share of Senior Non-Cumulative Perpetual, Series D preferred stock of Veritex ("Veritex Series D Preferred Stock"). Each share of the Veritex Series D Preferred Stock would provide the same rights, preferences, privileges and voting powers, and be subject to the same limitations and restrictions, as Sovereign SBLF Preferred Stock, taken as a whole, existing immediately prior to the consummation of the merger. In connection with consummation of the transaction, the merger agreement provides that two representatives of the Company's board of directors will join Veritex's board of directors. The merger agreement contains customary representations, warranties and covenants by Veritex and the Company. On April 6, 2017, Veritex and the Company each held a special meeting of its shareholders where Veritex's shareholders approved the issuance of the shares of common stock and Sovereign's shareholders approved the merger agreement. On July 7, 2017, Veritex received regulatory approval from the Board of Governors of the Federal Reserve System and the merger is expected to close on or about August 1, 2017, subject to the satisfaction or waiver of the customary closing conditions outlined in the merger agreement.

New authoritative accounting guidance:

ASU 2016-13 "Financial Instruments -Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13") amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, Topic 326 eliminates the probable initial recognition threshold in current GAAP and, instead, requires an entity to reflect its current estimate of all expected credit losses. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected. For available for sale debt securities, credit losses should be measured in a manner similar to current GAAP, however Topic 326 will require that credit losses be presented as an allowance rather than as a write-down. This Accounting Standards Update affects entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. For public business entities, this ASU is effective for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods therein. The Company is in process of evaluating the impact of this pronouncement.

ASU 2016-09 "Compensation -Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09") simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public business entities, this ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods therein. The Company adopted this pronouncement as of January 1, 2017 and there was no material impact.

ASU 2016-02 "Leases (Topic 842)" is intended to improve the reporting of leasing transactions to provide users of financial statements with more decision-useful information. ASU 2016-02 will require organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is in process of evaluating the impact of this pronouncement, which is not expected to have a significant impact on the consolidated financial statements.

ASU 2016-01 "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01") amends certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01, among other things, i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. This update will be effective for the Company on January 1, 2018. The Company is in process of evaluating the impact of this pronouncement, which is not expected to have a significant impact on the consolidated financial statements.

ASU 2014-09 "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09") implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 establishes a five-step model which entities must follow to recognize revenue and removes inconsistencies and weaknesses in existing guidance. The original effective date for ASU 2014-09 was for annual and interim periods beginning after December 15, 2016. However, in August 2015, the FASB issued ASU 2015-14, which deferred the effective date by one year, therefore it is now effective for interim and annual reporting periods beginning after December 15, 2017. The

Company's is continuing to evaluate the impact that ASU 2014-09 with the expectation to adopt the standard in the first quarter of 2018. This new standard would have an impact on components of non-interest income, however the Company's preliminary analysis suggests that the adoption of this accounting guidance is not expected to have a material impact on the Company's consolidated financial statements.

Note 2. Statements of Cash Flows

The Company reports on a net basis its cash receipts and cash payments for time deposits accepted and repayments of those deposits, loans made to customers and principal collections on those loans, interest-bearing deposits in other banks, and short-term borrowings. The Company uses the indirect method to present cash flows from operating activities. Other supplemental cash flow information for the six months ended June 30, 2017 and 2016 is presented as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Cash paid for interest	<u>\$ 3,443</u>	<u>\$ 2,888</u>
Cash paid for taxes	<u>\$ 1,250</u>	<u>\$ —</u>

Note 3. Securities

The amortized cost of securities and their approximate fair values at June 30, 2017 and December 31, 2016 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>Securities Held to Maturity</u>				
June 30, 2017:				
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	\$ 103,661	\$ 25	\$ (1,497)	\$ 102,189
	<u>\$ 103,661</u>	<u>\$ 25</u>	<u>\$ (1,497)</u>	<u>\$ 102,189</u>
<u>Securities Available for Sale</u>				
June 30, 2017:				
Municipal securities	\$ 60,758	\$ 2,524	\$ —	\$ 63,282
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	4,343	6	(23)	4,326
	<u>\$ 65,101</u>	<u>\$ 2,530</u>	<u>\$ (23)</u>	<u>\$ 67,608</u>
<u>Securities Held to Maturity</u>				
December 31, 2016:				
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	\$ 112,955	\$ 22	\$ (3,188)	\$ 109,789
	<u>\$ 112,955</u>	<u>\$ 22</u>	<u>\$ (3,188)</u>	<u>\$ 109,789</u>
<u>Securities Available for Sale</u>				
December 31, 2016:				
Municipal securities	\$ 62,979	\$ 2,103	\$ —	\$ 65,082
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	5,037	14	(74)	4,977
	<u>\$ 68,016</u>	<u>\$ 2,117</u>	<u>\$ (74)</u>	<u>\$ 70,059</u>

During June of 2014, the Company transferred investment securities with an amortized cost of approximately \$172,235,000 and unrealized losses of approximately \$4,453,000 from classification as available for sale to held to maturity. The unrealized loss at the time of transfer is amortized over the remaining life of the securities. The remaining unamortized balance of unrealized losses was \$2,486,000 and \$2,748,000 at June 30, 2017 at December 31, 2016, respectively.

Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2017 and December 31, 2016, are summarized as follows (in thousands):

Description of Securities	Continuous Unrealized Losses Existing for Less than 12 Months		Continuous Unrealized Losses Existing for Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2017:				
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC:				
Securities held to maturity	\$ 61,414	\$ 691	\$ 35,803	\$ 806
Securities available for sale	3,601	23	—	—
	\$ 65,015	\$ 714	\$ 35,803	\$ 806
December 31, 2016:				
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC:				
Securities held to maturity	\$ 68,720	\$ 1,735	\$ 38,336	\$ 1,453
Securities available for sale	3,950	74	—	—
	\$ 72,670	\$ 1,809	\$ 38,336	\$ 1,453

For all of the above investment securities, the unrealized losses are generally due to changes in interest rates and, as such, are considered by the Company to be temporary.

The scheduled maturities of securities at June 30, 2017 are shown below (in thousands). Expected maturities of pass-through securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Held to Maturity	
	Amortized Cost	Estimated Fair Value
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	\$ 103,661	\$ 102,189
	<u>\$ 103,661</u>	<u>\$ 102,189</u>
	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due 3 months or less	\$ 1,957	\$ 1,972
Due after 3 months through 1 year	1,996	2,039
Due after one year through 5 years	17,803	18,614
Due after five years through 10 years	25,819	26,916
Due after ten years	13,183	13,741
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA and SBIC	4,343	4,326
	<u>\$ 65,101</u>	<u>\$ 67,608</u>

There were no pledged investment securities at June 30, 2017 or December 31, 2016.

Proceeds from the sales of investment securities available for sale and gross realized gains and losses for the six months ended June 30, 2017 and 2016 are as follows (in thousands):

	2017	2016
Proceeds from sales	\$ —	\$ 41,121
Gross realized gains	\$ —	\$ 1,048
Gross realized losses	\$ —	\$ —

Note 4. Loans and Allowance for Loan Losses

Loans by portfolio segment and class at June 30, 2017 and December 31, 2016 consisted of the following (in thousands):

	2017	2016
Real estate:		
Construction	\$ 137,520	\$ 133,471
Residential	17,317	16,233
Owner occupied	123,982	137,298
Commercial and farmland	280,911	315,686
Commercial:		
Financial and agricultural	165,746	176,900
Energy	63,794	74,960
Consumer and other loans	3,416	5,129
	<u>792,686</u>	<u>859,677</u>
Unearned loan fees	(2,783)	(3,389)
Allowance for loan losses	<u>(10,890)</u>	<u>(10,771)</u>
	<u>\$ 779,013</u>	<u>\$ 845,517</u>

To determine an appropriate allowance, management separates loans into separate categories based on similar risk characteristics. These categories and their risk characteristics are described below:

- *Real estate - construction:* This category consists of loans secured by real estate under construction or land development, both commercial and residential. Construction and land development loans can carry additional risk of repayment from several different factors influencing the completion of the project on time and on budget. Other risks involved are market driven through real estate values and long-term financing options. As such, the Company takes additional steps to insure that sufficient equity is required, underwriting supports the project, and secondary sources of repayment are identified. This category also consists of loans secured by vacant land, which includes developed commercial land, undeveloped commercial land, rural land, single family residential lots, and lot development loans. These types of loans require larger down payments to help mitigate the risk.
- *Real estate - residential:* This category consists of loans secured by some form of both owner-occupied and non-owner occupied residential real estate. The category includes loans for 1-4 family home construction, home improvement, home equity lines of credit, closed-end financing for 1-4 family properties, and financing for multi-family residential properties. The overall credit risk in this segment of the loan portfolio is low given the nature of the collateral and the Company's strict underwriting standards for this type of financing. The Company does not originate sub-prime mortgage loans. The higher risk area of this category is the non-owner occupied portion of these loans, which are often reliant on rental income as the primary source of repayment.
- *Real estate - owner occupied:* This category consists of loans secured by commercial buildings that are occupied by companies that are run by the borrower or guarantors on the loan. These loans are lower risk than the non owner occupied loans because the borrower or guarantor has a personal interest in the success of the tenant company. In addition, more in-depth financial information can be obtained to help management evaluate the business and its profitability.
- *Real estate - commercial and farmland:* This category consists of loans secured by income-producing commercial buildings such as shopping centers, office buildings, office warehouse buildings, hotels, and multi-family properties. These loans carry a higher risk than owner-occupied properties because the repayment is based on the successful operations of the tenants and may be subject to adverse conditions in the real estate

market and/or general economy. A substantial majority of these loans have adequate secondary sources of repayment through financially strong guarantors that are well known to the Company.

- *Commercial - financial and agricultural:* This category consists of all business loans and leases secured by assets other than the business real estate. A substantial majority of these loans are secured by equipment, accounts receivable, and inventory. The primary risk involved with this category is that the loans and leases are typically secured by depreciable assets that may not provide an adequate source of repayment if the loan goes into default. However, the Company's very conservative underwriting standards and credit culture help mitigate risk.
- *Commercial - energy:* Energy loans are credits extended to businesses deriving a majority of their revenues from the sale of oil and gas related products or whose credit requires a technical evaluation of oil and gas reserves or where the forecasting and analysis of oil and gas prices directly impacts credit quality. The Energy Industry can be divided into three segments: Upstream (Oil and gas exploration and production or [E&P]); Midstream (refining, gathering, processing); and Downstream (selling product to end users). Integrated oil companies are generally involved in all three segments. The other oil and gas companies are involved in the upstream segment and may also be involved in midstream and downstream segments. Energy lending at Sovereign Bank focuses its efforts on upstream and midstream E&P companies. Loans are secured by proven, producing oil and gas reserves.
- *Consumer and other loans:* This category of loans includes all other forms of consumer debt, including automobiles, recreational vehicles, debt consolidation, household or personal use, education, taxes, and investments. A large majority of the loans in this category are relatively short-term loans secured by new and used automobiles, recreational vehicles, and bank certificates of deposit.

As part of the management of the loan portfolio, risk ratings are assigned to all loans. Through the loan review process, ratings are modified as believed to be appropriate to reflect changes in the credit. Lending is an important activity for the bank and represents a major asset commitment. The loan review function represents a significant self-monitoring process to ensure, across the organization, the quality of loans meets or exceeds corporate credit standards. The loan review team evaluates various related risks and management techniques involved with loan activities.

In order to manage credit risk, credit administration assigns a credit risk rating to each loan at the time of origination and reviews loans on a regular basis to determine each loan's credit risk rating on a scale of 1 through 10, with higher scores indicating higher risk. Creditworthiness of the borrower is the primary determinant in the assignment of risk ratings. In certain cases, however, risks inherent in the transaction itself may influence the final rating. The final rating should be the product of careful evaluation derived from an overall assessment of such factors as creditworthiness, structure and any unusual features.

- *1-6 - pass ratings:* Risk ratings from 1-6 are all "Pass" ratings and represent the loans considered acceptable to the bank. The ratings range from 1 being the Highest Quality to 6 being Minimum Acceptable Quality (including a 6 - pass/watch rating). All ratings reflect loans with a good primary and secondary source of repayment and/or well collateralized. While the availability varies within the Pass categories, borrowers typically have access to alternative financial markets.
- *7 - special mention:* A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the bank's credit position at some future date. Special Mention assets are not adversely classified and do not expose the bank to sufficient risk to warrant adverse classification.

The Special Mention category is not to be used to identify an asset that has as its sole weakness credit data exceptions, collateral documentation exceptions or other account management weaknesses where the exceptions/weaknesses are not material to the repayment of the loan.

- *8 - substandard:* The loan is inadequately protected by the current worth and paying capacity of the obligor or of the collateral pledged, if any. There are well-defined weaknesses that jeopardize the repayment of the debt.

Although loss may not be imminent, if the weaknesses are not corrected, there is a good possibility that the bank will sustain some loss. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified Substandard.

- *9 - doubtful:* The loan has the weaknesses of those in the classification of Substandard, one or more of which make collection or liquidation in full, on the basis of currently ascertainable facts, conditions and values, highly questionable or improbable. The possibility of loss is extremely high, but certain identifiable contingencies that are reasonably likely to materialize may work to the advantage and strengthening of the loan, such that it is reasonable to defer its classification as a loss until its more exact status may be determined. Contingencies that may call for deferral of loss classification include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on addition collateral and refinancing plans.

Loans in this classification are normally carried on interest non-accrual, and interest received is applied to reduce principal. Credits rated Doubtful are reviewed frequently to determine if events that might require a change in rating upward or downward have taken place.

- *10 - loss:* Loans in this classification are considered uncollectible and of such little value that their continued classification as bankable assets is not warranted. This classification does not mean the loan has absolutely no recovery or salvage value, but that it is neither practical nor desirable to defer writing off this basically worthless loan even though partial recovery may be affected in the future.

The following table presents the recorded investment in loans receivable (in thousands) by credit quality indicator as of June 30, 2017 and December 31, 2016:

	Pass (Rating 1-6)	Special Mention (Rating 7)	Substandard (Rating 8)	Doubtful (Rating 9)	Total
2017:					
Real estate:					
Construction	\$ 137,520	\$ —	\$ —	\$ —	\$ 137,520
Residential	17,317	—	—	—	17,317
Owner occupied	102,468	12,449	9,065	—	123,982
Commercial and farmland	278,137	2,774	—	—	280,911
Commercial:					
Financial and agricultural	154,551	10,890	305	—	165,746
Energy	34,962	9,412	19,420	—	63,794
Consumer and other loans	3,352	—	64	—	3,416
	\$ 728,307	\$ 35,525	\$ 28,854	\$ —	\$ 792,686
2016:					
Real estate:					
Construction	\$ 133,471	\$ —	\$ —	\$ —	\$ 133,471
Residential	16,233	—	—	—	16,233
Owner occupied	127,677	99	9,522	—	137,298
Commercial and farmland	310,363	—	5,323	—	315,686
Commercial:					
Financial and agricultural	164,538	9,712	2,650	—	176,900
Energy	35,160	19,869	19,931	—	74,960
Consumer and other loans	4,999	—	130	—	5,129
	\$ 792,441	\$ 29,680	\$ 37,556	\$ —	\$ 859,677

The Company's activity in the allowance for loan losses for the six months ended June 30, 2017 and year ended December 31, 2016 by portfolio segment and disaggregated on the basis of the Company's impairment methodology is as follows (in thousands):

	Real Estate			Commercial			Consumer and Other Loans	Total
	Construction	Residential	Owner Occupied	Commercial and Farmland	Financial and Agricultural	Energy		
2017:								
Beginning balance	\$ 1,536	\$ 140	\$ 1,246	\$ 2,776	\$ 1,966	\$ 3,025	\$ 83	\$ 10,772
Charge-offs	—	—	—	—	—	—	(31)	(31)
Recoveries	—	—	—	—	—	—	—	—
Provision	66	11	(116)	(361)	73	494	(18)	149
Ending balance	\$ 1,602	\$ 151	\$ 1,130	\$ 2,415	\$ 2,039	\$ 3,519	\$ 34	\$ 10,890
Period-end amount allocated to:								
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ 193	\$ 2,800	\$ —	\$ 2,993
Loans collectively evaluated for impairment	1,602	151	1,130	2,415	1,846	719	34	7,897
Ending balance	\$ 1,602	\$ 151	\$ 1,130	\$ 2,415	\$ 2,039	\$ 3,519	\$ 34	\$ 10,890
Loans:								
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ 305	\$ 11,617	\$ 29	\$ 11,951
Loans collectively evaluated for impairment	137,520	17,317	123,982	280,911	165,441	52,177	3,387	780,735
Ending balance	\$ 137,520	\$ 17,317	\$ 123,982	\$ 280,911	\$ 165,746	\$ 63,794	\$ 3,416	\$ 792,686
2016:								
Beginning balance	\$ 1,761	\$ 134	\$ 793	\$ 1,558	\$ 1,962	\$ 4,655	\$ 63	\$ 10,926
Charge-offs	—	—	—	—	—	(2,955)	(3)	(2,958)
Recoveries	—	—	—	—	54	—	—	54
Provision	(225)	6	453	1,218	(50)	1,325	23	2,749
Ending balance	\$ 1,536	\$ 140	\$ 1,246	\$ 2,776	\$ 1,966	\$ 3,025	\$ 83	\$ 10,771
Period-end amount allocated to:								
Loans individually evaluated for impairment	\$ —	\$ —	\$ 3	\$ 27	\$ 14	\$ 2,181	\$ 34	\$ 2,259
Loans collectively evaluated for impairment	1,536	140	1,242	2,749	1,952	844	49	8,512
Ending balance	\$ 1,536	\$ 140	\$ 1,245	\$ 2,776	\$ 1,966	\$ 3,025	\$ 83	\$ 10,771
Loans:								
Loans individually evaluated for impairment	\$ —	\$ —	\$ 311	\$ 2,803	\$ 1,439	\$ 12,050	\$ 91	\$ 16,694
Loans collectively evaluated for impairment	133,471	16,233	136,987	312,883	175,461	62,910	5,038	842,983
Ending balance	\$ 133,471	\$ 16,233	\$ 137,298	\$ 315,686	\$ 176,900	\$ 74,960	\$ 5,129	\$ 859,677

The following table presents the past due aging of the recorded investment in loans and loans on nonaccrual status as of June 30, 2017 and December 31, 2016 (in thousands):

	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Past Due	Total Past Due Loans	Non-Accrual Loans
2017:					
Real estate:					
Construction	\$ —	\$ —	\$ —	\$ —	—
Residential	—	—	305	305	—
Owner occupied	—	9,065	—	9,065	—
Commercial and farmland	—	—	—	—	—
Commercial:					
Financial and agricultural	—	—	—	—	305
Energy	6,824	—	9,231	16,055	9,231
Consumer and other loans	—	—	—	—	—
	\$ 6,824	\$ 9,065	\$ 9,536	\$ 25,425	\$ 9,536
2016:					
Real estate:					
Construction	\$ —	\$ —	\$ —	\$ —	—
Residential	—	—	—	—	—
Owner occupied	9,211	—	—	9,211	—
Commercial and farmland	—	2,520	—	2,520	—
Commercial:					
Financial and agricultural	3,256	99	—	3,355	—
Energy	—	—	9,569	9,569	9,569
Consumer and other loans	—	53	38	91	38
	\$ 12,467	\$ 2,672	\$ 9,607	\$ 24,746	\$ 9,607

The following table presents loans identified as impaired by class of loans as of June 30, 2017 and December 31, 2016 (in thousands):

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized on Impaired Loans
2017:							
Real estate:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	—
Residential	—	—	—	—	—	—	—
Owner occupied	—	—	—	—	—	—	—
Commercial and farmland	—	—	—	—	—	—	—
Commercial:							
Financial and agricultural	305	—	305	305	—	675	—
Energy	11,617	—	11,617	11,617	3	11,796	72
Consumer and other loans	29	—	29	29	—	68	1
	\$ 11,951	\$ —	\$ 11,951	\$ 11,951	\$ 3	\$ 12,539	\$ 73
2016:							
Real estate:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	—
Residential	—	—	—	—	—	—	—
Owner occupied	311	—	311	311	3	315	78
Commercial and farmland	2,803	—	2,803	2,803	27	2,837	183
Commercial:							
Financial and agricultural	1,439	—	1,439	1,439	14	1,575	59
Energy	12,050	—	12,050	12,050	2,182	14,232	196
Consumer and other loans	91	—	91	91	33	18	1
	\$ 16,694	\$ —	\$ 16,694	\$ 16,694	\$ 2,259	\$ 18,977	\$ 517

A loan is considered a troubled debt restructuring (TDR) if the Company, for economic or legal reasons related to a debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Concessions granted under a TDR typically involve a temporary or permanent reduction in the interest rate at less than a current market rate of interest or an extension of a loan's stated maturity date. Loans classified as TDR's are designated as impaired.

Three impaired loans totaling approximately \$2,368,000 and three impaired loans totaling approximately \$5,237,000 were accounted for as troubled debt restructurings as of June 30, 2017 and December 31, 2016, respectively. There were no TDRs that defaulted during the period ending June 30, 2017 and year ended December 31, 2016.

Note 5. Federal Home Loan Bank Advances

The Company periodically borrows from the Federal Home Loan Bank (FHLB) of Dallas. These advances are collateralized by approximately \$321,173,000 of loans and \$100,816,000 of investment securities and FHLB stock at June 30, 2017 and \$342,286,000 of loans and \$109,295,000 of investment securities and FHLB stock at December 31, 2016. The advances may be prepaid at any time, but such prepayment may be subject to a penalty or benefit depending upon the movement in market interest rates.

The maturities of FHLB advances are as follows (in thousands):

Maturity	Interest Rate	Principal Balance
July 7, 2017	1.34%	\$ 10,000
July 13, 2017	1.1%	10,000
July 21, 2017	1.11%	10,000
July 26, 2017	1.32%	10,000
July 31, 2017	1.31%	10,000
August 9, 2017	1.15%	10,000
August 14, 2017	1.19%	10,000
August 21, 2017	1.25%	10,000
		\$ 80,000

Note 6. Trust Preferred Subordinated Debentures

In May 2008, the Company, in a private placement, issued \$8,350,000 (8,350 shares with a liquidation amount of \$1,000 per security) of Floating Rate Cumulative Trust Preferred Securities (TruPS) through a newly formed, unconsolidated, wholly-owned subsidiary, SovDallas Capital Trust I (the Trust). The Company has an investment in 100% of the common shares of the Trust totaling \$259,000. The Trust invested the total proceeds from the sale of the TruPS and the investment in common shares in floating rate Junior Subordinated Debentures (the Debentures) issued by the Company. The terms of the Debentures are such that they qualify as Tier I capital under the Federal Reserve Board's regulatory capital guidelines applicable to bank holding companies. Interest on the TruPS is payable quarterly at a rate equal to 3 month LIBOR plus 4.0% (5.15% at June 30, 2017). Principal payments are due at maturity in July 2038. The TruPS are guaranteed by the Company and are subject to redemption. The Company may redeem the debt securities, in whole or in part, at any time at an amount equal to the principal amount of the debt securities being redeemed plus any accrued and unpaid interest.

Note 7. Income Taxes

The Company's estimated annual effective tax rate was approximately 29.8% and 28.9% for the six months ended June 30, 2017 and 2016. For the six months ended June 30, 2017 and 2016, the effective tax rate is below the statutory rate, primarily because of tax-exempt income generated from municipal securities. The increase in the effective tax rate from the six months ended June 30, 2016 was affected primarily by a decrease in municipal securities.

Note 8. Financial Instruments

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. At June 30, 2017 and December 31, 2016, the approximate amounts of these financial instruments were as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 221,372	\$ 242,306
Standby letters of credit	3,260	3,258
	<u>\$ 224,632</u>	<u>\$ 245,564</u>

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

Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount shown in the table above. If the commitment is funded, the Company would be entitled to seek recovery from the customer. As of June 30, 2017 and December 31, 2016, no amounts have been recorded as liabilities for the Company's potential obligations under these guarantees.

Note 9. Stock Compensation

Stock options: Under the Company's Employee Stock Option Plan, the Company may grant options and warrants to its directors, officers and employees for up to 1,098,113 shares of common stock, of which 493,164 remain to be granted. Both incentive stock options and nonqualified stock options may be granted under the Plan. The exercise price of each option equals the market price of the Company's stock on the date of grant and an option's maximum term is 10 years. Vesting periods range from immediate to five years from the date of grant.

The summary of stock option activity for the periods ended June 30, 2017 and 2016 follows:

	2017		2016	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	45,720	21.48	108,199	\$ 21.12
Exercised	(15,025)	20.41	(6,000)	15.00
Forfeited	—	—	(56,479)	21.48
Outstanding, end of year	<u>30,695</u>	<u>\$ 22.00</u>	<u>45,720</u>	<u>\$ 21.48</u>
Options exercisable	<u>30,695</u>	<u>\$ 22.00</u>	<u>45,720</u>	<u>\$ 21.48</u>
Weighted average remaining contractual life of options:				
Outstanding	.87 years		1.53 years	
Exercisable	.87 years		1.53 years	

The intrinsic value of options exercised during 2017 and 2016 was approximately \$234,000 and \$89,000, respectively. The intrinsic value of options outstanding at June 30, 2017 was approximately \$430,000.

No options were granted in 2017 or 2016. At June 30, 2017, there was no unrecognized compensation cost related to option compensation arrangements. No compensation expense related to option compensation arrangements was recognized during the six months ended June 30, 2017 and 2016.

Deferred stock: At June 30, 2017 and 2016, certain officers had outstanding deferred stock awards totaling 60,000 and 80,000 shares of common stock, respectively with values ranging from \$14.42 to \$29.82 per share at the date of grant. No deferred stock awards were granted in 2017 or 2016. The deferred stock awards have varying terms and vest various years from the date of grant. The grant of shares will take place following a “deferral period” or upon employee termination or change of control. Upon employee termination, shares will be granted based on the number of shares vested at the time of termination. Upon change in control, the shares vest immediately. The holders of the awards have no rights of a stockholder until shares are granted following the deferral period.

Total compensation expense related to these deferred stock awards totaled \$106,000 and \$158,000 during the first six months of 2017 and 2016, respectively. At June 30, 2017, future compensation expense related to deferred stock awards is approximately \$393,000 and will be recognized over a remaining weighted average period of 2.14 years.

Note 10. Regulatory Matters

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. Regulatory approval would be required for any dividends or other distributions to be made by the Bank during the time an accumulated deficit exists.

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

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes as of June 30, 2017 and December 31, 2016, that the Bank met all capital adequacy requirements to which it is subject.

At June 30, 2017 and December 31, 2016, the Bank's capital ratios exceeded those levels necessary to be categorized as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bank must maintain minimum total risk based, Tier I risk based, and Tier I leverage ratios as set forth in the following table. At June 30, 2017 and December 31, 2016, the Company met all capital requirements under the regulatory framework specified by the Federal Reserve Board. Management is not aware of any conditions subsequent to June 30, 2017 that would change the Bank's capital category.

The Company's and the Bank's actual capital amounts and ratios are presented in the following table (dollar amounts in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	June 30, 2017:					
Total capital (to risk weighted assets):						
Consolidated	\$ 141,741	15.04%	\$ 75,380	8.00%	N/A	N/A
Bank	140,900	14.96%	75,336	8.00%	94,170	10.00%
Tier I capital (to risk weighted assets):						
Consolidated	\$ 130,851	13.89%	\$ 56,535	6.00%	N/A	N/A
Bank	130,010	13.81%	56,502	6.00%	75,336	8.00%
Common equity (to risk weighted assets):						
Consolidated	\$ 98,001	10.40%	\$ 42,401	4.50%	N/A	N/A
Bank	130,010	13.81%	42,376	4.50%	61,210	6.50%
Tier I capital (to average assets):						
Consolidated	\$ 130,851	12.57%	\$ 41,628	4.00%	N/A	N/A
Bank	130,010	12.50%	41,597	4.00%	51,997	5.00%
December 31, 2016:						
Total capital (to risk weighted assets):						
Consolidated	\$ 138,068	13.57%	\$ 81,373	8.00%	N/A	N/A
Bank	137,362	13.52%	81,308	8.00%	101,635	10.00%
Tier I capital (to risk weighted assets):						
Consolidated	\$ 127,296	12.51%	\$ 61,029	6.00%	N/A	N/A
Bank	126,591	12.46%	60,981	6.00%	81,308	8.00%
Common equity (to risk weighted assets):						
Consolidated	\$ 94,446	9.29%	\$ 45,772	4.50%	N/A	N/A
Bank	126,591	12.46%	45,736	4.50%	66,063	6.50%
Tier I capital (to average assets):						
Consolidated	\$ 127,296	11.55%	\$ 44,100	4.00%	N/A	N/A
Bank	126,591	11.49%	44,069	4.00%	55,087	5.00%

In July 2013, the FDIC and other regulatory bodies issued final rules consisting of minimum requirements that increased both the quantity and quality of capital held by banking organizations. The final rules are a result of the implementation of the BASEL III capital reforms and various Dodd-Frank Act related capital provisions and impact all U.S. banking organizations with more than \$500 million in assets. Consistent with the Basel international framework, the new rule includes a new minimum ratio of common equity tier 1 to risk-weighted assets of 4.5 percent and a common equity

tier 1 capital conservation buffer of 2.5 percent of risk-weighted assets. The rule also raised the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent and includes a minimum leverage ratio of 4 percent for all banking organizations. Regarding the quality of capital, the new rule emphasizes common equity tier 1 capital and implements strict eligibility criteria for regulatory capital instruments. The new rule also improves the methodology for calculating risk-weighted assets to enhance risk sensitivity. The new rule is subject to a four year phase in period for mandatory compliance and the Company began to phase in the new rules beginning on January 1, 2015.

Note 11. Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

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

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

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

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

During 2017 there were no changes in valuation methodologies compared to 2016 and there were no transfers between levels.

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

	Assets/ Liabilities Measured at Fair Value	Fair Value Measurements at Reporting Date		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2017:				
Measured on a recurring basis:				
Assets:				
Municipal securities	\$ 63,282	\$ —	\$ 63,282	\$ —
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA, and SBIC	4,326	—	4,326	—
December 31, 2016:				
Measured on a recurring basis:				
Assets:				
Municipal securities	\$ 65,082	\$ —	\$ 65,082	\$ —
Pass-through securities guaranteed by FNMA, GNMA, FHLMC, SBA, and SBIC	4,977	—	4,977	—

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

The Company has no nonfinancial assets or nonfinancial liabilities measured at fair value on a recurring basis.

The following table presents assets measured at fair value on a nonrecurring basis (in thousands):

	Assets/ Liabilities Measured at Fair Value	Fair Value Measurements at Reporting Date			Net Change During Period
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
June 30, 2017:					
Measured on a nonrecurring basis:					
Assets:					
Impaired loans	\$ 11,951	\$ —	\$ —	\$ 11,951	805
December 31, 2016:					
Measured on a nonrecurring basis:					
Assets:					
Impaired loans	\$ 15,691	\$ —	\$ —	\$ 15,691	(163)

Certain impaired loans are reported at the fair value of underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on the fair value of the collateral discounted

based on internal criteria. Impaired loans are primarily comprised of collateral-dependent commercial and real estate loans.

Other real estate owned is measured at fair value on a nonrecurring basis (subsequent to initial recognition). Other real estate owned is classified within Level 3 of the valuation hierarchy. When transferred from the loan portfolio, other real estate is adjusted to and subsequently carried at fair value less estimated selling costs. The fair value is determined using an external appraisal process, discounted based on internal criteria.

The methods and assumptions used by the Bank in estimating fair values of financial instruments other than those measured at fair value on a recurring and nonrecurring basis discussed above, are as follows:

Cash and cash equivalents: The carrying amounts of cash, due from banks, and federal funds sold approximate their fair value.

Loans: The fair value for all fixed-rate loans is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality. The estimated fair value for variable rate loans is the carrying amount.

Federal Home Loan Bank stock: The carrying amount of Federal Home Loan Bank stock approximates its fair value.

Deposits: The fair values disclosed for demand deposits with no defined maturities are equal to their carrying amounts which are payable on demand. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Trust preferred subordinated debentures: It is not practicable to estimate the fair value of trust preferred subordinated debentures as there are currently no transactions of similar instruments.

Federal Home Loan Bank advances and federal funds purchased: The carrying amounts of variable rate borrowings approximate their fair values. The fair value of fixed rate borrowings is estimated based on the present value of expected cash flows using current interest rates for similar financial instruments.

Accrued interest receivable and payable: The carrying amounts of accrued interest approximate their fair values.

Off-balance sheet instruments: Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and the counterparties' credit standings.

The estimated fair value of the Company's financial instruments were as follows at June 30, 2017 and December 31, 2016 (in thousands):

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 42,315	\$ 42,315	\$ 10,079	\$ 10,079
Securities held to maturity	101,175	102,189	110,207	109,789
Securities available for sale	67,608	67,608	70,059	70,059
Loans, net	779,013	778,071	845,517	844,764
Federal Home Loan Bank stock	4,964	4,964	7,028	7,028
Accrued interest receivable	3,120	3,120	3,416	3,416
Financial liabilities:				
Deposits	812,952	813,150	857,254	857,421
Federal Home Loan Bank advances	80,000	80,030	90,000	90,003
Accrued interest payable	378	378	422	422
Off-balance sheet assets (liabilities):				
Commitments to extend credit	—	—	—	—
Standby letters of credit	—	—	—	—

Note 12. Capital Requirements

Small business lending fund preferred stock: On September 22, 2011, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with the Secretary of the United States Treasury (the "Secretary"), pursuant to which the Company issued 24,500 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series C (the "Series C Preferred Stock"), having a liquidation amount per share equal to \$1,000, for a total purchase price of \$24,500,000. The Purchase Agreement was entered into, and the Series C Preferred Stock was issued, as authorized by the Small Business Lending Fund program (SBLF).

The Series C Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, as a percentage of the liquidation amount, fluctuated on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock was outstanding, based upon changes in the level of "Qualified Small Business Lending" or "QSBL" by the Bank. Based upon the increase in the Bank's level of QSBL over the baseline level calculated under the terms of the Purchase Agreement, the dividend rate for the initial dividend period was set at 5%. For the second through tenth calendar quarters, the dividend rate fluctuated between 1% and 5% per annum, to reflect the amount of change in the Bank's level of QSBL. For the eleventh calendar quarter through four and one half years after issuance, the dividend rate is fixed at 1% based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to 9%. In addition, beginning on January 1, 2014, and on all Series C Preferred Stock dividend payment dates thereafter ending on April 1, 2016, the Company will be required to pay a fee equal to 0.5% of the liquidation amount per share of Series C Preferred Stock if the amount of eligible loans falls below the baseline.

The Series C Preferred Stock is non-voting, except in limited circumstances. The Series C Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of our federal banking regulator. The Company is permitted to repay its SBLF funding in increments of 25% or \$5.0 million, subject to the approval of the Company's federal banking regulator.

The Series C Preferred Stock was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Series C Preferred Stock is not subject to any contractual restrictions on transfer.

UNAUDITED PRO FORMA COMBINED CONSOLIDATED FINANCIAL STATEMENTS**Introductory Note to Unaudited Pro Forma Combined Consolidated Financial Information**

The following unaudited pro forma combined consolidated balance sheet as of June 30, 2017, and the unaudited pro forma combined consolidated statements of income for the six months ended June 30, 2017, and the year ended December 31, 2016 have been prepared to reflect the acquisition of Sovereign Bancshares, Inc. (“Sovereign”) by Veritex Holdings, Inc. (“Veritex”), which was completed on August 1, 2017 (the “Sovereign Merger”). The unaudited pro forma combined consolidated financial information is set forth as if the Sovereign Merger had occurred as of June 30, 2017, with respect to financial condition data and as of January 1, 2016, with respect to operations data, and includes 5,117,647 shares of Veritex common stock and \$56,209,647 in cash paid as consideration to the holders of shares of common stock of Sovereign in the acquisition, and 24,500 shares of Veritex’s Senior Non-Cumulative Perpetual Preferred Stock, Series D issued in exchange for an equal number of shares of Sovereign’s Non-Cumulative Perpetual Preferred Stock Series C.

The unaudited pro forma combined consolidated financial statements give effect to the acquisition of Sovereign as a business combination under U.S. generally accepted accounting principles (“GAAP”). Accordingly, all assets and liabilities were recorded at estimated fair value. Pro forma adjustments are included only to the extent they are (i) directly attributable to the acquisition, (ii) factually supportable and (iii) with respect to the unaudited pro forma combined statements of income, expected to have a continuing impact on the combined results. The pro forma adjustments are based on estimates made for the purpose of preparing these pro forma statements and are described in the accompanying notes. Veritex’s management believes that the estimates used in these pro forma financial statements are reasonable under the circumstances.

The pro forma adjustments included herein are subject to change as additional information becomes available and additional analyses are performed. The final allocation of the purchase price paid in connection with the Sovereign Merger will be determined after further valuation analyses under GAAP are performed with respect to the fair values of certain tangible and intangible assets and liabilities as of the date of acquisition. The final adjustments may be materially different from the unaudited pro forma adjustments presented herein. In addition, the pro forma financial statements do not include the effects of any potential cost savings, which Veritex’s management believes will result from combining certain operating procedures. It also does not necessarily reflect what the historical results of the combined company would have been had Veritex and Sovereign been combined during these periods.

The unaudited pro forma combined consolidated financial information has been derived from, and should be read in conjunction with, the respective historical consolidated financial statements and related notes of Veritex and Sovereign.

The unaudited pro forma stockholders’ equity and net income are qualified by the statements set forth under this caption and should not be considered indicative of the market value of Veritex’s common stock of the actual or future results of operations of Veritex for any period. Actual results may be materially different than the pro forma information presented herein.

The following table represents the preliminary allocation of the total consideration to Sovereign's tangible and intangible assets and liabilities as of June 30, 2017 based on each of their preliminary estimated fair values:

Preliminary Estimated Acquisition Consideration Allocation

	(In Thousands)
Assets acquired:	
Cash and cash equivalents	\$ 25,603
Investment securities	169,198
Loans	767,713
Premises and equipment	22,573
Goodwill	108,007
Intangibles	6,213
Other assets	21,978
Total assets acquired	\$ 1,121,285
Liabilities assumed:	
Deposits	\$ 812,952
FHLB advances	80,000
Junior subordinated debentures	8,609
Other liabilities	3,243
Total liabilities assumed	\$ 904,804
Series C Preferred Stock, 24,500 shares ⁽¹⁾	\$ 24,500
Total estimated fair value of net assets acquired	\$ 191,981
Consideration	
Issuance of 5,177,647 shares of common stock at \$26.53 per share	\$ 135,771
Cash paid	\$ 56,210
Total preliminary estimated merger consideration	\$ 191,981

(1) Each share of Sovereign's Senior Non-Cumulative Perpetual Preferred Stock, Series C shall be converted into one share of Veritex's Senior Non-Cumulative Perpetual Preferred Stock, Series D, with an equal redemption value of \$1,000 per share.

A final determination of the fair values of Sovereign's assets and liabilities will be based on the actual net tangible and intangible assets that exist as of the date of completion of the transaction is consummated. Consequently, fair value adjustments and amounts preliminarily allocated to goodwill and identifiable intangibles could change significantly from those allocations used in the unaudited pro forma combined financial statements presented herein and could result in a material change in amortization of acquired intangible assets. In addition, the value of the final purchase price of the Sovereign Merger is based on the the closing price per share of Veritex common stock on the NASDAQ as of July 28, 2017 which was \$26.53 and used for purposes of presenting the unaudited pro forma combined balance sheet as of June 30, 2017.

VERITEX HOLDINGS, INC./SOVEREIGN BANCSHARES, INC.
UNAUDITED PRO FORMA COMBINED CONSOLIDATED BALANCE SHEET
JUNE 30, 2017
(In Thousands)

	Veritex Historical	Sovereign Historical	Pro Forma Purchase Accounting Adjustments	Notes	Pro Forma Combined
ASSETS					
Cash and cash equivalents	\$ 173,146	\$ 42,315	\$ (74,692)	(A)	\$ 140,769
Investment securities	134,708	168,783	415	(B)	303,906
Loans held for sale	4,118	—	—		4,118
Loans, net	1,112,688	779,013	(11,300)	(C)	1,880,401
Accrued interest receivable	3,333	3,120	—		6,453
Bank-owned life insurance	20,369	—	—		20,369
Bank premises, furniture and equipment, net	17,978	21,573	1,000	(D)	40,551
Non-marketable equity securities	7,407	4,964	—		12,371
Investment in unconsolidated subsidiary	93	—	—		93
Other real estate owned and repossessed assets	493	282	(124)	(E)	651
Intangible assets, net	2,171	457	5,756	(F)	8,384
Goodwill	26,865	—	108,007	(G)	134,872
Other assets	5,220	6,812	7,424	(H)	19,456
Total assets	\$ 1,508,589	\$ 1,027,319	\$ 36,486		\$ 2,572,394
LIABILITIES AND STOCKHOLDERS' EQUITY					
Deposits:					
Noninterest-bearing	\$ 337,057	\$ 166,888	\$ —		\$ 503,945
Interest-bearing	874,050	646,064	—		1,520,114
Total deposits	1,211,107	812,952	—		2,024,059
Accounts payable and accrued expenses	2,574	—	—		2,574
Accrued interest payable and other liabilities	1,032	3,243	—		4,275
Advances from Federal Home Loan Bank	38,235	80,000	—		118,235
Junior subordinated debentures	3,093	8,609	—		11,702
Subordinated notes	4,946	—	—		4,946
Total liabilities	1,260,987	904,804	—		2,165,791
Commitments and contingencies					
Stockholders' equity:					
Preferred stock	—	24,500	—	(I)	24,500
Common stock	152	5,273	(5,222)	(J)	203
Additional paid-in capital	211,901	58,073	77,347	(K)	347,321
Retained earnings	36,003	34,655	(35,625)	(L)	35,033
Unallocated Employee Stock Ownership Plan shares	(209)	—	—		(209)
Accumulated other comprehensive income (loss)	(175)	14	(14)	(M)	(175)
Treasury stock	(70)	—	—		(70)
Total stockholders' equity	247,602	122,515	36,486		406,603
Total liabilities and stockholders' equity	\$ 1,508,589	\$ 1,027,319	\$ 36,486		\$ 2,572,394

Balance Sheet Pro Forma Accounting Adjustments Notes as of June 30, 2017

(A)	Adjustments to cash:		
	To reflect Sovereign's estimated transaction costs comprised of change in control and severance payments of \$11.3 million, investment banker fees of \$2.1 million, and other transaction costs of \$3.3 million	\$	(16,712)
	To reflect Veritex's estimated transaction costs comprised primarily of investment banker and legal fees		(1,470)
	To reflect \$56.2 million cash portion of consideration to Sovereign and offering expenses of \$300 thousand		(56,510)
		\$	<u>(74,692)</u>
(B)	Adjustment to Sovereign's investment securities:		
	To reflect estimated fair value of investment securities	\$	415
(C)	Adjustment to Sovereign's loans, net:		
	To eliminate allowance for loan loss	\$	10,890
	To reflect estimated fair value of loan portfolio		(22,190)
		\$	<u>(11,300)</u>
(D)	Adjustment to Sovereign's bank premises, furniture and equipment, net:		
	To reflect estimated fair value of land included within bank premises	\$	1,000
(E)	Adjustment to Sovereign's other real estate owned and repossessed assets:		
	To reflect estimated fair value of other real estate owned and repossessed assets	\$	(124)
(F)	Adjustment to intangible assets, net:		
	To reflect estimated fair value of core deposit intangible	\$	5,756
(G)	Adjustment to goodwill:		
	To reflect goodwill for amount of consideration and liabilities assumed in excess of fair value of assets received	\$	108,007
(H)	Adjustments to other assets:		
	To reflect Sovereign's current tax recoverable from estimated transaction costs	\$	5,436
	To reflect Veritex's current tax recoverable from estimated transaction costs		500
	To reflect fair market value adjustment on deferred tax accounts		1,488
		\$	<u>7,424</u>
(I)	Adjustment to preferred stock:		
	To reflect issuance of Veritex Series D preferred stock (in exchange for the Sovereign SBLF preferred stock)	\$	24,500
	To reflect issuance of Veritex Series D preferred stock (in exchange for the Sovereign SBLF preferred stock)		(24,500)
		\$	<u>—</u>
(J)	Adjustment to common stock:		
	Eliminate Sovereign common stock	\$	(5,273)
	To reflect issuance of 5,117,647 shares of Veritex common stock in the Sovereign Merger		51
		\$	<u>(5,222)</u>
(K)	Adjustment to additional paid-in capital:		
	Eliminate Sovereign's additional paid-in capital	\$	(58,073)
	To reflect issuance of 5,117,647 shares of Veritex common stock in the Sovereign Merger		135,420
		\$	<u>77,347</u>
(L)	Adjustment to retained earnings:		
	Eliminate Sovereign's retained earnings	\$	(23,379)
	To reflect Sovereign's estimated transaction costs, net of tax		(11,276)
	To reflect Veritex's estimated transaction costs, net of tax		(970)
		\$	<u>(35,625)</u>
(M)	Adjustment to accumulated other comprehensive income:		
	Eliminate Sovereign's accumulated other comprehensive income	\$	(14)

VERITEX HOLDINGS, INC./SOVEREIGN BANCSHARES, INC.
UNAUDITED PRO FORMA COMBINED CONSOLIDATED STATEMENTS OF INCOME
SIX MONTHS ENDED JUNE 30, 2017
(In Thousands, except per share information)

	Veritex Historical	Sovereign Historical	Pro Forma Purchase Accounting Adjustments	Notes	Pro Forma Combined
Interest income:					
Interest and fees on loans	\$ 24,907	\$ 19,022	\$ 1,393	(A)	\$ 45,322
Interest on investment securities	1,310	2,295	—		3,605
Interest on deposits in other banks	1,158	86	—		1,244
Interest on other	1	44	—		45
Total interest income	27,376	21,447	1,393		50,216
Interest expense:					
Interest on deposit accounts	3,389	2,800	—		6,189
Interest on borrowings	358	599	—		957
Total interest expense	3,747	3,399	—		7,146
Net interest income	23,629	18,048	1,393		43,070
Provision for loan losses	1,833	150	(150)	(B)	1,833
Net interest income after provision for loan losses	21,796	17,898	1,543		41,237
Noninterest income:					
Service charges and fees on deposit accounts	1,064	309	—		1,373
Gain on sales of loans	1,562	95	—		1,657
Loss on sales of other assets owned	(8)	—	—		(8)
Bank-owned life insurance	373	—	—		373
Other	310	337	—		647
Total noninterest income	3,301	741	—		4,042
Noninterest expense:					
Salaries and employee benefits	7,550	7,569	—		15,119
Occupancy and equipment	2,026	1,574	—		3,600
Professional fees	1,986	794	—		2,780
Data processing and software expense	732	367	—		1,099
FDIC assessment fees	651	364	—		1,015
Marketing	469	—	—		469
Other assets owned expenses and write-downs	38	347	—		385
Amortization of intangibles	190	—	288	(C)	478
Telephone and communications	208	328	—		536
Other	1,382	1,250	—		2,632
Total noninterest expense	15,232	12,593	288		28,113
Net income from operations	9,865	6,046	1,255		17,166
Income tax expense	3,152	1,801	536	(D)	5,489
Net income	6,713	4,245	719		11,677
Preferred stock dividends	—	1,102	—		1,102
Net income available to common stockholders	\$ 6,713	\$ 3,143	\$ 719		\$ 10,575
Basic earnings per share	\$ 0.44				\$ 0.52
Diluted earnings per share	\$ 0.43				\$ 0.51
Weighted-average shares outstanding for basic EPS	15,205		5,118	(E)	20,323
Adjusted weighted average shares outstanding for diluted EPS	15,633		5,118	(E)	20,751

Income Statement Pro Forma Accounting Adjustments Notes for the Six Months Ended June 30, 2017

(A)	Adjustments to interest and fees on loans:		
	To reflect the interest income for accretion on acquired loans based on expected fair market value adjustment	\$	1,393
(B)	Adjustment to the provision:		
	To eliminate Sovereign historical provision for loan losses. The Sovereign acquired loans, which are marked to fair value at the acquisition date, are not expected to require a provision	\$	(150)
(C)	Adjustment to amortization of intangibles:		
	To reflect the expected amortization of core deposit intangible based on a 10-year life	\$	288
(D)	Adjustment to income tax expense:		
	To reflect the tax adjustment related to other pro forma adjustments calculated at a 35% rate	\$	536
(E)	Adjustment to weighted average shares:		
	To reflect the increase in the weighted average shares in connection with the issuance of 5,117,647 shares of Veritex common stock in the Sovereign Merger		5,118 shares

VERITEX HOLDINGS, INC./SOVEREIGN BANCSHARES, INC.
UNAUDITED PRO FORMA COMBINED CONSOLIDATED STATEMENTS OF INCOME
YEAR ENDED DECEMBER 31, 2016
(In Thousands, except per share information)

	Veritex Historical	Sovereign Historical	Pro Forma Purchase Accounting Adjustments	Notes	Pro Forma Combined
Interest income:					
Interest and fees on loans	\$ 44,681	\$ 37,988	\$ 2,787	(A)	\$ 85,456
Interest on investment securities	1,409	4,953	—		6,362
Interest on deposits in other banks	503	93	—		596
Interest on other	2	97	—		99
Total interest income	46,595	43,131	2,787		92,513
Interest expense:					
Interest on deposit accounts	4,988	5,175	—		10,163
Interest on borrowings	652	1,098	—		1,750
Total interest expense	5,640	6,273	—		11,913
Net interest income	40,955	36,858	2,787		80,600
Provision for loan losses	2,050	2,750	(2,750)	(B)	2,050
Net interest income after provision for loan losses	38,905	34,108	5,537		78,550
Noninterest income:					
Service charges and fees on deposit accounts	1,846	589	—		2,435
Gain on sales of investment securities	15	1,052	—		1,067
Gain on sales of loans	3,288	868	—		4,156
Bank-owned life insurance	771	—	—		771
Other	583	844	—		1,427
Total noninterest income	6,503	3,353	—		9,856
Noninterest expense:					
Salaries and employee benefits	14,332	15,685	—		30,017
Occupancy and equipment	3,667	3,252	—		6,919
Professional fees	2,804	935	—		3,739
Data processing and software expense	1,158	732	—		1,890
FDIC assessment fees	661	857	—		1,518
Marketing	983	—	—		983
Other assets owned expenses and write-downs	163	985	—		1,148
Amortization of intangibles	380	—	576	(C)	956
Telephone and communications	402	597	—		999
Other	1,840	2,596	—		4,436
Total noninterest expense	26,390	25,639	576		52,605
Net income from operations	19,018	11,822	4,961		35,801
Income tax expense	6,467	3,386	214	(D)	10,067
Net income	12,551	8,436	4,747		25,734
Preferred stock dividends	—	1,825	—		1,825
Net income available to common stockholders	\$ 12,551	\$ 6,611	\$ 4,747		\$ 23,909
Basic earnings per share					
Basic earnings per share	\$ 1.16				\$ 1.50
Diluted earnings per share					
Diluted earnings per share	\$ 1.13				\$ 1.48
Weighted-average shares outstanding for basic EPS					
Weighted-average shares outstanding for basic EPS	10,849		5,118	(E)	15,967
Adjusted weighted average shares outstanding for diluted EPS					
Adjusted weighted average shares outstanding for diluted EPS	11,058		5,118	(E)	16,176

Income Statement Pro Forma Accounting Adjustments Notes for the Year Ended December 31, 2016

(A)	Adjustments to interest and fees on loans:		
	To reflect the interest income for accretion on acquired loans based on expected fair market value adjustment	\$	2,787
(B)	Adjustment to the provision:		
	To eliminate Sovereign historical provision for loan losses. The Sovereign acquired loans, which are marked to fair value at the acquisition date, are not expected to require a provision	\$	(2,750)
(C)	Adjustment to amortization of intangibles:		
	To reflect the expected amortization of core deposit intangible based on a 10-year life	\$	576
(D)	Adjustment to income tax expense:		
	To reflect the tax adjustment related to other pro forma adjustments calculated at a 35% rate	\$	214
(E)	Adjustment to weighted average shares:		
	To reflect the increase in the weighted average shares in connection with the issuance of 5,117,647 shares of Veritex common stock in the Sovereign Merger	5,118	shares