

MIDSOUTH BANCORP INC
Form 10-K
March 16, 2018

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017
Commission File number 1-11826

MIDSOUTH BANCORP, INC.

(Exact name of registrant as specified in its charter)

Louisiana 72-1020809

(State of Incorporation) (I.R.S. EIN Number)

102 Versailles Boulevard, Lafayette, Louisiana 70501

(Address of principal executive offices)

Registrant's telephone number, including area code: (337) 237-8343

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
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Common Stock, \$.10 par value	New York Stock Exchange
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Securities registered pursuant to Section 12(g) of the Act: none

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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

Large accelerated filer	Accelerated filer	<input checked="" type="checkbox"/> Nonaccelerated filer	Smaller reporting company	Emerging growth company
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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.)

Yes No

The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of the registrant at June 30, 2017 was approximately \$158,085,769 based upon the closing market price per share of the registrant's common

stock as reported on

The New York Stock Exchange, Inc. as of such date. As of March 16, 2018 there were 16,621,811 outstanding shares of MidSouth Bancorp, Inc. common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for its 2018 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

MIDSOUTH BANCORP, INC.
 2017 Annual Report on Form 10-K
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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

- changes in interest rates and market prices that could affect the net interest margin, asset valuation, and expense levels;
- changes in local economic and business conditions in the markets we serve, including, without limitation, changes related to the oil and gas industries that could adversely affect customers and their ability to repay borrowings under agreed upon terms, adversely affect the value of the underlying collateral related to their borrowings, and reduce demand for loans;
- increases in competitive pressure in the banking and financial services industries;
- increased competition for deposits and loans which could affect compositions, rates and terms;
- changes in the levels of prepayments received on loans and investment securities that adversely affect the yield and value of the earning assets;
- our ability to successfully implement and manage our recently announced strategic initiatives;
- costs and expenses associated with our strategic initiatives and possible changes in the size and components of the expected costs and charges associated with our strategic initiatives;
- our ability to realize the anticipated benefits and cost savings from our strategic initiatives within the anticipated time frame, if at all;
- the ability of our strategic initiatives to adequately address the concerns of the Office of the Comptroller of the Currency (the “OCC”) in its previous examination of us and the ability of the Company to comply with the terms of the formal agreement with the OCC;
- credit losses due to loan concentration, particularly our energy lending and commercial real estate portfolios;
- a deviation in actual experience from the underlying assumptions used to determine and establish our allowance for loan losses (“ALL”), which could result in greater than expected loan losses;
- the adequacy of the level of our ALL and the amount of loan loss provisions required in future periods including the impact of implementation of the new CECL (current expected credit loss) methodology;
- future examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, impose conditions on our operations or require us to increase our allowance for loan losses or write-down assets;
- changes in the availability of funds resulting from reduced liquidity or increased costs;
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the timing and impact of future acquisitions or divestitures, the success or failure of integrating acquired operations, and the ability to capitalize on growth opportunities upon entering new markets;

the ability to acquire, operate, and maintain effective and efficient operating systems;

increased asset levels and changes in the composition of assets that would impact capital levels and regulatory capital ratios;

loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;

legislative and regulatory changes, including the impact of regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and other changes in banking, securities and tax laws and regulations and their application by our regulators, changes in the scope and cost of FDIC insurance and other coverage;

regulations and restrictions resulting from our participation in government-sponsored programs such as the U.S. Treasury's Small Business Lending Fund, including potential retroactive changes in such programs; changes in accounting principles, policies, and guidelines applicable to financial holding companies and banking; increases in cybersecurity risk, including potential business disruptions or financial losses; acts of war, terrorism, cyber intrusion, weather, or other catastrophic events beyond our control; and the ability to manage the risks involved in the foregoing

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

Part I

Item 1 - Business

Overview

The Company was incorporated in 1984 as a Louisiana corporation and is a registered bank holding company headquartered in Lafayette, Louisiana. Its operations have been conducted primarily through its wholly owned bank subsidiary MidSouth Bank, N.A. The Bank, a national banking association, was chartered and commenced operations in 1985. As of December 31, 2017, the Bank operated through a network of 48 offices located in Louisiana and Texas.

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

Products and Services

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

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

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

Markets

We operate in Louisiana and central and east Texas along the Interstate 10, Interstate 49, Highway 90, Interstate 45, Interstate 20 and Interstate 35 corridors. As of December 31, 2017, our market area in Louisiana included 35 offices and is bound by Lafourche Parish to the south, East Baton Rouge Parish to the east, Caddo Parish to the north and Calcasieu Parish to the west. Our market areas in Texas include 13 offices located in the Beaumont, Houston, Conroe, Magnolia, College Station, Texarkana, Tyler and Dallas areas. For additional information regarding our properties, see Item 2 – Properties of this Report.

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

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

Competition

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

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

Employees

As of December 31, 2017, the Bank employed approximately 467 full-time equivalent employees. The Company had no employees who are not also employees of the Bank. Through the Bank, employees receive customary employee benefits, which include an employee stock ownership plan; a 401(K) plan; and life, health and disability insurance plans. Our directors, officers, and employees are important to the success of the Company and play a key role in business development by actively participating in the communities served by the Company. The Company considers the relationship of the Bank with its employees as a whole to be good.

Additional Information

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

Supervision and Regulation

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

Troubled Condition and Written Agreement

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

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

changing the responsibilities of any senior executive officer, and (2) the Bank may not, except under certain circumstances, enter into any agreements to make severance or indemnification payments or make any such payments to “institution-affiliated parties” as defined in the regulations.

On July 19, 2017, the Bank entered into a formal written agreement with the OCC that provides, among other things, that the Bank: (i) create a committee to monitor the Bank’s compliance with the Agreement and make quarterly reports to the Board of Directors and the OCC; (ii) adopt and implement a three-year strategic plan for the Bank consistent with regulatory guidance and to be reviewed and updated on at least an annual basis by the Board of Directors; (iii) protect its interests in its criticized assets (those assets classified as “doubtful,” “substandard,” or “special mention” by internal or external loan review or examination), and adopt and implement a written program designed to eliminate the basis of criticism of criticized assets equal

to or exceeding \$250,000, which shall be reviewed and, as necessary, revised, on a quarterly basis; (iv) may not extend additional credit to any borrower with an aggregate outstanding loan balance of \$250,000 that is a criticized asset unless approved and deemed by the Bank's Board of Directors to be necessary to promote the best interests of the Bank and will not compromise the Bank's written program with respect to such loans; (v) develop and implement a written program to improve the Bank's loan portfolio management and provide the Board of Directors with written reports on the Bank's loan portfolio to enhance problem loan identification; (vi) review and, as necessary, revise the Bank's loan review program to ensure the timely identification and categorization of problem credits consistent with regulatory guidance; (vii) adopt and implement certain enhancements to its policies and procedures relating to its ALLL and the methodology related thereto; and (viii) revise its internal audit program to ensure Bank adherence to an independent and comprehensive internal audit program.

Regulatory Reform

The financial crisis of 2008, including the downturn of global economic, financial and money markets and the threat of collapse of numerous financial institutions, and other recent events have led to the adoption of numerous new laws and regulations that apply to, and focus on, financial institutions. The most significant of these new laws is the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which was adopted on July 21, 2010 and, in part, is intended to implement significant structural reforms to the financial services industry. The Dodd-Frank Act is discussed in more detail below.

Bank Holding Companies

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

We elected to become a financial holding company in November 2012. However, related to the regulatory issues discussed above under "Troubled Condition and Written Agreement," we decertified as a financial holding company in November 2017. We remain a bank holding company under the Federal Bank Holding Company Act.

Dodd-Frank Act

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

Insurance of Deposit Accounts. The Dodd-Frank Act changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital. The Dodd-Frank Act also made permanent the \$250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from \$100,000 to \$250,000.

Payment of Interest on Demand Deposits. The Dodd-Frank Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Creation of the Consumer Financial Protection Bureau. The Dodd-Frank Act centralized significant aspects of consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the "CFPB"), which is discussed in more detail below.

Debit Card Interchange Fees. The Dodd-Frank Act amended the Electronic Fund Transfer Act to, among other things, require that debit card interchange fees be reasonable and proportional to the actual cost incurred by the issuer with respect to the transaction. In June 2011, the Federal Reserve Board adopted regulations setting the maximum permissible interchange fee as the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction, with an additional adjustment of up to one cent per transaction if the issuer implements additional fraud-prevention standards. Although issuers that have assets of less than \$10 billion are exempt from the Federal Reserve Board's regulations that set maximum interchange fees, these regulations could significantly impact the interchange fees that financial institutions with less than \$10 billion in assets, such as the Bank, are able to collect.

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

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- restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of national banks from availing themselves of such preemption;
- impose comprehensive regulation of the over-the-counter derivatives market, subject to significant rulemaking processes, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself;
- require depository institutions with total consolidated assets of more than \$10 billion to conduct regular stress tests and require large, publicly traded bank holding companies to create a risk committee responsible for the oversight of enterprise risk management;
- require loan originators to retain 5% of any loan sold or securitized, unless it is a “qualified residential mortgage,” subject to certain exceptions;
- prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the Volcker Rule); and
- implement corporate governance revisions that apply to all public companies, not just financial institutions.

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

Capital Requirements

We are subject to various regulatory capital requirements administered by the Federal Reserve and the OCC. Failure to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action (described below), we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting policies. Our capital amounts and classification are also subject to judgments by the regulators regarding qualitative components, risk weightings, and other factors. For further detail on capital and capital ratios, see the discussion under Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Basel III Capital Framework

The federal bank regulatory agencies have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and standards for calculating risk-weighted assets and risk-based capital measurements (collectively, the “Basel III Final Rules”). For purposes of these capital rules, (i) common equity Tier 1 capital (“CET1”) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stock and trust preferred securities; and (iii) Tier 2 capital consists principally of Tier 1 capital plus qualifying subordinated debt and preferred stock, and limited amounts of an institution’s allowance for loan losses. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the

Basel III Final Rules. The Basel III Final Rules also establish risk weightings that are applied to many classes of assets held by community banks, including, importantly, applying higher risk weightings to certain commercial real estate loans. The Company and the Bank are subject to the Basel III capital ratios.

The Basel III Final Rules were effective on January 1, 2015, and the Basel III Final Rules' capital conservation buffer (as described below) is being phased in beginning January 1, 2016 through 2019. When fully phased in, the Basel III Final Rules require banks to maintain (i) a minimum ratio of CET1