

FEDERAL RESERVE SYSTEM

First National Bank Group, Inc.
Edinburg, Texas

Order Approving the Acquisition of
Additional Shares of a Bank Holding Company

First National Bank Group, Inc. (“First National”), a bank holding company within the meaning of the Bank Holding Company Act (“BHC Act”), has requested the Board’s approval under section 3 of the BHC Act¹ to acquire up to 9.9 percent of the voting shares and control of Southside Bancshares, Incorporated (“Southside”), Tyler, and acquire indirect control of Southside’s subsidiary banks, Southside Bank, also of Tyler, and Fort Worth National Bank, Fort Worth, all of Texas.²

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the Federal Register (72 Federal Register 70862 (2007)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

First National, with total consolidated assets of \$4.1 billion, is the 18th largest depository organization in Texas, controlling deposits of \$3.3 billion, which represent less than 1 percent of total deposits of insured depository institutions in Texas (“state deposits”).³ Southside, with total consolidated assets of \$1.9 billion, is the

¹ 12 U.S.C. § 1842.

² Southside has two intermediate bank holding companies in Delaware, Southside Delaware Financial Corporation, Dover, and Fort Worth Bancorporation, Inc., Wilmington. In addition, Southside has an intermediate bank holding company in Texas, Fort Worth Bancshares, Inc., Fort Worth.

³ Asset data are as of September 30, 2007, and statewide deposit and ranking data are as of June 30, 2007.

29th largest depository organization in Texas, controlling deposits of \$1.4 billion.⁴ On consummation of the proposal, First National would become the 12th largest depository organization in Texas, controlling deposits of approximately \$4.7 billion, which would represent 1.1 percent of state deposits.

First National, together with its related interests and principal shareholders, currently owns 8.62 percent of Southside's voting shares and proposes to acquire the additional voting shares (up to 1.28 percent) through purchases on the open market. First National received approval from the Board to acquire up to 9.9 percent of the voting shares of Southside on September 11, 2006.⁵ As part of the approval, First National agreed to abide by certain commitments previously relied on by the Board in determining that an investing bank holding company would not be able to exercise a controlling influence over another bank holding company or bank for purposes of the BHC Act ("Passivity Commitments").

First National is proposing again to acquire up to 9.9 percent of the voting shares of Southside and has also requested approval to control Southside for purposes of the BHC Act.⁶ On acquiring control, First National would be required to treat Southside Bank as a subsidiary of First National and would be subject to certain obligations imposed by the BHC Act and other federal statutes, including obligations to serve as a source of financial and managerial strength to Southside.⁷

The Board received a comment from the management of Southside objecting to the proposal and questioning First National's compliance with the Passivity Commitments. Southside also expressed concerns about the management of First

⁴ Southside acquired Fort Worth Bancshares, Inc. (a small bank holding company) in October 2007. Fort Worth Bancshares' subsidiary bank, Fort Worth National Bank, Fort Worth, has assets of \$125 million. These assets were not included in Southside's September 30, 2007, asset figures.

⁵ 91 Federal Reserve Bulletin C164 (2006) ("2006 Order").

⁶ As part of the proposal, First National requests relief from the Passivity Commitments.

⁷ See 12 CFR 225.4; 12 U.S.C. § 1815(e)(1).

National. The Board has considered carefully First National's application and Southside's comments in light of the factors it must consider under section 3 of the BHC Act.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors. The Board has considered carefully these factors in light of all the facts of record, including, among other things, confidential reports of examination and other supervisory information received from the primary federal supervisors of the organizations and institutions involved in the proposal, publicly reported and other financial information, information provided by First National, and public comment received on the proposal.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the effect of the transaction on the financial condition of the applicant, including its capital position, asset quality, earnings prospects, and the impact of the proposed funding of the transaction.

Based on its review of the financial factors, the Board finds that First National has sufficient resources to effect the proposal. First National, Southside, and their subsidiary banks are well capitalized and would remain so on consummation of this proposal.⁸ The proposed transaction is structured as a share purchase, and the

⁸ As previously noted, the proposal provides that First National would acquire only up to 9.9 percent of Southside. Under these circumstances, the financial statements of Southside and First National would not be consolidated. Moreover, because First National will not acquire a majority of the voting shares of Southside in this transaction,

consideration to be received by Southside's shareholders would be funded from First National's existing liquid assets.

The Board also has considered the managerial resources of the organizations involved in the proposed transaction. The Board has reviewed the examination records of First National, Southside, and their subsidiary banks, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money laundering laws. First National, Southside, and their subsidiary banks are considered to be well managed.

As noted, Southside has alleged that certain actions taken by the management of First National violated the Passivity Commitments.⁹ Specifically, Southside alleged that requests made by First National for employment and compensation information on employees who are related to the president of Southside violated these commitments. Southside also asserted that a filing made by First National with the Securities and Exchange Commission ("SEC") evidenced First National's intent to change or influence control of Southside and was a prima facie violation of the Passivity Commitments. In addition, Southside alleged that the filing contained statements intended to force Southside to change its business and operations.¹⁰ The Board has

First National must obtain the Board's approval before acquiring more than 9.9 percent of Southside's voting shares.

⁹ Southside also criticized the management of First National, as trustee of First National's employee stock ownership plan ("ESOP"), for causing the ESOP to purchase shares of Southside. The amount of shares acquired by the ESOP did not exceed the percentage of shares authorized by the Board in the 2006 Order.

¹⁰ The SEC requires the owners of more than 5 percent of a class of equity securities of a registered company to file certain forms. See 15 U.S.C. § 78m(d); Rule 13d-1, 17 CFR 240.13d-1 (2007). First National filed a Schedule 13D report with the SEC, which is required for a 5 percent shareholder who "holds the securities with a purpose or effect of changing or influencing control of the issuer, or in connection with or as a participant in any transaction having that

reviewed the information provided by Southside and First National as well as public and confidential supervisory information. Based on all the facts of record, the Board finds that neither First National's request for information nor its mandatory filing with the SEC violated the Passivity Commitments.

Based on all the facts of record, the Board has concluded that the financial and managerial resources and the future prospects of First National, Southside, and their subsidiaries are consistent with approval of this application, as are the other supervisory factors the Board must consider under section 3 of the BHC Act.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. Section 3 also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the Board finds that the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.¹¹

First National's subsidiary bank, First National Bank, Edinburg, and Southside Bank compete directly in the Dallas banking market. In addition, First National Bank and Fort Worth National Bank compete directly in the Fort Worth banking market. The Board has reviewed carefully the competitive effects of the proposal in both banking markets in light of all the facts of record. In particular, the Board has considered

purpose or effect . . .". 17 CFR 240.13d-1(e)(1)(i) (2007). In its Schedule 13D report, First National stated that, after making its 2006 investment in Southside, it wanted to change its investment goals with respect to Southside and, accordingly, filed this application with the Board requesting approval to increase its investment in Southside and to be relieved of the Passivity Commitments. First National also stated that it did not intend to take any action inconsistent with the Passivity Commitments until after the Board approved this application and the applicable statutory waiting period expired.

¹¹ 12 U.S.C. § 1842(c)(1).

the number of competitors that would remain in the markets, the relative shares of total deposits of depository institutions in the markets (“market deposits”) controlled by First National and Southside,¹² the concentration level of market deposits and the increase in this level as measured by the Herfindahl-Hirschman Index (“HHI”) under the Department of Justice Merger Guidelines (“DOJ Guidelines”),¹³ and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and the DOJ Guidelines in both the Dallas and Fort Worth banking markets.¹⁴ On consummation of the proposal, the Dallas banking market would remain moderately concentrated and the Fort Worth banking market would remain unconcentrated, as measured by the HHI. There would be no change in the HHI’s measure of concentration in either market, and numerous competitors would remain in both banking markets.

¹² Deposit and market share data are as of June 30, 2007, are adjusted to reflect subsequent mergers and acquisitions as of January 28, 2008, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. See, e.g., Midwest Financial Group, 75 Federal Reserve Bulletin 386 (1989); National City Corporation, 70 Federal Reserve Bulletin 743 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. See, e.g., First Hawaiian, Inc., 77 Federal Reserve Bulletin 52 (1991).

¹³ Under the DOJ Guidelines, a market is considered moderately concentrated if the post-merger HHI is between 1000 and 1800 and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The Department of Justice has stated that the higher than normal HHI thresholds for screening bank mergers for anticompetitive effects implicitly recognize the competitive effects of limited-purpose lenders and other nondepository financial institutions.

¹⁴ Those banking markets and the effects of the proposal on the concentrations of banking resources are described in the appendix.

The Department of Justice also has reviewed the anticipated competitive effects of the proposal and advised the Board that consummation would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in either the Dallas or Fort Worth banking market or in any other relevant banking market and that competitive considerations are consistent with approval.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act (“CRA”).¹⁵ The Board has considered carefully all the facts of record, including evaluations of the CRA performance records of First National’s and Southside’s subsidiary banks, other information provided by First National, and confidential supervisory information. First National Bank received an “outstanding” rating at its most recent CRA evaluation by the Office of the Comptroller of the Currency (“OCC”), as of September 9, 2006. Southside Bank also received an “outstanding” rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation, as of March 12, 2007.¹⁶ Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs factor and

¹⁵ 12 U.S.C. § 2901 et seq.

¹⁶ Fort Worth National Bank received a “satisfactory” rating at its most recent CRA performance evaluation by the OCC, as of February 21, 2006.

the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved.¹⁷ In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by First National with the conditions imposed in this order and the commitments made to the Board in connection with the application. The conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The acquisition of additional Southside voting shares may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Dallas, acting pursuant to delegated authority.

By order of the Board of Governors,¹⁸ effective February 4, 2008.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

¹⁷ In granting this approval, the Board hereby relieves First National of the Passivity Commitments it provided in connection with the 2006 Order.

¹⁸ Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

Appendix

Banking Markets Consistent with Board Precedent and DOJ Guidelines						
Deposit data are as of June 30, 2007, and include mergers as of January 28, 2008. Deposit amounts are unweighted. Rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.						
Dallas – Dallas County, the southeastern quadrant of Denton County (including Denton and Lewisville), the southwestern quadrant of Collin County (including McKinney and Plano), Rockwall County, the communities of Forney and Terrell in Kaufman County, and Midlothian, Waxahachie, and Ferris in Ellis County.						
	Rank	Amount of Deposits	Market Deposit Shares (%)	Resulting HHI	Change in HHI	Remaining Number of Competitors
<i>First National Pre-Consummation</i>	52	\$118 mil.	0.14	1604	0	129
<i>Southside</i>	119	\$687,000	0			
<i>First National Post-Consummation</i>	52	\$118.8 mil.	0.14			
Fort Worth – The Fort Worth–Arlington Metropolitan Division, which consists of Tarrant, Johnson, Parker and Wise Counties and excludes Mineral Wells in Parker County.						
	Rank	Amount of Deposits	Market Deposit Shares (%)	Resulting HHI	Change in HHI	Remaining Number of Competitors
<i>First National Pre-Consummation</i>	76	Minimal	Minimal	886	0	79
<i>Southside</i>	29	\$100.1 mil.	0.45			
<i>First National Post-Consummation</i>	29	\$110.1 mil.	0.45			