

FEDERAL RESERVE SYSTEM

First National Bank Group, Inc.
Edinburg, Texas

Order Approving the Acquisition of 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 of Southside Bancshares, Incorporated (“Southside”), Tyler, Texas, and thereby acquire an indirect interest in Southside Delaware Financial Corporation, Dover, Delaware, and Southside’s subsidiary bank, Southside Bank, also of Tyler.²

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the Federal Register (71 Federal Register 28,865 (2006)). 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 \$3.3 billion, is the 22nd largest depository organization in Texas, controlling deposits of \$2.4 billion, which represent less than 1 percent of total deposits of insured depository

¹ 12 U.S.C. § 1842.

² First National currently owns 4.91 percent of Southside’s voting shares and proposes to acquire the additional voting shares through purchases on the open market.

institutions in Texas (“state deposits”).³ Southside, with total consolidated assets of \$1.8 billion, is the 36th largest depository organization in Texas, controlling deposits of \$1 billion. If First National were deemed to control Southside on consummation of the proposal, First National would become the 14th largest depository organization in Texas, controlling deposits of approximately \$3.4 billion, which would represent 1 percent of state deposits.

The Board received a comment from Southside questioning First National’s stated intention to make a passive investment in Southside and expressing concerns about the management of First National. The Board has considered carefully Southside’s comments in light of the factors it must consider under section 3 of the BHC Act.

The Board previously has stated that the acquisition of less than a controlling interest in a bank or bank holding company is not a normal acquisition for a bank holding company.⁴ The requirement in section 3(a)(3) of the BHC Act that the Board’s approval be obtained before a bank holding company acquires more than 5 percent of the voting shares of a bank, however, suggests that Congress contemplated the acquisition by bank holding companies of between 5 and 25 percent of the voting shares of banks.⁵ On this basis, the

³ Asset data are as of March 31, 2006, and statewide deposit and ranking data are as of June 30, 2005.

⁴ See, e.g., Brookline Bancorp, MHC, 86 Federal Reserve Bulletin 52 (2000) (“Brookline”) (acquisition of up to 9.9 percent of the voting shares of a bank holding company); GB Bancorporation, 83 Federal Reserve Bulletin 115 (1997) (acquisition of up to 24.9 percent of the voting shares of a bank); Mansura Bancshares, Inc., 79 Federal Reserve Bulletin 37 (1993) (acquisition of 9.7 percent of the voting shares of a bank holding company).

⁵ See 12 U.S.C. § 1842(a)(3).

Board previously has approved the acquisition by a bank holding company of less than a controlling interest in a bank or bank holding company.⁶

First National has stated that the acquisition is intended as a passive investment and that it does not propose to control or exercise a controlling influence over Southside or Southside Bank. In support of its stated intention, First National has 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.⁷ For example, First National has committed not to exercise or attempt to exercise a controlling influence over the management or policies of Southside or any of its subsidiaries; not to seek or accept representation on the board of directors of Southside or any of its subsidiaries; and not to have any director, officer, employee, or agent interlocks with Southside or any of its subsidiaries. First National also has committed not to attempt to influence the dividend policies, loan decisions, or operations of Southside or any of its subsidiaries. Moreover, the BHC Act prohibits First National from acquiring additional shares of Southside or attempting to exercise a controlling influence over Southside without the Board's prior approval.

The Board has adequate supervisory authority to monitor compliance by First National with the commitments and the ability to take enforcement action

⁶ See, e.g., Brookline; North Fork Bancorporation, Inc., 81 Federal Reserve Bulletin 734 (1995); First Piedmont Corp., 59 Federal Reserve Bulletin 456, 457 (1973).

⁷ See, e.g., Emigrant Bancorp, Inc., 82 Federal Reserve Bulletin 555 (1996); First Community Bancshares, Inc., 77 Federal Reserve Bulletin 50 (1991). These commitments are set forth in the appendix.

against First National if it violates any of the commitments.⁸ The Board also has authority to initiate a control proceeding against First National if facts presented later indicate that First National or any of its subsidiaries or affiliates in fact controls or exercises a controlling influence over Southside for purposes of the BHC Act.⁹ Based on these considerations and all other facts of record, the Board has concluded that First National would not acquire control of, or have the ability to exercise a controlling influence over, Southside through the proposed acquisition of voting shares.

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,

⁸ See 12 U.S.C. § 1818(b)(1).

⁹ See 12 U.S.C. § 1841(a)(2)(C).

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.¹⁰

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

Southside expressed concerns about the management of First National that relate to First National's proposal in 2004 to acquire a controlling interest in Alamo Corporation of Texas ("Alamo") (the "Alamo Proposal").¹¹ Southside has

¹⁰ 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.

¹¹ In 2004, First National applied to the Board for prior approval to acquire up to 14.99 percent of the voting shares of Alamo and to control Alamo.

alleged that in the Alamo Proposal, First National acquired shares of Alamo in violation of the BHC Act. Alamo made the same allegation in its comments on the Alamo Proposal. In approving the Alamo Proposal, the Board considered this allegation in light of the record and found no violation of the BHC Act. In considering Southside's reiteration of this claim, the Board has reviewed the information provided by Southside and First National and confidential supervisory information, and has found no new facts that would support modifying the Board's previous findings and determinations in the Alamo Proposal.¹²

See First National Bank Group, Inc., 91 Federal Reserve Bulletin 71 (2005). Alamo claimed that First National, in conjunction with its president and a First National shareholder, acted together to acquire more than 5 percent of Alamo's shares without the Board's prior approval. Id. at 72. The Board reviewed all the facts of record and concluded that the shares of First National and its president should not be aggregated with the shareholder's shares. Accordingly, the Board determined that First National did not violate the BHC Act and approved the proposal. First National did not acquire up to 14.99 percent of Alamo's shares and subsequently divested its entire shareholding in Alamo.

In this proposal, Southside alleges that the same shareholder identified by Alamo acted as a nominee purchaser for First National in acquiring the shares of Alamo and that the shareholder subsequently sold those shares to First National shortly after the Board approved the Alamo Proposal. First National denied Southside's allegations and stated that there was no agreement, oral or written, between First National's management and this shareholder to purchase his shares.

¹² Southside also claimed that in connection with the Alamo Proposal, First National purchased shares of Alamo through a tender offer that did not comply with applicable federal securities laws. In addition, Southside alleged that First National made improper comments about Alamo and its management to Alamo shareholders in connection with the tender offer. First National commenced a tender offer for shares of Alamo stock on or about March 28, 2005. Southside alleged that First National made several stock purchases before the March 28 tender offer, that those purchases constituted a tender offer, and that First National did not comply with applicable federal securities laws in connection with those

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.¹³

First National and Southside do not compete directly in any relevant banking market. Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive considerations are consistent with approval.

purchases. First National represented that the individuals who sold their shares to First National before March 28, 2005, approached First National and that all those transactions were individually negotiated. The Securities and Exchange Commission (“SEC”) has the authority to investigate and adjudicate any violations of federal securities laws. The Board has consulted with the SEC regarding Southside’s allegation.

¹³ 12 U.S.C. § 1842(c)(1).

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”).¹⁴ 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, as of October 7, 2002. Southside Bank also received an “outstanding” rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation, as of August 1, 2004. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs factor and 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. 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

¹⁴ 12 U.S.C. § 2901 et seq.

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 Southside's 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,¹⁵ effective September 11, 2006.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

¹⁵ Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, Kroszner, and Mishkin.

Appendix

In connection with its application to acquire up to 9.9 percent of Southside, First National committed that it will not:

- (1) Exercise or attempt to exercise a controlling influence over the management or policies of Southside or any of its subsidiaries;
- (2) Seek or accept representation on the board of directors of Southside or any of its subsidiaries;
- (3) Serve, have, or seek to have any employee or representative serve as an officer, agent, or employee of Southside;
- (4) Take any action causing Southside to become a subsidiary of First National;
- (5) Acquire or retain shares that would cause the combined interests of First National and its officers, directors, and affiliates to equal or exceed 25 percent of the outstanding shares of any class of voting securities of Southside;
- (6) Propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of Southside or any of its subsidiaries;
- (7) Solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of Southside;
- (8) Attempt to influence the dividend policies; loan, credit, or investment decisions or policies of Southside; the pricing of services; personnel decisions; operations activities (including the location of any offices or branches or hours of operation, etc.); or any similar activities of Southside or its subsidiaries;
- (9) Dispose or threaten to dispose of shares of Southside as a condition of specific action or nonaction by Southside; or
- (10) Enter into any other banking or nonbanking transactions with Southside or any of its subsidiaries, except that First National may establish and maintain deposit accounts with any depository institution subsidiary of Southside, provided that the aggregate balance of all such accounts does not exceed \$500,000 and that the accounts are maintained on substantially the same terms as those prevailing for comparable accounts of persons unaffiliated with Southside.