# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**
☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2021**

**OR**

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

**For the transition period from ______________ to_______________**

**Commission File Number 001-38895**

# South Plains Financial, Inc.
**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Texas** | **75-2453320** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **5219 City Bank Parkway** | |
| **Lubbock, Texas** | **79407** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**Registrant's telephone number, including area code: (806) 792-7101**

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

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---|---|---|
| Common Stock, par value $1.00 per share | SPFI | The Nasdaq Stock Market, LLC |

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 ☒ |
| Non-accelerated filer ☐ | Smaller reporting company ☐ |
| | Emerging growth company ☒ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the closing price of the shares of common stock on The NASDAQ Stock Market, LLC on June 30, 2021, was $309.2 million.

The number of shares of registrant's common stock outstanding as of March 3, 2022 was 17,693,639.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement relating to the Annual Meeting of Shareholders, scheduled to be held on May 11, 2022, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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## CAUTIONARY STATEMENT REGARDING

## FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K for the year ended December 31, 2021 ("Report") contains statements that we believe are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "might," "should," "could," "predict," "potential," "believe," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "strive," "projection," "goal," "target," "outlook," "aim," "would," "annualized" and "outlook," or the negative version of those words or other comparable words or phrases 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 our industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions, estimates and uncertainties that are difficult to predict. Although we believe 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.

There are or will be important factors that could cause our actual results to differ materially from those indicated in these forward-looking statements, including, but not limited to, the following:

- our ability to effectively execute our expansion strategy and manage our growth, including identifying and consummating suitable acquisitions;
- business and economic conditions, particularly those affecting our market areas, as well as the concentration of our business in such market areas, and the uncertain inflationary outlook in the United States and our market areas;
- the impact, duration and severity of the ongoing COVID-19 pandemic, and any current or future variants thereof, and the response of governmental authorities to the COVID-19 pandemic;
- high concentrations of loans secured by real estate located in our market areas;
- risks associated with our commercial loan portfolio, including the risk for deterioration in value of the general business assets that secure such loans;
- potential changes in the prices, values and sales volumes of commercial and residential real estate securing our real estate loans;
- risks associated with our agricultural loan portfolio, including the heightened sensitivity to weather conditions, commodity prices, and other factors generally outside the borrowers and our control;
- risks associated with the sale of crop insurance products, including termination of or substantial changes to the federal crop insurance program;
- risks related to the significant amount of credit that we have extended to a limited number of borrowers and in a limited geographic area;
- public funds deposits comprising a relatively high percentage of our deposits;
- potential impairment on the goodwill we have recorded or may record in connection with business acquisitions;
- our ability to maintain our reputation;
- our ability to successfully manage our credit risk and the sufficiency of our allowance for loan losses;
- our ability to attract, hire and retain qualified management personnel;
- our dependence on our management team, including our ability to retain executive officers and key employees and their customer and community relationships;
- interest rate fluctuations, which could have an adverse effect on our profitability;

- competition from banks, credit unions and other financial services providers;
- our ability to keep pace with technological change or difficulties we may experience when implementing new technologies;
- system failures, service denials, cyber-attacks and security breaches;
- our ability to maintain effective internal control over financial reporting;
- employee error, fraudulent activity by employees or customers and inaccurate or incomplete information about our customers and counterparties;
- increased capital requirements imposed by banking regulators, which may require us to raise capital at a time when capital is not available on favorable terms or at all;
- our ability to maintain adequate liquidity and to raise necessary capital to fund our acquisition strategy and operations or to meet increased minimum regulatory capital levels;
- costs and effects of litigation, investigations or similar matters to which we may be subject, including any effect on our reputation;
- natural disasters, severe weather, acts of god, acts of war or terrorism, outbreaks of hostilities, public health outbreaks (such as coronavirus), other international or domestic calamities, and other matters beyond our control;
- changes in tariffs and trade barriers;
- compliance with governmental and regulatory requirements, including the Dodd-Frank Act Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 ("EGRRCPA"), and others relating to banking, consumer protection, securities and tax matters; and
- changes in the laws, rules, regulations, interpretations or policies relating to financial institutions, accounting, tax, trade, monetary and fiscal matters, including the policies of the Board of Governors of the Federal Reserve System ("Federal Reserve") and as a result of initiatives of the Biden administration.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Report and the "Risk Factors" set forth under Part I, Item IA of this Report. Because of these risks and other uncertainties, our actual future results, performance or achievements, or industry results, may be materially different from the results indicated by the forward-looking statements in this Report. In addition, our past results of operations are not necessarily indicative of our future results. Accordingly, you should not rely on any forward-looking statements, which represent our beliefs, assumptions and estimates only as of the dates on which such forward-looking statements were made. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by law.

# Part I

## Item 1. Business

### General

South Plains Financial, Inc. (the "Company" or "SPFI") is a bank holding company headquartered in Lubbock, Texas, and City Bank, SPFI's wholly-owned banking subsidiary, is one of the largest independent banks in West Texas ("City Bank" or the "Bank"). The Company is hereafter collectively referred to as "we," "us" or "our."

We have additional banking operations in the Dallas, El Paso, Greater Houston, the Permian Basin, and College Station, Texas markets, and the Ruidoso, New Mexico market. Through City Bank, we provide a wide range of commercial and consumer financial services to small and medium-sized businesses and individuals in our market areas. Our principal business activities include commercial and retail banking, along with insurance, investment, trust and mortgage services.

We had total assets of $3.90 billion, gross loans held for investment of $2.44 billion, total deposits of $3.34 billion, and total shareholders' equity of $407.4 million as of December 31, 2021.

Our history dates back over 80 years. We trace our beginnings to the founding of First State Bank of Morton, a community bank headquartered in West Texas that held approximately $1 million of total assets in 1941. In 1962, the bank was sold to new management, including J.K. Griffith, the father of our current Chairman and Chief Executive Officer, Curtis C. Griffith. Since Mr. Griffith was elected Chairman of First State Bank of Morton in 1984, the Bank has transformed from a small-town institution with approximately $30 million in total assets and a single branch location into one of the largest community banks in West Texas. The parent company to First State Bank of Morton acquired South Plains National Bank of Levelland, Texas in 1991 and changed its name to South Plains Bank. The Company became the holding company to First State Bank of Morton and South Plains Bank in 1993, the same year we acquired City Bank. City Bank was originally established in Lubbock in 1984. We merged First State Bank of Morton and South Plains Bank into City Bank in 1998 and 1999, respectively. We had more than $175 million in assets upon the closing of these acquisitions. We acquired West Texas State Bank, Odessa, Texas, approximately $430 million in assets, in 2019 through the merger of West Texas State Bank with and into the Bank.

We currently operate 25 full-service banking locations across seven geographic markets resulting from six acquisitions, de novo branch establishments, and the formation of a de novo bank in Ruidoso, New Mexico, which we later merged into the Bank. We also operate 15 loan production offices both in our banking markets and in certain key areas in Texas that focus on mortgage loan origination. We build long-lasting relationships with our customers by delivering high quality products and services and have sought to capitalize on the opportunities presented by continued consolidation in the banking industry. We believe a major contributor to our historical success has been our focus on becoming the community bank of choice in the markets that we serve.

We operate in two reportable segments of business: community banking, which includes City Bank, our sole banking subsidiary, and insurance, which includes Windmark Insurance Agency, Inc. ("Windmark").

### Acquisition Activities

On July 25, 2019, we entered into an Agreement and Plan of Merger with West Texas State Bank, a Texas banking association ("WTSB"), providing for our acquisition of WTSB through the merger of SPFI Merger Sub, Inc., a Texas corporation and wholly-owned subsidiary of SPFI, with and into WTSB, with WTSB continuing as the surviving entity and thereafter being a wholly-owned subsidiary of SPFI. The merger was consummated on November 12, 2019 and WTSB merged with and into City Bank, with City Bank surviving the merger.

### Market Area

We operate in the following markets (deposit information is as of December 31, 2021):

Lubbock/South Plains - We operate 10 branches holding $2.1 billion of deposits in the Lubbock metropolitan statistical area ("MSA") and the surrounding South Plains region of Texas.

Dallas - We operate three branches with $450.3 million of deposits and eight loan production offices, which we refer to as mortgage offices, in the Dallas-Fort Worth-Arlington MSA, which we refer to as the Dallas-Fort Worth metroplex.

El Paso - We operate two bank branches with $204.9 million of deposits and one mortgage office in the El Paso MSA.

Houston - We operate one branch with $27.0 million of deposits in the Houston-The Woodlands-Sugarland MSA, which we refer to as Greater Houston. This branch is located in the city of Houston.

Bryan/College Station - We operate one branch and one mortgage office in the city of College Station, Texas, which has $72.6 million in deposits. We refer to the Bryan-College Station MSA as Bryan/College Station.

The Permian Basin - We operate six branches with $287.0 million of deposits in the Permian Basin region of Texas.

Ruidoso/Eastern New Mexico - We operate two branches with $170.8 million of deposits in the village of Ruidoso, New Mexico.

We believe our exposure to these dynamic and complementary markets provides us with economic diversification and the opportunity for expansion across Texas and New Mexico.

**Competition**

The banking and financial services industry is highly competitive, and we compete with a wide range of financial institutions within our markets, including local, regional and national commercial banks and credit unions. We also compete with mortgage companies, trust companies, brokerage firms, consumer finance companies, mutual funds, securities firms, insurance companies, third-party payment processors, financial technology companies and other financial intermediaries for certain of our products and services. Some of our competitors are not subject to the regulatory restrictions and level of regulatory supervision applicable to us.

Interest rates on loans and deposits, as well as prices on fee-based services, are typically significant competitive factors within the banking and financial services industry. Many of our competitors are much larger financial institutions that have greater financial resources than we do and compete aggressively for market share. These competitors attempt to gain market share through their financial product mix, pricing strategies and banking center locations. Other important competitive factors in our industry and markets include office locations and hours, quality of customer service, community reputation, continuity of personnel and services, capacity and willingness to extend credit, and ability to offer excellent banking products and services. While we seek to remain competitive with respect to fees charged, interest rates and pricing, we believe that our broad suite of financial solutions, our high-quality customer service culture, our positive reputation and our long-standing community relationships will enable us to compete successfully within our markets and enhance our ability to attract and retain customers.

**Human Capital Resources**

As of December 31, 2021, we had approximately 680 total employees, which included 609 full-time employees and 71 part-time employees. None of our employees are covered under a collective bargaining agreement and management considers its employee relations to be satisfactory.

We believe that the success of a business is largely due to the quality of its employees and the development of each employee’s full potential. We encourage and support the development of our employees and, whenever possible, strive to fill vacancies from within. Employee retention helps us operate efficiently and achieve our business objectives. We believe our ability to attract and retain employees is a key to our success. Accordingly, we strive to offer competitive salaries and employee benefits to all employees and monitor salaries in our market areas. In addition to competitive base salaries and benefits, additional employee programs include annual bonus opportunities, Company matched 401(k) Plan contributions, healthcare and insurance benefits, health savings and flexible spending accounts, long-term care and long-term disability benefits, life insurance benefits, a robust wellness program, and paid-time off.

**Lending Activities**

***General***. We adhere to what we believe are disciplined underwriting standards, but also remain cognizant of serving the credit needs of customers in our primary market areas by offering flexible loan solutions in a responsive and timely manner. We maintain asset quality through an emphasis on local market knowledge, long-term customer relationships, consistent and thorough underwriting and a conservative credit culture. We also seek to maintain a broadly diversified loan portfolio across customer, product and industry types. These components, together with active credit management, are the foundation of our credit culture, which we believe is critical to enhancing the long-term value of our organization to our customers, employees, shareholders and communities.

We have a service-driven, relationship-based, business-focused credit culture, rather than a price-driven, transaction-based culture. Substantially all of our loans are made to borrowers located or operating in our primary market areas with whom we have ongoing relationships across various product lines. The few loans secured by properties outside of our primary market areas were made to borrowers who are otherwise well-known to us.

***Credit Concentrations***. In connection with the management of our credit portfolio, we actively manage the composition of our loan portfolio, including credit concentrations. Our loan approval policies establish concentrations limits with respect to industry and loan product type to enhance portfolio diversification. Commercial real estate concentrations are monitored by the Board of Directors (“Board”) of the Bank, at least quarterly and the limits are reviewed bi-monthly as part of our credit analytics Board Credit Risk Committee program. The Board Credit Risk Committee is comprised of outside directors and two Bank officers, including the Chairman of the Board and the Bank’s Chief Executive Officer.

***Loan Approval Process***. We seek to achieve an appropriate balance between prudent, disciplined underwriting and flexibility in our decision-making and responsiveness to our customers. Our Board requires news loans over $5 million to relationships in excess of $20 million to be reported to the Board Credit Risk Committee. As of December 31, 2021, the Bank had a legal lending limit of approximately $97.5 million. As of that date, our 20 largest borrowing relationships ranged from approximately $18.6 million to $51.0 million (including unfunded commitments) and totaled approximately $515.9 million in total commitments (representing, in the aggregate, 17.3% of our total outstanding commitments).

Our credit approval policies provide for various levels of officer and senior management lending authority for new credits and renewals, which are based on position, capability and experience. Loans in excess of an individual officer's lending limit up to $3 million may be approved with joint authorities of a market president and a senior credit officer. Loan relationships over $3 million are approved by our Executive Loan Committee. These limits are reviewed periodically by the Bank's Board. We believe that our credit approval process provides for thorough underwriting and efficient decision-making.

***Credit Risk Management***. Credit risk management involves a partnership between our loan officers and our credit approval, credit administration and collections personnel. Loan delinquencies and exceptions are constantly monitored by credit personnel and consultations with loan officers occur as often as daily. Our performance evaluation program for our loan officers includes significant goals, such as the percentages of past due loans and charge-offs to total loans in the officer's portfolio, that we believe motivate the loan officers to focus on the origination and maintenance of high quality credits consistent with our strategic focus on asset quality.

Our policies require rapid notification of delinquency and prompt initiation of collection actions. Loan officers, credit administration personnel, and senior management proactively support collection activities.

In accordance with our credit risk management procedures, we perform annual asset reviews of our larger relationships. As part of these asset review procedures, we analyze recent financial statements of the property, borrower and any guarantor, the borrower's revenues and expenses, and any deterioration in the relationship or in the borrower's and any guarantor's financial condition. Upon completion, we update the grade assigned to each loan. Our credit policy requires that loan officers promptly update risk ratings for all loans as warranted by changing circumstances of the borrower or the credit and to notify credit administration personnel of any risks developing in a portfolio or in an individual borrowing relationship. We maintain a list of loans that receive additional attention if we believe there may be a potential credit risk.

Loans that are adversely classified undergo a detailed quarterly review by loan review personnel. This review includes an evaluation of the market conditions, the property's trends, the borrower and guarantor status, the level of reserves required and loan accrual status. These reports are reviewed by a group of lending and credit personnel to evaluate collection effectiveness for each loan reported. Additionally, we periodically have an independent, third-party review performed on our loan grades and our credit administration functions. Our external loan review firm schedules two to three visits per year and, in combination with our internal loan review function, attempts to achieve a combined review of at least 60% of the total dollar amount of the loan portfolio. Finally, we perform, at least annually, a stress test of our loan portfolio, in which we evaluate the impact of declining economic conditions on the portfolio based on previous recessionary periods. Credit personnel review these reports and present them to the Board Credit Risk Committee. These asset review procedures provide management with additional information for assessing our asset quality and lending strategies.

**Investments**

We manage our securities portfolio primarily for liquidity purposes, including depositor and borrower funding requirements and availability as collateral for public fund deposits, with a secondary focus on interest income. Our securities portfolio is classified as either available-for-sale or held-to-maturity and can be used for pledging on public deposits, selling under repurchase agreements and meeting unforeseen liquidity needs. The investments in our securities portfolio are a variety of high-grade securities, including government agency securities, government guaranteed mortgage backed securities and municipal securities.

Our investment policy is reviewed annually by the Bank's Board. Overall investment goals are established by the Bank's Board and the Bank's Investment/Asset Liability Committee. The Bank's Board has delegated the responsibility of monitoring our investment activities to the Investment/Asset Liability Committee.

## Sources of Funds

### *Deposits*

Deposits represent the Company's primary and most vital source of funds. We offer a variety of deposit products including demand deposits accounts, interest-bearing products, savings accounts and certificate of deposits. We put continued effort into gathering noninterest-bearing demand deposit accounts through loan production, customer referrals, marketing staffs, mobile and online banking and various involvements with community networks.

### *Borrowings*

In addition to deposits, we may utilize advances from the Federal Home Loan Bank of Dallas (the "FHLB"), and other borrowings, such as a line of credit with the Federal Reserve Bank of Dallas (the "FRB"), uncollateralized lines of credit with multiple banks, subordinated debt securities, and junior subordinated deferrable interest debentures as supplementary funding sources to finance our operations.

## Other Banking Services

### *Mortgage Banking*

Our mortgage originations totaled $1.5 billion for the year ended December 31, 2021. In 2021, we sold approximately 97% of the mortgages we originated. We originate mortgages primarily from our branches or loan production offices in Lubbock, El Paso, College Station, Abilene, Arlington, Austin, Beaumont, Dallas, Dripping Springs, Forney, Fort Worth, Grand Prairie, Houston, Midland, Southlake, and Waco, Texas. We refer to our loan production offices as mortgage offices. While our mortgage operation represents a sizable component of our total noninterest income, comprising 61%, or $59.7 million, for the year ended December 31, 2021, we view the mortgage business as an ancillary part of our operations. Within our mortgage origination portfolio, refinances of existing mortgages represented 54% of total mortgage originations in 2021. We retain mortgage servicing rights from time to time when we sell mortgages to third parties. As of December 31, 2021, we serviced $2.0 billion of mortgages that we originated and sold to third parties.

We leverage a variety of digital reporting tools to increase the efficiency of the underwriting process, enhance loan production and boost overall margins while keeping expenses to a minimum. New market expansion will depend primarily on opportunities to hire and retain high quality loan origination staff. Additionally, existing markets are monitored for profitability and efficiencies to determine if we would need to exit any locations.

### *Insurance*

Windmark Insurance, a wholly-owned subsidiary of the Bank, offers a variety of crop insurance products through our offices in Texas, Oklahoma, Nebraska, and Colorado and by acting as the general agency for independent agents in 17 states. Windmark Insurance's operations contributed $8.1 million of total revenues for the year ended December 31, 2021. That revenue was derived from a total insurance premium base of over $158 million. Crop insurance is offered to producers of many different crops from 14 approved providers who operate under agreements with the U.S. Department of Agriculture ("USDA"). We conduct business with five of these approved providers. The USDA shares underwriting losses with those providers and also reimburses them for certain administrative and operational expenses. Our revenue is based on a share of those reimbursements and profit sharing when underwriting losses are minimized by those providers. This program has been in place under prior federal farm bills and has been reauthorized until December 31, 2023 under the recently enacted Agriculture Improvement Act of 2018, more commonly referred to as the 2018 Farm Bill.

### *Trust Services*

City Bank Trust, a division of City Bank, provides a range of traditional trust products and services along with several retirement services and products, including estate administration, family trust administration, revocable and irrevocable trusts (including life insurance trusts), real estate administration, charitable trusts for individuals and corporations, 401(k) plans, self-directed individual retirement accounts ("IRAs"), simplified employee pensions plans, employee stock ownership plans ("ESOPs"), defined benefit plans, profit-sharing plans, Keoghs and managed IRAs. Our trust department had $457 million of assets under management at December 31, 2021, and contributed $2.9 million of fee income for the year ended December 31, 2021.

### *Investment Services*

The Investment Center at City Bank provides a variety of investments offered through Raymond James Financial Services, Inc. (Member FINRA/SIPC) including self-directed IRAs, money market funds, 401(k) plans, mutual funds, annuities and tax-deferred annuities, stocks and bonds, investments for non-U.S. residents, treasury bills, treasury notes and bonds and tax-exempt municipal bonds. Gross revenue derived from our investment services for 2021 was $1.9 million with $596.5 million in assets under management at December 31, 2021.

# SUPERVISION AND REGULATION

*The following is a general summary of the material aspects of certain statutes and regulations that are applicable to us. These summary descriptions are not complete, and you should refer to the full text of the statutes, regulations, and corresponding guidance for more information. These statutes and regulations are subject to change, and additional statutes, regulations, and corresponding guidance may be adopted. We are unable to predict these future changes or the effects, if any, that these changes could have on our business or our revenues.*

## General

We are extensively regulated under U.S. federal and state law. As a result, our growth and earnings performance may be affected not only by management decisions and general economic conditions, but also by federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the Texas Department of Banking ("TDB"), the Federal Reserve, the Federal Deposit Insurance Corporation ("FDIC"), and the Consumer Finance Protection Bureau ("CFPB"). Furthermore, tax laws administered by the Internal Revenue Service ("IRS"), and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board ("FASB"), securities laws administered by the Securities and Exchange Commission ("SEC"), and state securities authorities and anti-money laundering, or AML, laws enforced by the U.S. Department of the Treasury ("Treasury") also impact our business. The effect of these statutes, regulations, regulatory policies and rules are significant to our financial condition and results of operations. Further, the nature and extent of future legislative, regulatory or other changes affecting financial institutions are impossible to predict with any certainty.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of banks, their holding companies and their affiliates. These laws are intended primarily for the protection of depositors, customers and the Deposit Insurance Fund ("DIF"), rather than for shareholders. Federal and state laws, and the related regulations of the bank regulatory agencies, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates and the payment of dividends.

This supervisory and regulatory framework subjects banks and bank holding companies to regular examination by their respective regulatory agencies, which results in examination reports and ratings that, while not publicly available, can affect the conduct and growth of their businesses. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management's ability and performance, earnings, liquidity and various other factors. These regulatory agencies have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and the Bank. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

## Regulatory Capital Requirements

The federal banking agencies require that banking organizations meet several risk-based capital adequacy requirements. These risk-based capital adequacy requirements are intended to provide a measure of capital adequacy that reflects the perceived degree of risk associated with a banking organization's operations, both for transactions reported on the banking organization's balance sheet as assets and for transactions that are recorded as off-balance sheet items, such as letters of credit and recourse arrangements. In 2013, the federal bank regulatory agencies issued final rules, or the Basel III Capital Rules, establishing a new comprehensive capital framework for banking organizations. The Basel III Capital Rules implement the Basel Committee's December 2010 framework for strengthening international capital standards and certain provisions of the Dodd-Frank Act. The Basel III Capital Rules became effective on January 1, 2015.

The Basel III Capital Rules require the Bank and the Company, to comply with four minimum capital standards: a Tier 1 leverage ratio of at least 4.0%; a common equity Tier 1, or CET1, to risk-weighted assets ratio of 4.5%; a Tier 1 capital to risk-weighted assets ratio of at least 6.0%; and a total capital to risk-weighted assets ratio of at least 8.0%. CET1 capital is generally comprised of common shareholders' equity and retained earnings. Tier 1 capital is generally comprised of CET1 and additional Tier 1 capital. Additional Tier 1 capital generally includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (CET1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is generally comprised of capital instruments and related surplus meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income, or AOCI, up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Institutions that have not exercised the AOCI opt-out have AOCI incorporated into CET1 capital (including unrealized gains and losses on available-for-sale-securities). The calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

The Basel III Capital Rules also establish a “capital conservation buffer” of 2.5% above the regulatory minimum risk-based capital requirements. An institution is subject to limitations on certain activities, including payment of dividends, share repurchases and discretionary bonuses to executive officers, if its capital level is below the buffered ratio.

The Basel III minimum capital ratios are summarized in the table below.

| | **Basel III Minimum for Capital Adequacy Purposes** | **Basel III Additional Capital Conservation Buffer** | **Basel III Ratio with Capital Conservation Buffer** |
|---|---|---|---|
| Total risk based capital (total capital to risk-weighted assets) | 8.00% | 2.50% | 10.50% |
| Tier 1 risk based capital (Tier 1 to risk-weighted assets) | 6.00% | 2.50% | 8.50% |
| Common equity Tier 1 risk based capital (CET1 to risk-weighted assets) | 4.50% | 2.50% | 7.00% |
| Tier 1 leverage ratio (Tier 1 to average assets) | 4.00% | — | 4.00% |

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, a banking organization’s assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests), are multiplied by a risk weight factor assigned by the regulations based on perceived risks inherent in the type of asset. As a result, higher levels of capital are required for asset categories believed to present greater risk. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien 1-4 family residential mortgages, a risk weight of 100% is assigned to commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors. The Basel III Capital Rules increased the risk weights for a variety of asset classes, including certain commercial real estate mortgages. Additional aspects of the Basel III Capital Rules’ risk-weighting requirements that are relevant to the Company and the Bank include:

- assigning exposures secured by single-family residential properties to either a 50% risk weight for first-lien mortgages that meet prudent underwriting standards or a 100% risk weight category for all other mortgages;

- providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (increased from 0% under the previous risk-based capital rules);

- assigning a 150% risk weight to all exposures that are nonaccrual or 90 days or more past due (increased from 100% under the previous risk-based capital rules), except for those secured by single-family residential properties, which will be assigned a 100% risk weight, consistent with the previous risk-based capital rules;

- applying a 150% risk weight instead of a 100% risk weight for certain high-volatility commercial real estate, or HVCRE, loans, or acquisition, development, and construction, or ADC, loans; and

- applying a 250% risk weight to the portion of mortgage servicing rights and deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks that are not deducted from CET1 capital (increased from 100% under the previous risk-based capital rules).

As of December 31, 2021, the Company’s and the Bank’s capital ratios exceeded the minimum capital adequacy guideline percentage requirements under the Basel III Capital Rules on a fully phased-in basis.

**Community Bank Leverage Ratio**

On September 17, 2019, the federal banking agencies jointly finalized a rule effective as of January 1, 2020 and intended to simplify the regulatory capital requirements described above for qualifying community banking organizations, or QCBO, that opt into the Community Bank Leverage Ratio, or CBLR, framework, as required by Section 201 of the EGRRCPA. The final rule became effective on January 1, 2020, and the CBLR framework became available for banks to use beginning with their March 31, 2020 Call Reports. Under the final rule, if a QCBO opts into the CBLR framework and meets all requirements under the framework, it will be considered to have met the well-capitalized ratio requirements under the Prompt Corrective Action regulations described below and will not be required to report or calculate risk-based capital.

A QCBO, is defined as a bank, savings association, bank holding company or savings and loan holding company with:

- a CBLR of greater than 9%;
- total consolidated assets of less than $10 billion;
- total off-balance sheet exposures (excluding derivatives other than credit derivatives and unconditionally cancelable commitments) of 25% or less of total consolidated assets;
- total trading assets and trading liabilities of 5% or less of total consolidated assets; and
- non-advanced approaches institution.

The numerator of the CBLR is referred to as “CBLR tangible equity” and is calculated as the QCBO’s total capital as reported in compliance with the reporting instructions to the Call Report or the FR Y-9C, or Reporting Instructions (prior to including non-controlling interests in consolidated subsidiaries) less:

- Accumulated other comprehensive income, or AOCI;
- Intangible assets, calculated in accordance with Reporting Instructions, other than mortgage servicing assets; and
- Deferred tax assets that arise from net operating loss and tax credit carry forwards net of any related valuations allowances.

The denominator of the CBLR is the QCBO’s average assets, calculated in accordance with Reporting Instructions and less intangible assets and deferred tax assets deducted from CBLR tangible equity.

Although the Company and the Bank are QCBOs, the Company and the Bank have currently not elected to opt in to the CBLR framework at this time and will continue to follow the Basel III capital requirements as described above.

**Prompt Corrective Action**

The Federal Deposit Insurance Act (“FDIA”) requires federal banking agencies to take “prompt corrective action” with respect to depository institutions that do not meet minimum capital requirements. For purposes of prompt corrective action, the law establishes five capital tiers: “well-capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized.” A depository institution’s capital tier depends on its capital levels and certain other factors established by regulation. The applicable FDIC regulations have been amended to incorporate the increased capital requirements required by the Basel III Capital Rules that became effective on January 1, 2015. Under the amended regulations, an institution is deemed to be “well-capitalized” if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a CET1 ratio of 6.5% or greater and a leverage ratio of 5.0% or greater. Accordingly, a financial institution may be considered “well-capitalized” under the prompt corrective action framework, but not satisfy the full Basel III capital ratios. Generally, a financial institution must be “well capitalized” before the Federal Reserve will approve an application by a bank holding company to acquire a bank or merge with a bank holding company. The FDIC applies the same requirement in approving bank merger applications.

At each successively lower capital category, a bank is subject to increased restrictions on its operations. For example, a bank is generally prohibited from making capital distributions and paying management fees to its holding company if doing so would make the bank “undercapitalized.” Asset growth and branching restrictions apply to undercapitalized banks, which are required to submit written capital restoration plans meeting specified requirements (including a guarantee by the parent holding company, if any). “Significantly undercapitalized” banks are subject to broad regulatory restrictions, including among other things, capital directives, forced mergers, restrictions on the rates of interest they may pay on deposits, restrictions on asset growth and activities, and prohibitions on paying bonuses or increasing compensation to senior executive officers without FDIC approval. “Critically undercapitalized” are subject to even more severe restrictions, including, subject to a narrow exception, the appointment of a conservator or receiver within 90 days after becoming critically undercapitalized.

The appropriate federal banking agency may determine (after notice and opportunity for a hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice. The appropriate agency is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution.

The capital classification of a bank affects the frequency of regulatory examinations, the bank’s ability to engage in certain activities and the deposit insurance premium paid by the bank. A bank’s capital category is determined solely for the purpose of applying prompt correct action regulations and the capital category may not accurately reflect the bank’s overall financial condition or prospects.

As of December 31, 2021, the Bank met the requirements for being deemed "well-capitalized" for purposes of the prompt corrective action regulations.

**Enforcement Powers of Federal and State Banking Agencies**

The federal bank regulatory agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties, and appoint a conservator or receiver for financial institutions. Failure to comply with applicable laws and regulations could subject us and our officers and directors to administrative sanctions and potentially substantial civil money penalties. In addition to the grounds discussed above under "Prompt Corrective Actions," the appropriate federal bank regulatory agency may appoint the FDIC as conservator or receiver for a depository institution (or the FDIC may appoint itself, under certain circumstances) if any one or more of a number of circumstances exist, including, without limitation, the fact that the depository institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized, fails to become adequately capitalized when required to do so, fails to submit a timely and acceptable capital restoration plan or materially fails to implement an accepted capital restoration plan. The TDB also has broad enforcement powers over us, including the power to impose orders, remove officers and directors, impose fines and appoint supervisors and conservators.

**The Company**

***General***. As a bank holding company, the Company is subject to regulation and supervision by the Federal Reserve under the Bank Holding Company Act of 1956, as amended, or the BHCA. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is required to file with the Federal Reserve periodic reports of its operations and such additional information as the Federal Reserve may require.

***Acquisitions, Activities and Change in Control***. The BHCA generally requires the prior approval by the Federal Reserve for any merger involving a bank holding company or a bank holding company's acquisition of more than 5% of a class of voting securities of any additional bank or bank holding company or to acquire all or substantially all of the assets of any additional bank or bank holding company. In reviewing applications seeking approval of merger and acquisition transactions, the Federal Reserve considers, among other things, the competitive effect and public benefits of the transactions, the capital position and managerial resources of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act ("CRA") and the effectiveness of all organizations involved in the merger or acquisition in combating money laundering activities. In addition, failure to implement or maintain adequate compliance programs could cause bank regulators not to approve an acquisition where regulatory approval is required or to prohibit an acquisition even if approval is not required.

Subject to certain conditions (including deposit concentration limits established by the BHCA and the Dodd-Frank Act), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the U.S. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, bank holding companies must be well-capitalized and well-managed in order to complete interstate mergers or acquisitions. For a discussion of the capital requirements, see "Regulatory Capital Requirements" above.

The BHCA also prohibits any company from acquiring "control" of a bank or bank holding company without prior notice to the appropriate federal bank regulator. "Control" is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise based on the facts and circumstances even with ownership below 5.00% up to 24.99% ownership. On September 30, 2020, the Federal Reserve's final rule revising the Federal Reserve's regulations related to determinations of whether a company has "control" over another company, including a bank holding company or a bank, for purposes of the BHCA, became effective. The final rule created a tiered system of non-control presumptions based upon the percentage of any class of voting securities held by an acquirer and the presence of other indicia of control, The final rule's four categories of tiered presumptions of non-control, based upon the percentage of ownership of any class of voting securities held by an acquirer, are (i) less than 5%, (ii) 5% to 9.99%, (iii) 10% to 14.99%, and (iv) 15% to 24.99%. By codifying the non-control presumptions, the final rule provides greater transparency with respect to the total level of equity, representative directors, management interlocks, limiting contractual provisions and business relationships that would be permissible to the Federal Reserve in order to avoid a determination of control. The Federal Reserve's final rule applies to control determinations under the BHCA, but does not apply to the Change in Bank Control Act, as amended (the "CIBC Act").

The CIBC Act provides that a person, which includes a natural person or entity, directly or indirectly, has “control” of a bank or bank holding company if it (i) owns, controls, or has the power to vote 25% or more of the voting securities of the bank or bank holding company, (ii) controls the election of directors, trustees, or general partners of the company, (iii) has a controlling influence over the management or policies of the company, or (iv) conditions in any manner the transfer of 25% or more of the voting securities of the company upon the transfer of 25 % or more of the outstanding shares of any class of voting securities of another company. Accordingly, the CIBC Act requires that prior to the acquisition of any class of voting securities of a bank or bank holding company that prior notice to the Federal Reserve be provided, if, immediately after the transaction, the acquiring person (or persons acting in concert) will own, control, or hold the power to vote 25% or more of any class of voting securities of the bank or bank holding company. A rebuttable presumption of control arises under the CIBC Act where a person (or persons acting in concert) controls 10% or more (but less than 25%) of a class of the voting securities of a bank or bank holding (i) which has registered securities under the Exchange Act, such as the Company, or (ii) no other person owns, controls, or holds the power to vote a greater percentage of any class of voting securities immediately after the transaction.

***Permissible Activities***. The BHCA generally prohibits the Company from controlling or engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be “so closely related to banking as to be a proper incident thereto.” This authority would permit the Company to engage in a variety of banking-related businesses, including the ownership and operation of a savings association, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies. The Federal Reserve has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the Federal Reserve has reasonable grounds to believe that continuing such activity, ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

In connection with the Dodd-Frank Act, Section 13 of the BHCA, commonly known as the “Volcker Rule,” was amended to generally prohibit banking entities from engaging in the short-term proprietary trading of securities and derivatives for their own account and barred them from having certain relationships with hedge funds or private equity funds. However, Section 203 of the EGRRCPA, exempts community banks from the restrictions of the Volcker Rule if (i) the community bank, and every entity that controls it, has total consolidated assets equal to or less than $10 billion; and (ii) trading assets and liabilities of the community bank, and every entity that controls it, is equal to or less than 5% of its total consolidated assets. As the consolidated assets of the Company are less than $10 billion and the Company does not currently exceed the 5% threshold, this aspect of the Volcker Rule does not have any impact on the Company’s consolidated financial statements at this time.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of non-banking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature or incidental to any such financial activity or that the Federal Reserve determines by order to be complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The Company has not elected to be a financial holding company, and we have not engaged in any activities determined by the Federal Reserve to be financial in nature or incidental or complementary to activities that are financial in nature.

If the Company should elect to become a financial holding company, the Company and the Bank must be well-capitalized, well-managed, and have a least a satisfactory CRA rating. If the Company were to become a financial holding company and the Federal Reserve subsequently determined that the Company, as a financial holding company, is not well-capitalized or well-managed, the Company would have a period of time during which to achieve compliance, but during the period of noncompliance, the Federal Reserve may place any limitations on the Company that the Federal Reserve believes to be appropriate. Furthermore, if the Company became a financial holding company and the Federal Reserve subsequently determined that the Bank, as a financial holding company subsidiary, has not received a satisfactory CRA rating, the Company would not be able to commence any new financial activities or acquire a company that engages in such activities.

***Source of Strength***. Federal Reserve policy historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement the Company is expected to commit resources to support the Bank, including at times when the Company may not be in a financial position to provide it. The Company must stand ready to use its available resources to provide adequate capital to the Bank during periods of financial stress or adversity. The Company must also maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting the Bank. The Company’s failure to meet its source of strength obligations may constitute an unsafe and unsound practice or a violation of the Federal Reserve’s regulations or both. The source of strength obligation most directly affects bank holding companies where a bank holding company’s subsidiary bank fails to maintain adequate capital levels. Any capital loans by a bank holding company to the subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of the subsidiary bank. The BHCA provides that 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 its subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

***Imposition of Liability for Undercapitalized Subsidiaries***. Bank regulators are required to take "prompt corrective action" to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes "undercapitalized," it must submit a capital restoration plan to its regulators. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary's compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution's holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution's assets at the time it became undercapitalized or the amount necessary to cause the institution to be "adequately capitalized." The bank regulators have greater power in situations where an institution becomes "significantly" or "critically" undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve approval of proposed dividends, or it may be required to consent to a consolidation or to divest the troubled institution or other affiliates.

***Safe and Sound Banking Practices***. Bank holding companies and their non-banking subsidiaries are prohibited from engaging in activities that represent unsafe and unsound banking practices or that constitute a violation of law or regulations. Under certain conditions the Federal Reserve may conclude that certain actions of a bank holding company, such as a payment of a cash dividend, would constitute an unsafe and unsound banking practice. The Federal Reserve also has the authority to regulate the debt of bank holding companies, including the authority to impose interest rate ceilings and reserve requirements on such debt. Under certain circumstances the Federal Reserve may require a bank holding company to file written notice and obtain its approval prior to purchasing or redeeming its equity securities, unless certain conditions are met.

***Tie in Arrangements***. Federal law prohibits bank holding companies and any subsidiary banks from engaging in certain tie in arrangements in connection with the extension of credit. For example, the Bank may not extend credit, lease or sell property, or furnish any services, or fix or vary the consideration for any of the foregoing on the condition that (i) the customer must obtain or provide some additional credit, property or services from or to the Bank other than a loan, discount, deposit or trust services, (ii) the customer must obtain or provide some additional credit, property or service from or to the Company or the Bank, or (iii) the customer must not obtain some other credit, property or services from competitors, except reasonable requirements to assure soundness of credit extended.

***Dividend Payments, Stock Redemptions and Repurchases***. The Company's ability to pay dividends to its shareholders is affected by both general corporate law considerations and the regulations and policies of the Federal Reserve applicable to bank holding companies, including the Basel III Capital Rules. Generally, a Texas corporation may not make distributions to its shareholders if (i) after giving effect to the dividend, the corporation would be insolvent, or (ii) the amount of the dividend exceeds the surplus of the corporation. Dividends may be declared and paid in a corporation's own treasury shares that have been reacquired by the corporation out of surplus. Dividends may be declared and paid in a corporation's own authorized but unissued shares out of the surplus of the corporation upon the satisfaction of certain conditions.

It is the Federal Reserve's policy that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. It is also the Federal Reserve's policy that bank holding companies should not maintain dividend levels that undermine their ability to be a source of strength to its banking subsidiaries. Additionally, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. The Federal Reserve possesses enforcement powers over bank holding companies and their nonbank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

Bank holding companies must consult with the Federal Reserve before redeeming any equity or other capital instrument included in Tier 1 or Tier 2 capital prior to stated maturity, if (x) such redemption could have a material effect on the level or composition of the organization's capital base, or (y) as a result of such repurchase, there is a net reduction of the outstanding amount of common stock or preferred stock outstanding at the beginning of the quarter in which the redemption or repurchase occurs. In addition, bank holding companies are unable to repurchase shares equal to 10% or more of its net worth if it would not be well-capitalized (as defined by the Federal Reserve) after giving effect to such repurchase. Bank holding companies experiencing financial weaknesses, or that are at significant risk of developing financial weaknesses, must consult with the Federal Reserve before redeeming or repurchasing common stock or other regulatory capital instruments.

**The Bank**

***General***. City Bank is a Texas banking association and is subject to supervision, regulation and examination by the TDB and the FDIC. City Bank is also subject to certain regulations of the CFPB. The TDB supervises and regulates all areas of the Bank's operations including, without limitation, the making of loans, the issuance of securities, the conduct of the Bank's corporate affairs, the satisfaction of capital adequacy requirements, the payment of dividends and the establishment or closing of banking offices. The FDIC is the Bank's primary federal regulatory agency and periodically examines the Bank's operations and financial condition and compliance with federal law. In addition, the Bank's deposit accounts are insured by the DIF to the maximum extent provided under federal law and FDIC regulations, and the FDIC has certain enforcement powers over the Bank.

***Depositor Preference***. In the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors including the parent bank holding company with respect to any extensions of credit they have made to that insured depository institution.

***Brokered Deposit Restrictions***. Well-capitalized institutions are not subject to limitations on brokered deposits, while adequately capitalized institutions are able to accept, renew or roll over brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the yield paid on such deposits. Undercapitalized institutions are generally not permitted to accept, renew or roll over brokered deposits. As of December 31, 2021, the Bank was eligible to accept brokered deposits without a waiver from the FDIC as the Bank was a well-capitalized institution.

***Deposit Insurance***. As an FDIC-insured institution, the Bank is required to pay deposit insurance premiums to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. For deposit insurance assessment purposes, an insured depository institution is placed in one of four risk categories each quarter. An institution's assessment is determined by multiplying its assessment rate by its assessment base. The total base assessment rates range from 1.5 basis points to 40 basis points. While in the past an insured depository institution's assessment base was determined by its deposit base, amendments to the FDIA revised the assessment base so that it is calculated using average consolidated total assets minus average tangible equity.

Additionally, the Dodd-Frank Act altered the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. The FDIC had until September 3, 2020 to meet the 1.35% reserve ratio target, but it announced in November 2018 that the DIF had reached 1.36%, exceeding the 1.35% reserve ratio target. Because the reserve ratio exceeded the targeted 1.35% by the Dodd-Frank Act, two deposit assessment changes occurred under FDIC regulations: (i) surcharges on large banks ended, and the last surcharge on large banks was collected on December 28, 2018; and (ii) small banks were awarded assessment credits for the portion of their assessment that contributed to the growth in the reserve ratio from 1.15% to 1.35%, to be applied when the reserve ratio is at least 1.38%. The Bank's assessment credit as calculated by the FDIC was $675,000 and was first applied to the Bank's September 2019 Quarterly Invoice for Deposit Insurance, and then was applied on a quarterly basis until it was exhausted in March 2020. As of September 30, 2020, the FDIC announced that the ratio had declined to 1.30% due largely to consequences of the COVID-19 pandemic. The FDIC adopted a plan to restore the DIF to the 1.35% ratio within eight years but did not change its assessment schedule. Under the FDIC's restoration plan, FDIC staff will update its projections for the DIF balance and DIF reserve ratio at least semiannually while the restoration plan is in effect. FDIC staff may in the future recommend assessment rate adjustments if deemed necessary.

At least semi-annually, the FDIC updates its loss and income projections for the DIF and, if needed, may increase or decrease the assessment rates following notice and comment on proposed rulemaking. As a result, the Bank's FDIC deposit insurance premiums could increase. During the year ended December 31, 2021, the Bank paid $952,000 in FDIC deposit insurance premiums.

***Audit Reports***. For insured institutions with total assets of $1.0 billion or more, financial statements prepared in accordance with generally accepted accounting principles, or GAAP, management's certifications signed by our and the Bank's chief executive officer and chief accounting or financial officer concerning management's responsibility for the financial statements, and an attestation by the auditors regarding the Bank's internal controls must be submitted. For institutions with total assets of more than $3.0 billion, independent auditors may be required to review quarterly financial statements. The Federal Deposit Insurance Corporation Improvement Act requires that the Bank have an independent audit committee, consisting of outside directors only, or that we have an audit committee that is entirely independent. The committees of such institutions must include members with experience in banking or financial management, must have access to outside counsel and must not include representatives of large customers. The Bank's audit committee consists entirely of independent directors.

***Examination Assessments***. Texas-chartered banks are required to pay an annual assessment fee to the TDB to fund its operations. The fee is based on the amount of the bank's assets at rates established by the Finance Commission of Texas. During the year ended December 31, 2021, the Bank paid examination assessments to the TDB totaling $279,000.

***Capital Requirements***. Banks are generally required to maintain minimum capital ratios. For a discussion of the capital requirements applicable to the Bank, see "Regulatory Capital Requirements" above.

***Bank Reserves***. The Federal Reserve requires all depository institutions to maintain reserves against some transaction accounts (primarily NOW and Super NOW checking accounts). The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy liquidity requirements. An institution may borrow from the Federal Reserve "discount window" as a secondary source of funds if the institution meets the Federal Reserve's credit standards.

***Liquidity Requirements***. Historically, regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III liquidity framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests. The federal banking agencies adopted final Liquidity Coverage Ratio rules in September 2014 and proposed Net Stable Funding Ratio rules in May 2016. These rules introduced two liquidity related metrics: Liquidity Coverage Ratio is intended to require financial institutions to maintain sufficient high-quality liquid resources to survive an acute stress scenario that lasts for one month; and Net Stable Funding Ratio is intended to require financial institutions to maintain a minimum amount of stable sources relative to the liquidity profiles of the institution's assets and contingent liquidity needs over a one-year period.

While the Liquidity Coverage Ratio and the proposed Net Stable Funding Ratio rules apply only to the largest banking organizations in the country, certain elements may filter down and become applicable to or expected of all insured depository institutions and bank holding companies.

***Dividend Payments***. The primary source of funds for the Company is dividends from the Bank. Unless the approval of the FDIC is obtained, the Bank may not declare or pay a dividend if the total of all dividends declared during the calendar year, including the proposed dividend, exceeds the sum of the Bank's net income during the current calendar year and the retained net income of the prior two calendar years. In addition, pursuant to the Texas Finance Code, as a Texas banking association, the Bank generally may not pay a dividend that would reduce its outstanding capital and surplus unless it obtains the prior approval of the Texas Banking Commissioner. As a Texas corporation, we may, under the Texas Business Organizations Code ("TBOC"), pay dividends out of net profits after deducting expenses, including loan losses. The FDIC and the TDB also may, under certain circumstances, prohibit the payment of dividends to the Company from the Bank. Texas corporate law also requires that dividends only be paid out of funds legally available therefor.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its minimum capital requirements under applicable regulatory guidelines as of December 31, 2021.

***Transactions with Affiliates***. The Bank is subject to sections 23A and 23B of the Federal Reserve Act, or the Affiliates Act, and the Federal Reserve's implementing Regulation W. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. Accordingly, transactions between the Company, the Bank and any non-bank subsidiaries will be subject to a number of restrictions. The Affiliates Act imposes restrictions and limitations on the Bank from making extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of, the Company or other affiliates, the purchase of, or investment in, stock or other securities thereof, the taking of such securities as collateral for loans and the purchase of assets of the Company or other affiliates. Such restrictions and limitations prevent the Company or other affiliates from borrowing from the Bank unless the loans are secured by marketable obligations of designated amounts. Furthermore, such secured loans and investments by the Bank to or in the Company or to or in any other non-banking affiliate are limited, individually, to 10% of the Bank's capital and surplus, and such transactions are limited in the aggregate to 20% of the Bank's capital and surplus. All such transactions, as well as contracts entered into between the Bank and affiliates, must be on terms that are no less favorable to the Bank than those that would be available from non-affiliated third parties. Federal Reserve policies also forbid the payment by bank subsidiaries of management fees which are unreasonable in amount or exceed the fair market value of the services rendered or, if no market exists, actual costs plus a reasonable profit.

***Financial Subsidiaries***. Under the Gramm-Leach-Bliley Act ("GLBA"), subject to certain conditions imposed by their respective banking regulators, national and state-chartered banks are permitted to form "financial subsidiaries" that may conduct financial activities or activities incidental thereto, thereby permitting bank subsidiaries to engage in certain activities that previously were impermissible. The GLBA imposes several safeguards and restrictions on financial subsidiaries, including that the parent bank's equity investment in the financial subsidiary be deducted from the bank's assets and tangible equity for purposes of calculating the bank's capital adequacy. In addition, the GLBA imposed new restrictions on transactions between a bank and its financial subsidiaries similar to restrictions applicable to transactions between banks and non-bank affiliates. As of December 31, 2021, the Bank did not have any financial subsidiaries.

***Loans to Directors, Executive Officers and Principal Shareholders***. The authority of the Bank to extend credit to its directors, executive officers and principal shareholders, including their immediate family members and corporations and other entities that they control, is subject to substantial restrictions and requirements under the Federal Reserve's Regulation O, as well as the Sarbanes-Oxley Act. These statutes and regulations impose limits on the amount of loans the Bank may make to directors and other insiders and require that (i) the loans must be made on substantially the same terms, including interest rates and collateral, as prevailing at the time for comparable transactions with persons not affiliated with the Company or the Bank, (ii) the Bank must follow credit underwriting procedures at least as stringent as those applicable to comparable transactions with persons who are not affiliated with the Company or the Bank, and (iii) the loans must not involve a greater than normal risk of non-payment or include other features not favorable to the Bank. Furthermore, the Bank must periodically report all loans made to directors and other insiders to the bank regulators. As of December 31, 2021, the Bank's total amount of lines of credit for loans to insiders and loans outstanding to insiders was $12.2 million.

***Limits on Loans to One Borrower***. As a Texas banking association, the Bank is subject to limits on the amount of loans it can make to one borrower. With certain limited exceptions, loans and extensions of credit from Texas banking associations outstanding to any borrower (including certain related entities of the borrower) at any one time may not exceed 25% of the Tier 1 capital of the Bank. A Texas banking association may lend an additional amount if the loan is fully secured by certain types of collateral, like bonds or notes of the U.S. Certain types of loans are exempted from the lending limits, including loans secured by segregated deposits held by the Bank. The Bank's legal lending limit to any one borrower was approximately $97.5 million as of December 31, 2021.

***Safety and Soundness Standards / Risk Management***. The federal banking agencies have adopted guidelines establishing operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the financial institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If a financial institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator's order is cured, the regulator may restrict the financial institution's rate of growth, require the financial institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal bank regulatory agencies, including cease and desist orders and civil money penalty assessments.

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the financial institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal and reputational risk. In particular, recent regulatory pronouncements have focused on operational risk, which arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or unforeseen catastrophes will result in unexpected losses. New products and services, third party risk management and cybersecurity are critical sources of operational risk that financial institutions are expected to address in the current environment. The Bank is expected to have active board and senior management oversight; adequate policies, procedures and limits; adequate risk measurement, monitoring and management information systems; and comprehensive internal controls.

***Branching Authority***. Deposit-taking banking offices must be approved by the FDIC and, if such office is established within Texas, the TDB, which consider a number of factors including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate power. The Dodd-Frank Act permits insured state banks to engage in interstate branching if the laws of the state where the new banking office is to be established would permit the establishment of the banking office if it were chartered by a bank in such state. Finally, the Bank may also establish banking offices in other states by merging with banks or by purchasing banking offices of other banks in other states, subject to certain restrictions.

***Interstate Deposit Restrictions***. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Interstate Act"), together with the Dodd-Frank Act, relaxed prior branching restrictions under federal law by permitting, subject to regulatory approval, banks to establish branches in states where the laws permit banks chartered in such states to establish branches.

Section 109 of the Interstate Act prohibits a bank from establishing or acquiring a branch or branches outside of its home state primarily for the purpose of deposit production. To determine compliance with Section 109, the appropriate federal banking agency first compares a bank's estimated statewide loan-to-deposit ratio to the estimated host state loan-to-deposit ratio for a particular state. If a bank's statewide loan-to-deposit ratio is at least one-half of the published host state loan-to-deposit ratio, the bank has complied with Section 109. A second step is conducted if a bank's estimated statewide loan-to-deposit ratio is less than one-half of the published ratio for that state. The second step requires the appropriate agency to determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank's interstate branches. A bank that fails both steps is in violation of Section 109 and subject to sanctions by the appropriate agency. Those sanctions may include requiring the bank's interstate branches in the non-compliant state be closed or not permitting the bank to open new branches in the non-compliant state.

For purposes of Section 109, the Bank's home state is Texas and the Bank operates branches in one host state: New Mexico. The most recently published host state loan-to-deposit ratio using data as of June 30, 2020 reflects a statewide loan-to-deposit ratio in New Mexico of 64%. As of December 31, 2021, the Bank's statewide loan-to-deposit ratio in New Mexico was 33%. Accordingly, management believes that the Bank is in compliance with Section 109 in New Mexico after application of the first step of the two-step test.

***Community Reinvestment Act***. The CRA and the regulations issued thereunder are intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal bank regulatory agencies, in examining insured depository institutions, to assess their record of helping to meet the credit needs of their entire community, including low and moderate income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions or holding company formations.

The federal banking agencies have adopted regulations which measure a bank's compliance with its CRA obligations on a performance based evaluation system. This system bases CRA ratings on an institution's actual lending service and investment performance rather than the extent to which the institution conducts needs assessments, documents community outreach or complies with other procedural requirements. The ratings range from a high of "outstanding" to a low of "substantial noncompliance." The Bank had a CRA rating of "satisfactory" as of its most recent CRA assessment.

On December 12, 2019, the OCC and the FDIC issued a joint proposal to revamp how the agencies will assess banks' performance under the CRA. Among other changes, the proposal (i) expands the concept of assessment area ("AA") to include geographies outside of a bank's current AAs and in which the bank receives at least 5% of its retail deposits and (ii) introduces a series of objective tests for determining a bank's presumptive CRA rating. While the OCC adopted a final rule on May 20, 2020, published on June 5, 2020 (the "June 2020 CRA rule"), that was generally consistent with the proposed rule, the FDIC did not join in the June 2020 CRA rule and has indicated it is not ready to adopt a final rule at this time, particularly in light of the ongoing COVID-19 pandemic. Members of Congress and community groups expressed hostility to the June 2020 CRA rule, and raised the possibility of repealing it through legislative action. In light of this, the OCC issued a final rule on December 14, 2021 rescinding the June 2020 CRA rule and replaced it with a rule based on the CRA rules adopted jointly by the federal banking agencies sin 1995. The Company and the Bank will continue to monitor these developments.

***Bank Secrecy Act, Anti-Money Laundering and the Office of Foreign Assets Control Regulation***. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA PATRIOT Act") is designed to deny terrorists and criminals the ability to obtain access to the U.S. financial system and has significant implications for depository institutions, brokers, dealers and other businesses involved in the transfer of money. The USA PATRIOT Act substantially broadened the scope of U.S. anti-money laundering ("AML") laws and regulations by imposing significant compliance and due diligence obligations, created new crimes and penalties and expanded the extra territorial jurisdiction of the U.S. Financial institutions are also prohibited from entering into specified financial transactions and account relationships, must use enhanced due diligence procedures in their dealings with certain types of high risk customers and must implement a written customer identification program. Financial institutions must take certain steps to assist government agencies in detecting and preventing money laundering and report certain types of suspicious transactions. Regulatory authorities routinely examine financial institutions for compliance with these obligations and failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with the USA PATRIOT Act or its regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required. Regulatory authorities have imposed cease and desist orders and civil money penalties against institutions found to be in violation of these obligations.

Among other requirements, federal laws, including the Bank Secrecy Act ("BSA"), as amended by the USA PATRIOT Act and as further amended by the National Defense Authorization Act for Fiscal Year 2021 (the "National Defense Authorization Act"), and implementing regulations, require banks to establish and maintain AML programs that include, at a minimum:

- internal policies, procedures and controls designed to implement and maintain the bank's compliance with all of the requirements of the BSA, the USA PATRIOT Act, the National Defense Authorization Act and related laws and regulations;
- systems and procedures for monitoring and reporting suspicious transactions and activities;
- a designated compliance officer;
- employee training;
- an independent audit function to test the AML program;
- procedures to verify the identity of each customer upon the opening of accounts; and
- heightened due diligence policies, procedures and controls applicable to certain foreign accounts and relationships.

Additionally, the USA PATRIOT Act requires each financial institution to develop a customer identification program ("CIP") as part of its AML program. The key components of the CIP are identification, verification, government list comparison, notice and record retention. The purpose of the CIP is to enable the financial institution to determine the true identity and anticipated account activity of each customer. To make this determination, among other things, the financial institution must collect certain information from customers at the time they enter into the customer relationship with the financial institution. This information must be verified within a reasonable time through documentary and non-documentary methods. Furthermore, all customers must be screened against any CIP-related government lists of known or suspected terrorists. Financial institutions are also required to comply with various reporting and recordkeeping requirements. The Federal Reserve and the FDIC consider an applicant's effectiveness in combating money laundering, among other factors, in connection with an application to approve a bank merger or acquisition of control of a bank or bank holding company.

Likewise, the Office of Foreign Accounts Control ("OFAC") administers and enforces economic and trade sanctions against targeted foreign countries and regimes under authority of various laws, including designated foreign countries, nationals and others. OFAC publishes lists of specially designated targets and countries. Financial institutions are responsible for, among other things, freezing or blocking accounts of, and transactions with, such targets and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked transactions after their occurrence.

The Financial Crimes Enforcement Network ("FinCEN") issued a final rule regarding customer due diligence requirements for covered financial institutions in connection with their BSA and AML policies, that became effective in May 2018. The final rule adds a requirement to understand the nature and purpose of customer relationships and identify the "beneficial owner" (25% or more ownership interest) of legal entity customers. Bank regulators routinely examine institutions for compliance with these obligations and they must consider an institution's anti-money laundering compliance when considering regulatory applications filed by the institution, including applications for bank mergers and acquisitions. The regulatory authorities have imposed "cease and desist" orders and civil money penalty sanctions against institutions found to be violating these obligations.

Further, on January 1, 2021, Congress passed the National Defense Authorization Act, which enacted the most significant overhaul of the BSA and related AML laws since the USA PATRIOT Act. Notable amendments include (1) significant changes to the collection of beneficial ownership information and the establishment of a beneficial ownership registry, which requires corporate entities (generally, any corporation, limited liability company, or other similar entity with 20 or fewer employees and annual gross income of $5 million or less) to report beneficial ownership information to FinCEN (which will be maintained by FinCEN and made available upon request to financial institutions); (2) enhanced whistleblower provisions, which provide that one or more whistleblowers who voluntarily provide original information leading to the successful enforcement of violations of the anti-money laundering laws in any judicial or administrative action brought by the Secretary of the Treasury or the Attorney General resulting in monetary sanctions exceeding $1 million (including disgorgement and interest but excluding forfeiture, restitution, or compensation to victims) will receive not more than 30 percent of the monetary sanctions collected and will receive increased protections; (3) increased penalties for violations of the BSA; (4) improvements to existing information sharing provisions that permit financial institutions to share information relating to suspicious activity reports (SARs) with foreign branches, subsidiaries, and affiliates (except those located in China, Russia, or certain other jurisdictions) for the purpose of combating illicit finance risks; and (5) expanded duties and powers of FinCEN. Many of the amendments, including those with respect to beneficial ownership, require the Department of Treasury and FinCEN to promulgate rules.

Failure of a financial institution to maintain and implement adequate AML and OFAC programs, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

***Concentrations in Commercial Real Estate***. The federal banking agencies have promulgated guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (i) total reported loans for construction, land development, and other land represent 100% or more of total capital or (ii) total reported loans secured by multifamily and non-farm nonresidential properties (excluding loans secured by owner-occupied properties) and loans for construction, land development, and other land represent 300% or more of total capital and the bank's commercial real estate loan portfolio has increased 50% or more during the prior 36 months. If a concentration is present, management must employ heightened risk management practices that address the following key elements: including board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending. On December 18, 2015, the federal banking agencies jointly issued a "statement on prudent risk management for commercial real estate lending". As of December 31, 2021, the Company did not exceed the levels to be considered to have a concentration in commercial real estate lending and believes its credit administration to be consistent with the published policy statement.

The Basel III Capital Rules also require loans categorized as "high-volatility commercial real estate," or HVCRE, to be assigned a 150% risk weighting and require additional capital support. However, the EGRRCPA, signed into law in May 2018, prohibits federal banking regulators from imposing higher capital standards on HVCRE exposures unless they are for ADC and clarifying ADC status. As of December 31, 2021, we had $323.1 million in ADC loans and $3.6 million in HVCRE loans.

**Consumer Financial Services**

We are subject to a number of federal and state consumer protection laws that extensively govern our relationship with our customers. These laws include the Equal Credit Opportunity Act ("ECOA"), the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act ("FHA"), the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act, the Military Lending Act, and these laws' respective state law counterparts, as well as state usury laws and laws regarding unfair and deceptive acts and practices. These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit unfair, deceptive and abusive practices and subject us to substantial regulatory oversight. Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys' fees. Federal bank regulators, state attorneys general and state and local consumer protection agencies may also seek to enforce consumer protection requirements and obtain these and other remedies, including regulatory sanctions, customer rescission rights, action by the state and local attorneys general in each jurisdiction in which we operate and civil money penalties. Failure to comply with consumer protection requirements may also result in failure to obtain any required bank regulatory approval for mergers or acquisitions or prohibition from engaging in such transactions even if approval is not required.

Many states and local jurisdictions have consumer protection laws analogous, and in addition, to those listed above. These state and local laws regulate the manner in which financial institutions deal with customers when taking deposits, making loans or conducting other types of transactions. Failure to comply with these laws and regulations could give rise to regulatory sanctions, customer rescission rights, action by state and local attorneys general and civil or criminal liability.

Rulemaking authority for most federal consumer protection laws was transferred from the prudential regulators to the CFPB on July 21, 2011. In some cases, regulators such as the Federal Trade Commission ("FTC") and the U.S. Department of Justice ("DOJ") also retain certain rulemaking or enforcement authority. The CFPB also has broad authority to prohibit unfair, deceptive and abusive acts and practices, or UDAAP, and to investigate and penalize financial institutions that violate this prohibition. While the statutory language of the Dodd-Frank Act sets forth the standards for acts and practices that violate the prohibition on UDAAP, certain aspects of these standards are untested, and thus it is currently not possible to predict how the CFPB will exercise this authority.

The consumer protection provisions of the Dodd-Frank Act and the examination, supervision and enforcement of those laws and implementing regulations by the CFPB have created a more intense and complex environment for consumer finance regulation. The CFPB has significant authority to implement and enforce federal consumer protection laws and new requirements for financial services products provided for in the Dodd-Frank Act, as well as the authority to identify and prohibit UDAAP. The review of products and practices to prevent such acts and practices is a continuing focus of the CFPB, and of banking regulators more broadly. The ultimate impact of this heightened scrutiny is uncertain but could result in changes to pricing, practices, products and procedures. It could also result in increased costs related to regulatory oversight, supervision and examination, additional remediation efforts and possible penalties. In addition, the Dodd-Frank Act provides the CFPB with broad supervisory, examination and enforcement authority over various consumer financial products and services, including the ability to require reimbursements and other payments to customers for alleged legal violations and to impose significant penalties, as well as injunctive relief that prohibits lenders from engaging in allegedly unlawful practices. The CFPB also has the authority to obtain cease and desist orders providing for affirmative relief or monetary penalties. The Dodd-Frank Act does not prevent states from adopting stricter consumer protection standards. State regulation of financial products and potential enforcement actions could also adversely affect our business, financial condition or results of operations.

The CFPB has examination and enforcement authority over providers with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets, like the Bank, will continue to be examined by their applicable bank regulators.

***Mortgage and Mortgage-Related Products, Generally***. Because abuses in connection with home mortgages were a significant factor contributing to the financial crisis, many provisions of the Dodd-Frank Act and rules issued thereunder address mortgage and mortgage-related products, their underwriting, origination, servicing and sales. The Dodd-Frank Act significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property and augmented federal law combating predatory lending practices. In addition to numerous disclosure requirements, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks, in an effort to strongly encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain "qualified mortgages." The Dodd-Frank Act generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans that the lender sells, and other asset-backed securities that the securitizer issues, if the loans do not comply with the ability-to-repay standards described below. The Bank does not currently expect these provisions of the Dodd-Frank Act or any related regulations to have a significant impact on its operations, except for higher compliance costs.

***Ability-to-Repay Requirement and Qualified Mortgage Rule***. In January 2013, the CFPB issued a final rule implementing the Dodd-Frank Act's ability-to-repay requirements. Under this rule, lenders, in assessing a borrower's ability to repay a mortgage-related obligation, must consider eight underwriting factors: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) monthly payment on the subject transaction; (iv) monthly payment on any simultaneous loan; (v) monthly payment for all mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) monthly debt-to-income ratio or residual income; and (viii) credit history. This rule also includes guidance regarding the application of, and methodology for evaluating, these factors. The EGRRCPA provides that for certain insured depository institutions and insured credit unions with less than $10 billion in total consolidated assets, mortgage loans that are originated and retained in portfolio will automatically be deemed to satisfy the "ability to repay" requirement. To qualify for this treatment, the insured depository institutions and credit unions must meet conditions relating to prepayment penalties, points and fees, negative amortization, interest-only features and documentation.

***Home Mortgage Disclosure Act ("HMDA")***. On October 15, 2015, pursuant to Section 1094 of the Dodd-Frank Act, the CFPB issued amended rules in regard to the collection, reporting and disclosure of certain residential mortgage transactions under the Home Mortgage Disclosure Act (the "HMDA Rules"). The Dodd-Frank Act mandated additional loan data collection points in addition to authorizing the Bureau to require other data collection points under implementing Regulation C. Most of the provisions of the HMDA Rule went into effect on January 1, 2018 and apply to data collected in 2018 and reporting in 2019 and later years. The HMDA Rule adopts a uniform loan volume threshold for all financial institutions, modifies the types of transactions that are subject to collection and reporting, expands the loan data information being collected and reported, and modifies procedures for annual submission and annual public disclosures. EGRRCPA amended provisions of the HMDA Rule to exempt certain insured institutions from most of the expanded data collection requirements required of the Dodd-Frank Act. Institutions originating fewer than 500 dwelling secured closed-end mortgage loans or fewer than 500 dwelling secured open-end lines are exempt from the expanded data collection requirements that went into effect January 1, 2018. The Bank does not receive this reporting relief based on the number of dwelling secured mortgage loans reported annually.

***UDAP and UDAAP***. Banking regulatory agencies have increasingly used a general consumer protection statute to address "unethical" or otherwise "bad" business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. The law of choice for enforcement against such business practices has been Section 5 of the Federal Trade Commission Act, referred to as the FTC Act, which is the primary federal law that prohibits unfair or deceptive acts or practices, referred to as UDAP, and unfair methods of competition in or affecting commerce. "Unjustified consumer injury" is the principal focus of the FTC Act. UDAP laws and regulations were expanded under the Dodd-Frank Act to apply to "unfair, deceptive or abusive acts or practices," referred to as UDAAP, which have been delegated to the CFPB for rule-making. The federal banking agencies have the authority to enforce such rules and regulations.

**Incentive Compensation Guidance**

The federal bank regulatory agencies have issued comprehensive guidance intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of those organizations by encouraging excessive risk-taking. The incentive compensation guidance sets expectations for banking organizations concerning their incentive compensation arrangements and related risk-management, control and governance processes. The incentive compensation guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon three primary principles: (1) balanced risk-taking incentives; (2) compatibility with effective controls and risk management; and (3) strong corporate governance. Any deficiencies in compensation practices that are identified may be incorporated into the organization's supervisory ratings, which can affect its ability to make acquisitions or take other actions. In addition, under the incentive compensation guidance, a banking organization's federal supervisor may initiate enforcement action if the organization's incentive compensation arrangements pose a risk to the safety and soundness of the organization. Further, the Basel III capital rules limit discretionary bonus payments to bank executives if the institution's regulatory capital ratios fail to exceed certain thresholds. Although the federal bank regulatory agencies proposed additional rules in 2016 related to incentive compensation for all banks with more than $1.0 billion in assets, those rules have not yet been finalized. The scope and content of the U.S. banking regulators' policies on executive compensation are continuing to develop and are likely to continue evolving in the near future.

The Dodd-Frank Act requires public companies to include, at least once every three years, a separate non-binding "say-on-pay" vote in their proxy statement by which shareholders may vote on the compensation of the public company's named executive officers. In addition, if such public companies are involved in a merger, acquisition, or consolidation, or if they propose to sell or dispose of all or substantially all of their assets, shareholders have a right to an advisory vote on any golden parachute arrangements in connection with such transaction (frequently referred to as "say-on-golden parachute" vote). Although we will be exempt from these requirements while we are an emerging growth company, other provisions of the Dodd-Frank Act may impact our corporate governance. For instance, the SEC adopted rules prohibiting the listing of any equity security of a company that does not have a compensation committee consisting solely of independent directors, subject to certain exceptions. In addition, the Dodd-Frank Act requires the SEC to adopt rules requiring all exchange-traded companies to adopt claw-back policies for incentive compensation paid to executive officers in the event of accounting restatements based on material non-compliance with financial reporting requirements. Those rules, however, have not yet been finalized. The scope and content of the U.S. banking regulators' policies on executive compensation are continuing to develop and are likely to continue evolving in the near future.

### Financial Privacy

The federal bank regulatory agencies have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a non-affiliated third party. These regulations affect how consumer information is transmitted through financial services companies and conveyed to outside vendors. In addition, consumers may also prevent disclosure of certain information among affiliated companies that is assembled or used to determine eligibility for a product or service, such as that shown on consumer credit reports and asset and income information from applications. Consumers also have the option to direct banks and other financial institutions not to share information about transactions and experiences with affiliated companies for the purpose of marketing products or services.

### Impact of Monetary Policy

The monetary policy of the Federal Reserve has a significant effect on the operating results of financial or bank holding companies and their subsidiaries. Among the tools available to the Federal Reserve to affect the money supply are open market transactions in U.S. government securities, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These tools are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits.

### Environmental Laws Potentially Impacting the Bank

We are subject to state and federal environmental laws and regulations. The Comprehensive Environmental Response, Compensation and Liability Act, (“CERCLA”), is a federal statute that generally imposes strict liability on all prior and present “owners and operators” of sites containing hazardous waste. However, Congress acted to protect secured creditors by providing that the term “owner and operator” excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this “secured creditor exemption” has been the subject of judicial interpretations which have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan, which costs often substantially exceed the value of the property.

### New Banking Reform Legislation

Other key provisions of the EGRRCPA as it relates to community banks and bank holding companies include, but are not limited to: (i) assisting smaller banks with obtaining stable funding by providing an exception for reciprocal deposits from FDIC restrictions on acceptance of brokered deposits; (ii) raising the eligibility for use of short-form Call Reports from $1 billion to $5 billion in assets; and (iii) changing the eligibility for use of the small bank holding company policy statement from institutions with under $1 billion in assets to institutions with under $3 billion in assets.

At this time, it is difficult to anticipate the continued impact this expansive legislation will have on the Company, its customers and the financial industry generally. To the extent the Dodd-Frank Act remains in place or is not further amended, it is likely to continue to increase the Company’s cost of doing business, limit the Bank’s permissible activities, and affect the competitive balance within the industry and market.

### Government and Regulatory Response to the COVID-19 Pandemic

The onset of the COVID-19 pandemic in the United States in certain respects, at least temporarily, impacted the Company’s operations and risk management and resulted in changes to its safety and soundness regulation. For instance, the federal banking agencies have encouraged banking organizations to work constructively and prudently with borrowers impacted by the COVID-19 pandemic in order to meet the borrowers’ financial needs. Guidance published by the Federal Reserve encourages banking organizations to consider undertaking a variety of efforts during a major disaster or national emergency such as the COVID-19 pandemic, including: waiving ATM, overdraft, and late fees, as well as early withdrawal penalties on time deposits; increasing ATM daily cash withdrawal limits; easing credit terms for new loans; increasing credit limits for creditworthy customers; offering payment accommodations such as allowing loan customers to defer or skip some payments or extending payment due dates, which would avoid delinquencies and negative credit bureau reporting caused by disaster-related disruptions; and conducting a review of an affected borrower’s financial condition in an effort to implement a prudent loan workout arrangement. The federal banking agencies have stated that they will not criticize a banking organization that implements prudent loan workouts for affected customers even if the restructured loans result in adverse classifications or credit risk downgrades. In addition, the agencies temporarily suspended examination activity in the second quarter of 2020 to allow banking organization to focus on the needs of their customers and revised examination guidance to require examiners to consider, in conducting supervisory assessments, whether banking organizations have taken appropriate actions in response to the stress caused by the COVID-19 pandemic and managed associated risk appropriately. Consistent with the regulators’ guidance, the Company has and continues to work with its customers during the COVID-19 pandemic to provide them with greater access to their funds, waive certain fees and provide short-term payment deferrals for borrowers impacted by the COVID-19 pandemic and requiring assistance.

In response to the COVID-19 pandemic, Congress, through the enactment of the CARES Act, and the federal banking agencies, through rulemaking, interpretive guidance and modifications to agency policies and procedures, have taken a series of actions to address regulatory capital, liquidity risk management, financial management and reporting, and operational considerations for banking organizations. Notable developments not otherwise discussed above include the following.

- On March 15, 2020, the Federal Reserve issued a statement encouraging banks to use their capital and liquidity buffers to lend to households and businesses impacted by the COVID-19 pandemic. The following day, the Federal Reserve issued a statement encouraging banks to access the Federal Reserve's discount window to assist with capital and liquidity management in light of the increased credit needs of banking customers.

- The Bank is also typically required by the FRB to maintain in reserves certain amounts of vault cash and/or deposits with the FRB, however, in response to the COVID-19 pandemic, this requirement has been eliminated until further notice.

- Section 4013 of the CARES Act provides financial institutions the option to suspend the application of GAAP to any loan modification related to COVID-19 from treatment as a troubled debt restructuring ("TDR") for the period between March 1, 2020 and the earlier of (i) 60 days after the end of the national emergency proclamation or (ii) December 31, 2020. Section 541 of the Consolidated Appropriations Act, 2021, amended Section 4013 of the CARES Act to extend this relief to the earlier of (i) 60 days after the end of the national emergency proclamation or (ii) January 1, 2022. A financial institution may elect to suspend GAAP only for a loan that was not more than 30 days past due as of December 31, 2019. In addition, the temporary suspension of GAAP does not apply to any adverse impact on the credit of a borrower that is not related to COVID-19. The suspension of GAAP is applicable for the entire term of the modification, including an interest rate modification, a forbearance agreement, a repayment plan, or other agreement that defers or delays the payment of principal and/or interest. Accordingly, a financial institution that elects to suspend GAAP should not be required to increase its reported TDRs at the end of the period of relief, unless the loans require further modification after the expiration of that period.

For additional information regarding actions taken by regulatory agencies to provide relief to consumers who have been adversely impacted by the ongoing COVID-19 pandemic, see the discussion below under Item 1A, "Risk Factors—Risks Related to our Business," of this Report.

**Other Pending and Proposed Legislation**

Other legislative and regulatory initiatives which could affect the Company, the Bank and the banking industry in general may be proposed or introduced before the U.S. Congress, the Texas Legislature and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions, and may subject the Company or the Bank to increased regulation, disclosure and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulations may be enacted or the extent to which the business of the Company or the Bank would be affected thereby.

Although the majority of the Dodd-Frank Act's rulemaking requirements have been met with finalized rules, approximately one-fifth of the rulemaking requirements are either still in the proposal stage or have not yet been proposed. On February 2, 2017, President Donald Trump signed an executive order calling for the administration to review various U.S. financial laws and regulations. The full scope of the current administration's legislative and regulatory agenda is not yet fully known, but it may include further deregulatory measures for the banking industry, including the structure and powers of the CFPB and other areas under the Dodd-Frank Act.

## AVAILABLE INFORMATION

The Company maintains an Internet web site at www.spfi.bank. The Company makes available, free of charge, on its web site (under www.spfi.bank/financials-filings/sec-filings) the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or Section 15(d) of the Exchange Act as soon as reasonably practicable after the Company files such material with, or furnishes it to, the SEC. The Company also makes, free of charge, through its web site (under www.spfi.bank/corporate-governance/documents-charters) links to the Company's Code of Business Conduct and Ethics and the charters for its Board committees. In addition, the SEC maintains an Internet web site (at www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

The Company routinely posts important information for investors on its web site (under www.spfi.bank and, more specifically, under the News & Events tab at www.spfi.bank/news-events/press-releases). The Company intends to use its web site as a means of disclosing material non-public information and for complying with its disclosure obligations under SEC Regulation FD (Fair Disclosure). Accordingly, investors should monitor the Company's web site, in addition to following the Company's press releases, SEC filings, public conference calls, presentations and webcasts.

The information contained on, or that may be accessed through, the Company's web site is not incorporated by reference into, and is not a part of, this Report.

## Item 1A. Risk Factors

*Investing in our common stock involves a high degree of risk. Before you decide to invest, you should carefully consider the risks described below, together with all other information included in this Report. We believe the risks described below are the risks that are material to us. Any of the following risks, as well as risks that we do not know or currently deem immaterial, could have a material adverse effect on our business, financial condition, results of operations and growth prospects. In that case, you could experience a partial or complete loss of your investment.*

### Risks Related to Our Business

***The COVID-19 pandemic is adversely affecting us and our customers, employees, and third-party service providers, and the adverse impacts on our business, financial position, results of operations, and prospects could be significant.***

The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains, lowered equity market valuations, created significant volatility and disruption in financial markets, increased unemployment levels and decreased consumer confidence generally. In addition, many state and local governments responded to the COVID-19 pandemic with the temporary closure of brick-and-mortar "non-essential" businesses, schools, and limitations on social gatherings, stay-at-home advisories and mandates, and travel bans and restrictions. Although many of these restrictions have eased or been lifted, these restrictions have resulted in significant adverse effects on our customers and business partners, particularly those in the retail, hospitality and food and beverage industries, among many others, including a significant number of layoffs and furloughs of employees nationwide, and in the regions and communities in which we operate. These measures may be implemented again in the event of another COVID-19 outbreak or any current or future variant thereof and could adversely affect our business, operations and financial condition, as well as the business, operations and financial conditions of our customers and business partners. There is no certainty that such measures will be sufficient to mitigate the risks posed by the virus or otherwise be satisfactory to government authorities.

Our borrowers have had, and may have again, difficulties in repaying their loans. Governmental actions providing payment relief to borrowers affected by COVID-19 could preclude our ability to initiate foreclosure proceedings in certain circumstances and, as a result, the collateral we hold may decrease in value or become illiquid, and the level of our nonperforming loans, charge-offs and delinquencies could rise and require significant additional provisions for loan losses. Additional factors related to the credit quality of certain commercial real estate and multifamily residential loans include the duration of state and local moratoriums on evictions for non-payment of rent or other fees. The payment on these loans that are secured by income producing properties are typically dependent on the successful operation of the related real estate property and may subject us to risks from adverse conditions in the real estate market or the general economy.

Bank regulatory agencies and various governmental authorities are urging financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. We have actively worked to support our borrowers to mitigate the impact of the COVID-19 pandemic on them and on our loan portfolio, including through loan modifications that defer payments for those who experienced a hardship as a result of the COVID-19 pandemic. Although loans on deferral related to the COVID-19 pandemic at December 31, 2021 were only $15.9 million, we cannot predict whether any such loan modifications may ultimately have an adverse impact on our profitability in future periods.

The ultimate effect of COVID-19 and related events, including those described above and those not yet known or knowable, could have a negative effect on the stock price, business prospects, financial condition and results of operations of the Company, including as a result of quarantines, market volatility, market downturns, changes in consumer behavior, business closures, deterioration in the credit quality of borrowers or the inability of borrowers to satisfy their obligations to the Company (and any related forbearances or restructurings that may be implemented), declines in the value of collateral securing outstanding loans, branch or office closures and business interruptions.

***Changes in market interest rates or capital markets, including volatility resulting from the COVID-19 pandemic, could affect our revenues and expenses, the value of assets and obligations, and the availability and cost of capital or liquidity.***

The COVID-19 pandemic has significantly affected the financial markets and has resulted in a number of Federal Reserve actions. Market interest rates declined significantly in 2020 and have remained at such levels over the past year. We expect that these reductions in interest rates, especially if prolonged, could adversely affect our net interest income and margins and our profitability.

Given our business mix, and the fact that most of our assets and liabilities are financial in nature, we tend to be sensitive to market interest rate movements and the performance of the financial markets. Our primary source of income is net interest income. Prevailing economic conditions, fiscal and monetary policies and the policies of various regulatory agencies all affect market rates of interest and the availability and cost of credit, which, in turn, significantly affect financial institutions' net interest income. If the interest we pay on deposits and other borrowings increases at a faster rate than increases in the interest we receive on loans and investments, net interest income, and, therefore, our earnings, could be affected. Earnings could also be affected if the interest we receive on loans and other investments falls more quickly than the interest we pay on deposits and other borrowings.

In addition, the continued spread of COVID-19, and any current or future variant thereof, has also led to disruption and volatility in financial markets, which could increase our cost of capital and adversely affect our ability to access financial markets, which may in turn affect the value of the subordinated notes. This market volatility could result in a significant decline in our stock price and market capitalization, which could result in goodwill impairment charges.

***Unpredictable future developments related to or resulting from the COVID-19 pandemic could materially and adversely affect our business and results of operations.***

Given the ongoing and dynamic nature of the circumstances, it is not possible to predict the ultimate impact of the coronavirus outbreak on our stock price, business prospects, financial condition or results of operations. Any future development is highly uncertain and cannot be predicted, including the scope and duration of the pandemic, third party providers' ability to support our operation, and any actions taken by governmental authorities and other third parties in response to the pandemic. We are continuing to monitor the COVID-19 pandemic and related risks, although the rapid development and fluidity of the situation precludes any specific prediction as to its ultimate impact on us. However, if the pandemic continues to spread or otherwise results in a continuation or worsening of the current economic and commercial environments, our business, financial condition, results of operations and cash flows as well as our regulatory capital and liquidity ratios could be materially adversely affected and many of the risks described herein will be heightened.

***Our business has been and may continue to be adversely affected by current conditions in the financial markets and economic conditions generally.***

Our business and operations, which primarily consist of lending money to customers in the form of loans, borrowing money from customers in the form of deposits and investing in securities, are sensitive to general business and economic conditions in the U.S. Uncertainty about the federal fiscal policymaking process, and the medium and long-term fiscal outlook of the federal government and U.S. economy, is a concern for businesses, consumers and investors in the U.S. Our business is also significantly affected by monetary and related policies of the U.S. government and its agencies. The Federal Reserve's recent unprecedented cuts to the federal funds interest rate in response to the COVID-19 pandemic may further impact our ability to attract deposits, generate attractive earnings through our investment portfolio, and negatively affect the value of our loans and other assets. If and when monetary policy changes lead to an increase in interest rates, it may also have an adverse effect on our business, financial condition and results of operations as it could reduce the demand for loans and affect the ability of our borrowers to repay their indebtedness subjecting us to potential loan losses. Changes in any of these policies are beyond our control. Adverse economic conditions and government policy responses to such conditions could have a material adverse effect on our business, financial condition, results of operations and prospects. All of these factors are detrimental to our business, and the interplay between these factors can be complex and unpredictable.

In addition, the inflationary outlook in the United States remains uncertain. The consumer price index increased 7 percent year-over-year in December 2021. The risks to our business from inflation depends on the durability of the current inflationary pressures in our markets. Transitory increases in inflation are unlikely to have a material impact on our business or earnings. However, more persistent inflation could lead to tighter-than-expected monetary policy which could, in turn, increase the borrowings costs of our customers, making it more difficult for them to repay their loans or other obligations. High interest rates may be needed to tame persistent inflationary price pressures, which could also push down asset prices and weaken economic activity. A deterioration in economic conditions in the United States and our markets could result in an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for our products and services, all of which, in turn, would adversely affect our business, financial condition and results of operations.

***We may grow through acquisitions, a strategy which may not be successful or, if successful, may produce risks in successfully integrating and managing the acquisitions and may dilute our shareholders.***

As part of our growth strategy, we may pursue acquisitions of banks and nonbank financial services companies within or outside our principal market areas. We regularly identify and explore specific acquisition opportunities as part of our ongoing business practices. However, we have no current arrangements, understandings, or agreements to make any material acquisitions. We face significant competition from numerous other financial services institutions, many of which will have greater financial resources or more liquid securities than we do, when considering acquisition opportunities. Accordingly, attractive acquisition opportunities may not be available to us. There can be no assurance that we will be successful in identifying or completing any future acquisitions.

Acquisitions involve numerous risks, any of which could harm our business. Acquisitions also frequently result in the recording of goodwill and other intangible assets, which are subject to potential impairments in the future and that could harm our financial results. In addition, if we finance acquisitions by issuing convertible debt or equity securities, our existing shareholders may be diluted, which could negatively affect the market price of our common stock. As a result, if we fail to properly evaluate mergers, acquisitions or investments, we may not achieve the anticipated benefits of any such merger, acquisition, or investment, and we may incur costs in excess of what we anticipate. The failure to successfully evaluate and execute mergers, acquisitions or investments or otherwise adequately address these risks could materially harm our business, financial condition and results of operations.

***We may not be able to adequately measure and limit our credit risk, which could lead to unexpected losses.***

As a lender, we are exposed to the risk that our loan customers may not repay their loans according to the terms of these loans and the collateral securing the payment of these loans may be insufficient to fully compensate us for the outstanding balance of the loan plus the costs to dispose of the collateral. We may experience significant loan losses, which could have a material adverse effect on our operating results and financial condition. Management makes various assumptions and judgments about the collectability of our loan portfolio, including the diversification by industry of our commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume, growth and composition of our loan portfolio, the effects on the loan portfolio of current economic indicators and their probable impact on borrowers and the evaluation of our loan portfolio through our internal loan review process and other relevant factors.

Accordingly, we maintain an allowance for loan losses that represents management's judgment of probable losses and risks inherent in our loan portfolio. There is no precise method of predicting loan losses, and therefore, we always face the risk that charge offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. The level of the allowance for loan losses reflects our management's continuing evaluation of specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions; industry concentrations; and other unidentified losses inherent in the Bank's current loan portfolio. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and judgment and requires the Bank to make significant estimates of current credit risks and future trends. Changes in economic conditions affecting borrowers, increases in our nonperforming loans, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Bank's control, may require an increase in the allowance for loan losses.

In addition, we may further experience increased delinquencies, credit losses, and corresponding charges to capital, which could require us to increase our provision for loan losses associated with impacts related to the coronavirus outbreak due to quarantines, market downturns, increased unemployment rates, changes in consumer behavior related to pandemic fears, and related emergency response legislation, including the Families First Coronavirus Response Act. Further, if real estate markets or the economy in general deteriorate, the Bank may experience increased delinquencies and credit losses. The allowance for loan losses may not be sufficient to cover actual loan-related losses. Additionally, banking regulators may require the Bank to increase its allowance for loan losses in the future, which could have a negative effect on the Bank's financial condition and results of operations. Additions to the allowance for loan losses will result in a decrease in net earnings and capital and could hinder our ability to grow our assets.

***A new accounting standard will result in a significant change in how we recognize credit losses and may result in material increases to our allowance for loan losses.***

The FASB has adopted a new accounting standard referred to as Current Expected Credit Loss ("CECL"). As we are an emerging growth company and take advantage of the extended transition period for complying with new or revised financial accounting standards under the JOBS Act, CECL will be effective for the Company and the Bank for our first fiscal quarter after December 15, 2022. This standard requires financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which would likely require us to increase our allowance for loan losses, and to greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for loan losses. In anticipation of the adoption of CECL, we have incurred, and will likely continue to incur, significant additional expense to comply with the standard.

***Many of our loans are to commercial borrowers, which have a higher degree of risk than other types of loans.***

As of December 31, 2021, loans to commercial borrowers represent approximately 71.4% of total loans. Loans to commercial borrowers are often larger and involve greater risks than other types of lending. Because payments on these loans are often dependent on the successful operation or development of the property or business involved, their repayment is more sensitive than other types of loans to adverse conditions in the real estate market or the general economy. In general, these loans are collateralized by real estate and general business assets, including, among other things, accounts receivable, inventory and equipment and are typically backed by a personal guaranty of the borrower or principal. The collateral securing such may decline in value more rapidly than we anticipate, exposing us to increased credit risk. Accordingly, a downturn in the real estate market and economy could heighten our risk related to commercial loans, particularly commercial real estate loans. Unlike residential mortgage loans, which generally are made on the basis of the borrowers' ability to make repayment from their employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans typically are made on the basis of the borrowers' ability to make repayment from the cash flow of the commercial venture. If the cash flow from business operations is reduced, the borrowers' ability to repay the loan may be impaired. As a result of the larger average size of each commercial loan as compared with other loans such as residential loans, as well as the collateral which is generally less readily marketable, losses incurred on a small number of commercial loans could have a material adverse impact on our financial condition and results of operations.

***We may be subject to additional credit risk with respect to loans that we make to other lenders.***

As a part of our commercial lending activities, we may make loans to customers that, in turn, make commercial and residential real estate loans to other borrowers. When we make a loan of this nature, we take as collateral the promissory notes issued by the end borrowers to our customer, which are themselves secured by the underlying real estate. Because we are not lending directly to the end borrower, and because our collateral is a promissory note rather than the underlying real estate, we may be subject to risks that are different from those we are exposed to when it makes a loan directly that is secured by commercial or residential real estate. Because the ability of the end borrower to repay its loan from our customer could affect the ability of our customer to repay its loan from us, our inability to exercise control over the relationship with the end borrower and the collateral, except under limited circumstances, could expose us to credit losses that adversely affect our business, financial condition and results of operations.

***Because a portion of our loan portfolio is comprised of real estate loans, negative changes in the economy affecting real estate values and liquidity could impair the value of collateral securing our real estate loans and result in loan and other losses.***

As of December 31, 2021, approximately 69.4% of our loan portfolio was comprised of loans with real estate as a primary component of collateral. Adverse developments affecting real estate values, particularly in our markets, could increase the credit risk associated with our real estate loan portfolio. Negative changes in the economy affecting real estate values and liquidity in our market areas could significantly impair the value of property pledged as collateral on loans and affect our ability to sell the collateral upon foreclosure without a loss or additional losses. Collateral may have to be sold for less than the outstanding balance of the loan, which could result in losses on such loans. Such declines and losses could have a material adverse impact on our business, results of operations and growth prospects. If real estate values decline, it is also more likely that we would be required to increase our allowance for loan losses, which could adversely affect our business, financial condition and results of operations.

***Our commercial real estate loan portfolio exposes us to risks that may be greater than the risks related to other mortgage loans.***

Our loan portfolio includes non-owner-occupied commercial real estate loans for individuals and businesses for various purposes, which are secured by commercial properties, as well as real estate construction and development loans. As of December 31, 2021, our non-owner-occupied commercial real estate loans totaled approximately 36.7% of our total loan portfolio. These loans typically involve repayment dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. These loans expose us to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be liquidated as easily as residential real estate because there are fewer potential purchasers of the collateral. Additionally, non-owner-occupied commercial real estate loans generally involve relatively large balances to single borrowers or related groups of borrowers. Accordingly, charge-offs on non-owner-occupied commercial real estate loans may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios. Unexpected deterioration in the credit quality of our commercial real estate loan portfolio would require us to increase our provision for loan losses, which would reduce our profitability, and could materially adversely affect our business, financial condition and results of operations.

***Our portfolio of indirect dealer lending exposes us to increased credit risks.***

At December 31, 2021, approximately 9.3% of our total loan portfolio, consisted of indirect dealer loans, originated through automobile dealers for the purchase of new or used automobiles, as well as recreational vehicles, boats, and personal watercraft. We serve customers that cover a range of creditworthiness and the required terms and rates are reflective of those risk profiles. Auto loans are inherently risky as they are often secured by assets that may be difficult to locate and can depreciate rapidly. In some cases, repossessed collateral for a defaulted auto loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency may not warrant further substantial collection efforts against the borrower. Auto loan collections depend on the borrower’s continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness, or personal bankruptcy. Additional risk elements associated with indirect lending include the limited personal contact with the borrower as a result of indirect lending through non-bank channels, namely automobile dealers.

***The small to medium-sized businesses that we lend to may have fewer resources to weather adverse business conditions, which may impair their ability to repay a loan, and such impairment could adversely affect our results of operations and financial condition.***

Our business development and marketing strategies primarily result in us serving the banking and financial services needs of small- to medium-sized businesses. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities, frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower’s ability to repay a loan. In addition, the success of a small- to medium-sized business often depends on the management skills, talents and efforts of one or two people or a small group of people, and the death, disability or resignation of one or more of these people could have a material adverse impact on the business and its ability to repay its loans. If general economic conditions negatively impact Texas, New Mexico or the specific markets in these states in which we operate and small to medium-sized businesses are adversely affected or our borrowers are otherwise affected by adverse business conditions, our business, financial condition and results of operations could be adversely affected.

***Agricultural lending and volatility in commodity prices may adversely affect our financial condition and results of operations.***

At December 31, 2021, agricultural loans were approximately 4.2% of our total loan portfolio. Agricultural lending involves a greater degree of risk and typically involves higher principal amounts than many other types of loans. Repayment is dependent upon the successful operation of the business, which is greatly dependent on many things outside the control of either us or the borrowers. These factors include adverse weather conditions that prevent the planting of a crops or limit crop yields (such as hail, drought, fires and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally) and the impact of government regulations (including changes in price supports, subsidies and environmental regulations). Volatility in commodity prices could adversely impact the ability of borrowers in these industries to perform under the terms of their borrowing arrangements with us, and as a result, a severe and prolonged decline in commodity prices may have a material adverse effect our financial condition and results of operations. It is also difficult to project future commodity prices as they are dependent upon many different factors beyond our control. In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. Consequently, agricultural loans may involve a greater degree of risk than other types of loans, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets such as farm equipment (some of which is highly specialized with a limited or no market for resale), or assets such as livestock or crops. In such cases, any repossessed collateral for a defaulted agricultural operating loan my not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation or because the assessed value of the collateral exceeds the eventual realization value.

***We generate noninterest income through the sale of crop insurance products, and a termination of or substantial changes to the Federal crop insurance program would adversely impact our revenues from such business.***

Through the Federal Crop Insurance Corporation, the federal government subsidizes insurance companies by assuming an increasingly higher portion of losses incurred by farmers as a result of weather-related and other perils as well as commodity price fluctuations. The federal government also subsidizes the premium cost to farmers for multi-peril crop yield and revenue insurance. Without this risk assumption, losses incurred by insurers would be higher, increasing the premium on such insurance, and without the premium subsidy, the number of farmers purchasing multi-peril crop insurance would decline significantly. Periodically, members of the U.S. Congress propose to significantly reduce the government's involvement in the federal crop insurance program in an effort to reduce government spending. If legislation is adopted to reduce the amount of risk the government assumes, reduce the amount of insurance premium subsidies provided to farmers or otherwise change the coverage provided under multi-peril crop insurance policies, purchases of multi-peril crop insurance could experience a significant decline nationwide and in our market areas. For the year ended December 31, 2021, the Bank had approximately $8.1 million in noninterest income attributable to sales of crop insurance.

***Sustained volatility in oil prices and the energy industry, including in Texas, could lead to increased credit losses in our energy portfolio, weaker demand for energy lending, and adversely affect our business, results of operations and financial condition.***

Although our energy loan portfolio is relatively small, the energy industry is a significant sector in our markets in Texas, and we intend to increase our energy lending. A downturn or lack of growth in the energy industry and energy-related business, including sustained low oil prices or the failure of oil prices to rise in the future, could adversely affect our intention to increase our energy lending, and our business, financial condition and results of operations. In addition to our direct exposure to energy loans, we also have indirect exposure to energy prices, as some of our non-energy customers' businesses are directly affected by volatility with the oil and gas industry and energy prices. While oil prices have increased in 2022, the oil and gas industry has remained volatile and prolonged volatility may cause further worsening conditions of energy industry and overall economic activities in the Company's primary markets and could lead to increased credit stress in its loan portfolio, increased losses and weaker demand for lending. More significantly for the Company, prolonged pricing pressure on oil and gas or general uncertainty resulting from energy price volatility could lead to increased credit stress in our energy portfolio, increased losses associated with our energy portfolio, increased utilization of our contractual obligations to extend credit and weaker demand for energy lending. Such a decline or general uncertainty could have other adverse and unpredictable impacts, such as job losses in industries tied to energy, increased spending habits, lower borrowing needs, higher transaction deposit balances or a number of other effects that are difficult to isolate or quantify, particularly in states with significant dependence on the energy industry like Texas and New Mexico, all of which could reduce our growth rate, affect the ability of our customers to repay their loans, affect the value of any collateral underlying our loans, and generally affect our business, financial condition and results of operations. Due to our geographic concentration, specifically in Texas, we may be less able than other larger regional or national financial institutions to diversify our credit risk across multiple markets.

***Changes in U.S. trade policies and other factors beyond the Company's control, including the imposition of tariffs and retaliatory tariffs, may adversely impact our business, financial condition and results of operations.***

There have been discussions regarding potential changes to U.S. trade policies, legislation, treaties and tariffs. Tariffs and retaliatory tariffs have been imposed, and additional tariffs and retaliation tariffs have been proposed. Such tariffs, retaliatory tariffs or other trade restrictions on products and materials that our customers import or export could impact the prices of our customers' products, which could reduce demand for such products, reduce our customers' margins, and adversely impact their revenues, financial results and ability to service their debt. In addition, to the extent changes in the political environment have a negative impact on us or on the markets in which we operate, our business, results of operations and financial condition could be adversely impacted. However, a de minimis amount of collateral securing our loans is located outside of the U.S. A trade war or other governmental action related to tariffs or international trade agreements or policies have the potential to negatively impact our and/or our customers' costs, demand for our customers' products, and/or the U.S. economy or certain sectors thereof and, thus, adversely affect our business, financial condition, and results of operations.

***Climate change and related legislative and regulatory initiatives may materially affect the Company's business and results of operations.***

The effects of climate change continue to create an alarming level of concern for the state of the global environment. As a result, the global business community has increased its political and social awareness surrounding the issue. Further, the U.S. Congress, state legislatures and federal and state regulatory agencies continue to propose numerous initiatives to supplement the global effort to combat climate change. Similar and even more expansive initiatives are expected under the current administration, including potentially increasing supervisory expectations with respect to banks' risk management practices, accounting for the effects of climate change in stress testing scenarios and systemic risk assessments, revising expectations for credit portfolio concentrations based on climate-related factors and encouraging investment by banks in climate-related initiatives and lending to communities disproportionately impacted by the effects of climate change. The lack of empirical data surrounding the credit and other financial risks posed by climate change render it impossible to predict how specifically climate change may impact our financial condition and results of operations; however, the physical effects of climate change may also directly impact us. Specifically, unpredictable and more frequent weather disasters may adversely impact the value of real property securing the loans in our portfolios. Additionally, if insurance obtained by our borrowers is insufficient to cover any losses sustained to the collateral, or if insurance coverage is otherwise unavailable to our borrowers, the collateral securing our loans may be negatively impacted by climate change, which could impact our financial condition and results of operations. Further, the effects of climate change may negatively impact regional and local economic activity, which could lead to an adverse effect on our customers and impact the communities in which we operate. Overall, climate change, its effects and the resulting, unknown impact could have a material adverse effect on our financial condition and results of operations.

***The amount of nonperforming assets may increase and can take significant time and resources to resolve.***

Nonperforming assets adversely affect our net income in various ways. We generally do not record interest income on nonperforming loans, thereby adversely affecting our income and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related asset to the then fair market value of the collateral, which may ultimately result in a loss. An increase in the level of nonperforming assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile. While we reduce problem assets through loan workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management, which may materially and adversely impact their ability to perform their other responsibilities. There can be no assurance that we will not experience future increases in nonperforming assets.

***The properties that we own and certain foreclosed real estate assets could subject us to environmental risks and associated costs.***

There is a risk that hazardous substances or wastes, contaminants, pollutants or other environmentally restricted substances could be discovered on our properties or our foreclosed assets (particularly with real estate loans). In this event, we might be required to remove the substances from the affected properties or to engage in abatement procedures at our cost. Besides being directly liable under certain federal and state statutes for our own conduct, we may also be held liable under certain circumstances for actions of borrowers or other third parties on property that secures our loans. Potential environmental liability could include the cost of remediation and also damages for any injuries caused to third parties. We cannot assure you that the cost of removal or abatement would not substantially exceed the value of the affected properties or the loans secured by those properties, that we would have adequate remedies against the prior owners or other responsible parties or that we would be able to resell the affected properties either before or after completion of any such removal or abatement procedures. If material environmental problems are discovered before foreclosure, we generally will not foreclose on the related collateral or will transfer ownership of the loan to a subsidiary. It should be noted, however, that the transfer of the property or loans to a subsidiary may not protect us from environmental liability. Furthermore, despite these actions on our part, the value of the property as collateral will generally be substantially reduced and, as a result, we may suffer a loss upon collection of the loan. Currently, we are not, and the Company is not, a party to any pending legal proceeding under any environmental statute, nor are we aware of any instances that may give rise to such liability.

***Our accounting policies and methods are fundamental to how we report our financial condition and results of operations and we use estimates in determining the fair value of certain of our assets, which estimates may prove to be imprecise and result in significant changes in valuation which could affect our, and thus the Company's, shareholders' equity.***

A portion of our assets are carried on the balance sheet at fair value, including investment securities. Generally, for assets that are reported at fair value, we use quoted market prices or have third parties analyze our holdings and assign a market value. We rely on the analysis provided by our service providers. However, different valuations could be derived if our service providers used different financial models or assumptions.

As it relates to our investment securities portfolio, declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary would be included in earnings as realized losses. In estimating other-than-temporary impairment losses, management of the Company considers (i) whether there is intent to sell securities prior to recovery and/or maturity; (ii) whether it is more likely than not that securities will have to be sold prior to recovery and/or maturity; and (iii) whether there is a credit loss component to the impairment.

Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency actions in respect of the securities, defaults by the issuer or with respect to the underlying securities, and changes in market interest rates and continued instability in the capital markets. In addition, an economic downturn could result in losses, as determined under our accounting methodologies that may materially and adversely affect our business, financial condition, results of operations and future prospects.

***Our largest loan relationships make up a material percentage of our total loan portfolio.***

We have extended significant amounts of credit to a limited number of borrowers As of December 31, 2021, our 20 largest borrowing relationships ranged from approximately $18.6 million to $51.0 million (including unfunded commitments) and totaled approximately 17.3% of our outstanding commitments. If any of these relationships become delinquent or suffer default, we could be exposed to material losses which may have a material adverse effect on our business, financial condition and results of operations.

***Our largest deposit relationships currently make up a material percentage of our deposits and the withdrawal of deposits by our largest depositors could force us to fund our business through more expensive and less stable sources.***

At December 31, 2021, our 20 largest deposit relationships accounted for approximately 14.4% of our total deposits. Withdrawals of deposits by any one of our largest depositors or by one of our related customer groups could force us to rely more heavily on other potentially more expensive and less stable sources of funding for our business and withdrawal demands, adversely affecting our net interest margin and results of operations. Additionally, such circumstances could require us to raise deposit rates in an attempt to attract new deposits, which could adversely affect our results of operations. Under applicable regulations, if the Bank were no longer "well capitalized," the Bank would not be able to accept brokered deposits without the approval of the FDIC.

***Liquidity risk could impair our ability to fund operations and meet our obligations as they become due and could jeopardize our financial condition.***

Liquidity is essential to the business of the Bank. Liquidity risk is the potential that the Bank will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding. The Bank's access to funding sources in amounts adequate to finance its activities or on acceptable terms could be impaired by factors that affect our organization specifically or the financial services industry or economy in general. Factors that could detrimentally impact access to liquidity sources include a decrease in the level of the Bank's business activity as a result of a downturn in the markets in which its loans are concentrated or adverse regulatory actions against the Bank. Market conditions or other events could also negatively affect the level or cost of funding, affecting the Bank's ongoing ability to accommodate liability maturities and deposit withdrawals, meet contractual obligations and fund asset growth and new business transactions at a reasonable cost, in a timely manner and without adverse consequences. Any substantial, unexpected and/or prolonged change in the level or cost of liquidity could have a material adverse effect on our financial condition and results of operations.

***Customers could pursue alternatives to bank deposits, causing us to lose a relatively inexpensive source of funding.***

Technology has made it more convenient for bank customers to transfer funds into alternative investments or other deposit accounts, including products offered by other financial institutions or non-bank service providers. In addition, our level of deposits may be affected by lack of consumer confidence in financial institutions, which have caused fewer depositors to be willing to maintain deposits that are not fully insured by the FDIC. Depositors may withdraw certain deposits from the Bank and place them in other institutions or invest uninsured funds in investments perceived as being more secure, such as securities issued by the U.S. Treasury. In the current environment of low interest rates, our deposits may not be as stable or as interest rate insensitive as similar deposits may have been in the past, and some existing or prospective deposit customers of banks generally, including the Bank, may be inclined to pursue other investment alternatives, which may negatively impact our net interest margin. Efforts and initiatives we undertake to retain and increase deposits, including deposit pricing, can increase our costs. As our assets grow, we may face increasing pressure to seek new deposits through expanded channels from new customers at favorable pricing, further increasing our costs.

***We continually encounter technological changes which could result in us having fewer resources than many of our competitors to continue to invest in technological improvements.***

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively or timely implement new technology-driven products and services or be successful in marketing these products and services to our customers and clients. Failure to keep pace with technological change affecting the financial services industry could have a material adverse impact on our business, financial condition, and results of operations.

***Our profitability is vulnerable to interest rate fluctuations.***

Our profitability, like that of most financial institutions, is dependent to a large extent on our net interest income. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets in a given period, a significant increase in market interest rates could adversely affect net interest income. Conversely, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income.

In periods of increasing interest rates, loan originations may decline, and our borrowers may experience greater difficulties meeting their obligations, depending on the performance of the overall economy, which may adversely affect income from these lending activities. This could result in decreased interest income, decreased mortgage revenues and corresponding decreases in noninterest income from projected levels. During periods of reduced loan demand, results of operations may be adversely affected to the extent that we would be unable to reduce mortgage-related noninterest expenses commensurately with the decline in mortgage loan origination activity. Increases in interest rates could also adversely affect the market value of our fixed income assets. Conversely, in the current environment of decreasing interest rates and associated impacts of the COVID-19 pandemic on the overall economy, such as rising unemployment levels or changes in consumer behavior related to loans, loan originations may also decline, and our borrowers may experience difficulties meeting their obligations or seek to refinance their loans for lower rates, which may adversely affect income from these lending activities and negatively impact our net interest margin.

Although our asset-liability management strategy is designed to control and mitigate exposure to the risks related to changes in market interest rates, those rates are affected by many factors outside of our control, including governmental monetary policies, inflation, deflation, recession, changes in unemployment, the money supply, international disorder and instability in domestic and foreign financial markets.

***We may be adversely impacted by the transition from LIBOR as a reference rate.***

The United Kingdom’s Financial Conduct Authority (the authority that regulates LIBOR) previously announced it intends to stop compelling banks to submit rates for the calculation of LIBOR after December 31, 2021 and the publication of the most commonly used U.S. dollar LIBOR settings will cease to be published after June 2023. While there is no consensus on what rate or rates may become accepted alternatives to LIBOR, the Alternative Reference Rates Committee has proposed the Secured Overnight Financing Rate (“SOFR”) as the alternative rate for use in derivatives and other financial contracts currently being indexed to LIBOR. SOFR is a daily index of the interest rate banks and hedge funds pay to borrow money overnight, secured by U.S. Treasury securities. At this time, it is not possible to predict whether SOFR will attain market traction as a LIBOR replacement tool, and the future of LIBOR is still uncertain.

In October 2021, the federal bank regulatory agencies issued a Joint Statement on Managing the LIBOR Transition. In that guidance, the agencies offered their regulatory expectations and outlined potential supervisory and enforcement consequences for banks that fail to adequately plan for and implement the transition away from LIBOR. The failure to properly transition away from LIBOR may result in increased supervisory scrutiny. In addition, the implementation of LIBOR reform proposals may result in increased compliance costs and operational costs, including costs related to continued participation in LIBOR and the transition to a replacement reference rate or rates. We cannot reasonably estimate the expected cost. At December 31, 2021, we had interest-rate swap contracts, other borrowings, and one loan indexed to LIBOR.

***Deposit outflows may increase reliance on borrowings and brokered deposits as sources of funds.***

We have traditionally funded asset growth principally through deposits and borrowings. As a general matter, deposits are typically a lower cost source of funds than external wholesale funding (brokered deposits and borrowed funds), because interest rates paid for deposits are typically less than interest rates charged for wholesale funding. If, as a result of competitive pressures, market interest rates, alternative investment opportunities that present more attractive returns to customers, general economic conditions or other events, the balance of the Company’s deposits decreases relative to the Company’s overall banking operations, the Company may have to rely more heavily on wholesale or other sources of external funding, or may have to increase deposit rates to maintain deposit levels in the future. Any such increased reliance on wholesale funding, or increases in funding rates in general, could have a negative impact on the Company’s net interest income and, consequently, on its results of operations and financial condition.

***We may be adversely impacted by an economic downturn or a natural disaster affecting one or more of our market areas.***

Because most of our business activities are conducted in Texas and New Mexico and most of our credit exposure is there, we are at risk to adverse economic, political or business developments, including a downturn in real estate values, agricultural activities, the oil and gas industry and natural hazards such as floods, ice storms and tornadoes that affect Texas and New Mexico. Although our customers’ business and financial interests may extend beyond these market areas, adverse conditions that affect these market areas could reduce our growth rate, affect the ability of our customers to repay loans, affect the value of collateral underlying loans, impact our ability to attract deposits, and generally affect our financial condition and results of operations. Because of our geographic concentration, we may be less able than other financial institutions to diversify our credit risks across multiple markets.

***Mortgage originations have begun to decrease due to declines in refinance activity, and this trend may continue.***

Mortgage revenues, which are primarily recognized from the sale in the secondary market of mortgage loans, are a source of noninterest income for the Bank and a contributor to the Bank’s net income. Mortgage revenues for the year ended December 31, 2021 were $59.7 million. As the result of the low level of market interest rates that existed for the past several years, demand for loans to refinance existing mortgages remained strong through most of 2021. As market interest rates have increased from the prior low rate environment, there may be fewer opportunities for financial institutions to originate loans to refinance existing mortgages. If mortgage originations continue to decrease, projected mortgage revenues and noninterest income will decrease.

***Market conditions could have a material impact on our ability to sell originated mortgages in the secondary market.***

In addition to being affected by interest rates, the secondary mortgage markets are also subject to investor demand for residential mortgage loans and increased investor yield requirements for those loans. These conditions may fluctuate or even worsen in the future. A reduction in our ability to sell mortgages that we originate on the secondary market would reduce our noninterest income from such sales and may increase our credit risk by causing us to retain mortgage loans that we would otherwise sell. As a result, a prolonged period of secondary market illiquidity may result in a reduction in our mortgage origination volumes which, in turn, could have a material adverse effect on our financial condition and results of operation from our mortgage operations.

***The value of our mortgage servicing rights can be volatile.***

We earn revenue from fees we receive for servicing mortgage loans. As a result of our mortgage servicing business, we have a growing portfolio of mortgage servicing rights. A mortgage servicing right is the right to service a mortgage loan—collect principal, interest, and escrow amounts—for a fee. We acquire mortgage servicing rights when we keep the servicing rights in connection with the sale of loans we have originated.

Changes in interest rates may impact our mortgage servicing revenues, which could negatively impact our noninterest income. When rates rise, net revenue from our mortgage servicing activities can increase due to slower prepayments. When rates fall, the value of our mortgage servicing rights usually tends to decline as a result of a higher volume of prepayments, resulting in a decline in our net revenue. It is possible that, because of economic conditions and/or a weak or deteriorating housing market, even if interest rates were to fall or remain low, mortgage originations may also fall or any increase in mortgage originations may not be enough to offset the decrease in the mortgage servicing rights value caused by the lower rates. Because the value of our mortgage servicing rights is capitalized on our balance sheet and evaluated on a quarterly basis, any significant decline in value could adversely affect our income, our capital ratios or require us to raise additional capital, which may not be available on favorable terms. We had $19.7 million of mortgage servicing rights as of December 31, 2021.

***Our risk management framework may not be effective in mitigating risks or losses to us.***

Our risk management framework consists of various processes, systems and strategies, and is designed to manage the types of risks to which we are subject, including credit, market, liquidity, interest rate, operational, reputation, business and compliance risks. Our framework also includes financial or other modeling methodologies that involve management assumptions and judgment. Our risk management framework may not be effective under all circumstances and may not adequately mitigate risk or loss to us. If our framework is not effective, we could suffer unexpected losses and our business, financial condition, results of operations or growth prospects could be materially and adversely affected. We may also be subject to potentially adverse regulatory consequences.

***We are dependent on the use of data and modeling in our management’s decision-making and faulty data or modeling approaches could negatively impact our decision-making ability or possibly subject us to regulatory scrutiny in the future.***

The use of statistical and quantitative models and other quantitative analyses is endemic to bank decision-making, and the employment of such analyses is becoming increasingly widespread in our operations. Stress testing, interest rate sensitivity analysis, and the identification of possible violations of anti-money laundering regulations are all examples of areas in which we are dependent on models and the data that underlies them. The use of statistical and quantitative models is also becoming more prevalent in regulatory compliance. We currently utilize stress testing for capital, credit and liquidity purposes and anticipate that model-derived testing may become more extensively implemented by regulators in the future.

We anticipate data-based modeling will penetrate further into bank decision-making, particularly risk management efforts, as the capacities developed to meet stress testing requirements are able to be employed more widely and in differing applications. While we believe these quantitative techniques and approaches improve our decision-making, they also create the possibility that faulty data or flawed quantitative approaches could negatively impact our decision-making ability or result in adverse regulatory scrutiny. Secondarily, because of the complexity inherent in these approaches, misunderstanding or misuse of their outputs could similarly result in suboptimal decision-making. We seek to mitigate this risk by increasingly performing back-testing to analyze the accuracy of these techniques and approaches.

***There are investment performance, fiduciary and asset servicing risks associated with our trust operations.***

Our investment management, fiduciary and asset servicing businesses are significant to the business of the Company. Generating returns that satisfy clients in a variety of asset classes is important to maintaining existing business and attracting new business. Managing or servicing assets with reasonable prudence in accordance with the terms of governing documents and applicable laws is also important to client satisfaction. Failure to do so can generate liability, as can failure to manage the differing interests often involved in the exercise of fiduciary responsibilities or the failure to manage these risks adequately, all of which could adversely affect our business, financial condition, results of operations and/or future prospects.

***We are exposed to cybersecurity risks associated with our internet-based systems and online commerce security.***

Third party or internal systems and networks may fail to operate properly or become disabled due to deliberate attacks or unintentional events. Our operations are vulnerable to disruptions from human error, natural disasters, power loss, computer viruses, spam attacks, denial of service attacks, unauthorized access and other unforeseen events. Undiscovered data corruption could render our customer information inaccurate. These events may obstruct our ability to provide services and process transactions. While we believe we are in compliance with all applicable privacy and data security laws, an incident could put our customer confidential information at risk. Although we have not experienced a cyber-incident which has compromised our data or systems, we can never be certain that all of our systems are entirely free from vulnerability to breaches of security or other technological difficulties or failures. We monitor and modify, as necessary, our protective measures in response to the perpetual evolution of cyber threats.

A breach in the security of any of our information systems, or other cyber incident, could have an adverse impact on, among other things, our revenue, ability to attract and maintain customers and business reputation. In addition, as a result of any breach, we could incur higher costs to conduct our business, to increase protection or related to remediation. Furthermore, our customers could terminate their accounts with us because of a cyber-incident which occurred on their own system or with that of an unrelated third party, which is outside of our control. In addition, a security breach could also subject us to additional regulatory scrutiny and expose us to civil litigation and possible financial liability.

***Our operations could be interrupted if our third-party service providers experience difficulty, terminate their services or fail to comply with banking regulations.***

We depend on a number of relationships with third-party service providers. Specifically, we receive certain third-party services including, but not limited to, core systems processing, essential web hosting and other Internet systems, online banking services, deposit processing and other processing services. If these third-party service providers experience difficulties or terminate their services, and we are unable to replace them with other service providers, particularly on a timely basis, our operations could be interrupted. If an interruption were to continue for a significant period of time, our business, financial condition and results of operations could be adversely affected, perhaps materially. Even if we are able to replace third-party service providers, it may be at a higher cost to us, which could adversely affect our business, financial condition and results of operations.

***We are subject to certain operating risks related to employee error and customer, employee and third party misconduct, which could harm our reputation and business.***

Employee error or employee and customer misconduct could subject us to financial losses or regulatory sanctions and harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee error or misconduct, and the precautions we take to prevent and detect this activity may not always be effective. Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and rectified. Our necessary dependence upon processing systems to record and process transactions and our large transaction volume may further increase the risk that employee errors, tampering or manipulation of those systems will result in losses that are difficult to detect. Employee error or misconduct could also subject us to financial claims. If our internal control systems fail to prevent or detect an occurrence, or if any resulting loss is not insured, exceeds applicable insurance limits or if insurance coverage is denied or not available, it could have a material adverse effect on our business, financial condition and results of operations.

***We rely heavily on our management team and the unexpected loss of key officers may adversely affect our operations.***

Our success has been and will continue to be greatly influenced by our ability to retain the services of existing senior management and, as we expand, to attract and retain qualified additional senior and middle management. Our senior executive officers have had, and will continue to have, a significant role in the development and management of our business. The loss of services of any of our executive officers could have an adverse effect on our business and financial results. Accordingly, should we lose the services of any of the executive officers, our Board may have to search outside of the Bank for a qualified permanent replacement. This search may be prolonged and we cannot assure you that we will be able to locate and hire a qualified replacement. If any of our executive officers leave their respective positions, our business, financial condition, results of operations and future prospects may suffer. We also depend upon the experience of the other officers of the Bank, the managers of our banking facilities and on their relationships with the communities they serve. We may not be able to retain our current personnel or attract additional qualified key persons as needed.

***Our ability to develop, retain and recruit additional successful bankers is critical to the success of our business strategy, and any failure to do so could adversely affect our business, financial condition, results of operations and future prospects.***

Our ability to retain and grow our loans, deposits and fee income depends upon the business generation capabilities, reputation and relationship management skills of our bankers, many of whom we develop internally. If we lose the services of any of our bankers, including successful bankers employed by financial institutions that we may acquire, to a new or existing competitor or otherwise, or fail to successfully recruit bankers or develop bankers internally, we may not be able to implement our growth strategy, retain valuable relationships and some of our customers could choose to use the services of a competitor instead of our services. Additionally, we may incur significant expenses and expend significant time and resources on training, integration and business development before it is able to determine whether a new banker will be profitable or effective. If we are unable to develop, attract or retain successful bankers, or if our bankers fail to meet our expectations in terms of customer relationships and profitability, we may be unable to execute our business strategy and our business, financial condition, results of operations and future prospects may be adversely affected.

***Competition from other financial intermediaries may adversely affect our profitability.***

We face substantial competition in originating loans and in attracting deposits. The competition in originating loans comes principally from other U.S. banks, mortgage banking companies, consumer finance companies, credit unions, insurance companies and other institutional lenders and purchasers of loans. We will encounter greater competition as we expand our operations. A number of institutions with which we compete have significantly greater assets, capital and other resources. Increased competition could require us to increase the rates we pay on deposits or lower the rates we offer on loans, which could adversely affect our profitability. Also, many of our non-bank competitors have fewer regulatory constraints and may have lower cost structures. We expect competition to intensify due to financial institution consolidation; legislative, regulatory and technological changes; and the emergence of alternative banking sources. Furthermore, our legal lending limit is significantly less than the limits for many of our competitors, and this may hinder our ability to establish relationships with larger businesses in our primary service area. This competition may limit our future growth and earnings prospects.

***If we fail to maintain effective internal control over financial reporting, we may not be able to accurately report its financial results or prevent fraud.***

Our management may conclude that our internal control over financial reporting is not effective due to our failure to cure any identified material weakness or otherwise. Moreover, even if our management concludes that its internal control over financial reporting is effective, our independent registered public accounting firm may not conclude that our internal control over financial reporting is effective. In addition, during the course of the evaluation, documentation and testing of our internal control over financial reporting, we may identify deficiencies that we may not be able to remediate in time to meet the deadline imposed by the Federal Deposit Insurance Corporation Improvement Act of 1991 (the “FDICIA”) for compliance with the requirement of FDICIA. Any such deficiencies may also subject us to adverse regulatory consequences. If we fail to achieve and maintain the adequacy of our internal control over financial reporting, as these standards are modified, supplemented or amended from time to time, we may be unable to report our financial information on a timely basis, we may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act or the FDICIA, and we may suffer adverse regulatory consequences or violations of listing standards. There could also be a negative reaction in the financial markets due to a loss of investor confidence in the reliability of our financial statements.

***The obligations associated with being a public company require significant resources and management attention.***

We expect to incur significant incremental costs related to operating as a public company, particularly when we no longer qualify as an emerging growth company. We are subject to the reporting requirements of the Exchange Act, which require that we file annual, quarterly and current reports with respect to our business and financial condition and proxy and other information statements, and the rules and regulations implemented by the SEC, the Sarbanes-Oxley Act, the Dodd-Frank Act, the Public Company Accounting Oversight Board (the “PCAOB”) and NASDAQ, each of which imposes additional reporting and other obligations. We expect these rules and regulations and changes in laws, regulations and standards relating to corporate governance and public disclosure to increase legal and financial compliance costs and make some activities more time consuming and costly. These laws, regulations and standards are subject to varying interpretations and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. Our investment in compliance with existing and evolving regulatory requirements will result in increased administrative expenses and a diversion of management’s time and attention from revenue-generating activities to compliance activities, which could have a material adverse effect on our business, financial condition and results of operations.

***Our equity compensation plan will cause dilution and increase our costs, which will reduce our income.***

Our equity compensation plan allows us to award shares of our common stock (at no cost to the participant), award options to purchase shares of our common stock, and award other equity-based compensation. Additionally, on an annual basis and without shareholder approval, the number of approved shares available for issuance under the equity compensation plan increases by 3% of our total issued and outstanding shares as of the beginning of that fiscal year unless our Board exercises its discretion to limit such an increase. Issuance of awards under our equity compensation plan is a risk factor our shareholders in at least two ways. First, issuances of our common stock and exercise of equity-based awards underlying our common stock causes dilution of shareholders’ ownership interests which, in the aggregate, may be significant. Second, issuances of our common stock and other equity-based awards are expensed by us over their vesting period at the fair market value of the shares on the date they are awarded. Accordingly, grants made under the equity compensation plan will increase our costs, which will reduce our net income.

***Negative public opinion could damage our reputation and adversely impact our earnings.***

Reputation risk, or the risk to our business, earnings and capital from negative public opinion is inherent in our business. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to keep and attract customers and employees and can expose us to litigation and regulatory action and adversely affect our results of operations. Although we take steps to minimize reputational risk in dealing with our customers and communities, this risk will always be present given the nature of our business. In addition, companies are facing increased scrutiny from customers, regulators, investors, and other stakeholders related to their environmental, social and governance ("ESG") practices and disclosure. Investor advocacy groups, investment funds and influential investors are also increasingly focused on these practices, especially as they relate to the environment, health and safety, diversity, labor conditions and human rights. For example, certain investors are beginning to incorporate the business risks of climate change and the adequacy of companies' responses to climate change and other ESG matters as part of their investment theses. These shifts in investing priorities may result in adverse effects on the trading price of the Company's common stock if investors determine that the Company has not made sufficient progress on ESG matters. In addition, new government regulations could also result in new or more stringent forms of ESG oversight and expanding mandatory and voluntary reporting, diligence, and disclosure. Increased ESG-related compliance costs could result in increases to our overall operational costs.

***We may be adversely affected by the soundness of other financial institutions.***

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty, and other relationships. We have exposure to different industries and counterparties, and through transactions with counterparties in the financial services industry, including broker-dealers, commercial banks, investment banks, and other financial intermediaries. In addition, we participate in loans originated by other institutions, and we participate in syndicated transactions (including shared national credits) in which other lenders serve as the lead bank. As a result, defaults by, declines in the financial condition of, or even rumors or questions about, one or more financial institutions, financial service companies or the financial services industry generally, may lead to market-wide liquidity, asset quality or other problems and could lead to losses or defaults by us or by other institutions. These problems, losses or defaults could have an adverse effect on our business, financial condition and results of operations.

***Until May 31, 2018, our Company was an S Corporation, and claims of taxing authorities related to our prior status as an S Corporation could harm us.***

Until May 31, 2018, our Company was an S Corporation. Effective May 31, 2018, the Company revoked its S Corporation election and the Company became taxed as a C Corporation under the provisions of Sections 301 to 385 of the Internal Revenue Code of 1986, as amended (the "Code") (which treat the corporation as an entity that is subject to an entity level U.S. federal income tax). If the unaudited, open tax years in which we were an S Corporation are audited by the IRS, and we are determined not to have qualified for, or to have violated, our S Corporation status, we likely would be obligated to pay corporate level tax, plus interest and possible penalties, with respect to those open tax years. This could result in tax liability with respect to all of the income we reported for periods when we believed we properly were treated as an S Corporation not subject to entity level taxation. Any such claims could result in additional costs to us and could have a material adverse effect on our results of operations and financial condition.

## Risks Related to Our Regulatory Environment

***We operate in a highly regulated environment and the laws and regulations that govern our operations, corporate governance, executive compensation and accounting principles, or changes in them, or failure to comply with them, could adversely affect us.***

We are subject to extensive regulation, supervision and legal requirements that govern almost all aspects of our operations. These laws and regulations are not intended to protect our shareholders. Rather, these laws and regulations are intended to protect customers, depositors, the DIF and the overall financial stability of the banking system in the United States. Compliance with laws and regulations can be difficult and costly, and changes to laws and regulations often impose additional compliance costs. For example, the Dodd-Frank Act and related regulations, including the Home Mortgage Disclosure Act, subject us to additional restrictions, oversight and reporting obligations, which have significantly increased costs. And over the last several years, state and federal regulators have focused on enhanced risk management practices, mortgage law and regulation, compliance with the BSA and AML laws, data integrity and security, use of service providers, and fair lending and other consumer protection issues, which has increased our need to build additional processes and infrastructure. Government agencies charged with adopting and interpreting laws and regulations may do so in an unforeseen manner, including in ways that potentially expand the reach of the laws or regulations more than initially contemplated or currently anticipated. We cannot predict the substance or impact of pending or future legislation or regulation, or the application thereof. Our failure to comply with these laws and regulations, even if the failure follows good faith effort or reflects a difference in interpretation, could subject us to restrictions on our business activities, fines and other penalties, any of which could adversely affect our results of operations, capital base and the price of our securities. Further, any new laws, rules and regulations could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition and results of operations.

***We are subject to commercial real estate lending guidance issued by the federal banking regulators that impacts our operations and capital requirements.***

The federal bank regulators have issued final guidance regarding concentrations in commercial real estate lending directed at institutions that have concentrations of ADC loans and non-owner occupied commercial real estate loans within their lending portfolios. In general, the guidance establishes the following supervisory criteria as preliminary indications of possible concentration risk: (1) the institution's total ADC loans represent 100% or more of total capital; or (2) total non-owner occupied commercial real estate loans represent 300% or more of total capital, and such loans have increased by 50% or more during the prior 36-month period. This guidance suggests that institutions whose commercial real estate loans exceed these guidelines should implement heightened risk management practices appropriate to their concentration risk and may be required to maintain higher capital ratios than institutions with lower concentrations in commercial real estate lending. Our ADC loans comprise 74.7% of the Bank's capital, and our non-owner occupied commercial real estate loans comprise 207.1% of the Bank's capital. Although we are below the concentrations set forth in the guidance, we cannot guarantee that any risk management practices we implement will be effective to prevent losses relating to our commercial real estate portfolio. Management has implemented controls to monitor the Bank's commercial real estate lending concentrations, but we cannot predict the extent to which this guidance will impact our operations or capital requirements.

***Legislative and regulatory actions taken now or in the future may increase our costs and impact our business, governance structure, financial condition or results of operations.***

New proposals for legislation continue to be introduced in the U.S. Congress that could further substantially increase regulation of the financial services industry, impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices, including in the areas of compensation, interest rates, financial product offerings and disclosures, and have an effect on bankruptcy proceedings with respect to consumer residential real estate mortgages, among other things. Certain aspects of current or proposed regulatory or legislative changes, including laws applicable to the financial industry and federal and state taxation, if enacted or adopted, may impact the profitability of our business activities, require more oversight or change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations to comply, and could have a material adverse effect on our business, financial condition and results of operations. In addition, any proposed legislative or regulatory changes, including those that could benefit our business, financial condition and results of operations, may not occur on the timeframe that is proposed, or at all, which could result in additional uncertainty for our business.

***Many of our new activities and expansion plans require regulatory approvals, and failure to obtain them may restrict our growth.***

Generally, we must receive federal regulatory approval before we can acquire an FDIC-insured depository institution or related business. Such regulatory approvals may not be granted on terms that are acceptable to us, or at all. We may also be required to sell banking locations as a condition to receiving regulatory approval, which condition may not be acceptable to us or, if acceptable to us, may reduce the benefit of any acquisition. In addition, as opportunities arise, we may continue de novo branching as a part of our expansion strategy. De novo branching and acquisitions carry with them numerous risks, including the inability to obtain all required regulatory approvals. The failure to obtain these regulatory approvals for potential future strategic acquisitions and de novo banking locations could impact our business plans and restrict our growth.

***The Federal Reserve may require the Company to commit capital resources to support the Bank.***

The Dodd-Frank Act and the Federal Reserve require a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. Accordingly, a capital injection may be required to provide financial assistance to the Bank if it experiences financial distress. Such capital injection may be required at times when the Company may not have the resources to provide and therefore may be required to borrow the funds or raise capital to make the required capital injection. Any borrowing by the Company in order to make the required capital injection may be more difficult and expensive and may adversely impact the Company's financial condition, results of operations and/or future prospects.

***As a regulated entity, we and the Bank must maintain certain required levels of regulatory capital that may limit our and the Bank's operations and potential growth.***

We and the Bank are subject to various regulatory capital requirements administered by the FDIC and the Federal Reserve, respectively. See "Supervision and Regulation—Regulatory Capital Requirements." Many factors affect the calculation of our risk-based assets and our ability to maintain the level of capital required to achieve acceptable capital ratios. For example, any increases in our risk-weighted assets will require a corresponding increase in our capital to maintain the applicable ratios. In addition, recognized loan losses in excess of amounts reserved for such losses, loan impairments, impairment losses on securities and other factors will decrease our capital, thereby reducing the level of the applicable ratios. Our failure to remain well-capitalized for bank regulatory purposes, either under the existing capital requirements or under the CBLR framework, if applicable, could affect customer confidence, our ability to grow, our costs of funds and FDIC insurance costs, the Bank's ability to pay dividends to the Company, the Company's ability to pay dividends on its common stock, our ability to make acquisitions, and on our business, results of operations and financial condition. Under regulatory rules, if we cease to be a well-capitalized institution for bank regulatory purposes, the interest rates that we pay on deposits and our ability to accept brokered deposits may be restricted.

***Bank regulatory agencies periodically examine our business, including compliance with laws and regulations, and our failure to comply with any supervisory actions to which we become subject as a result of such examinations could materially and adversely affect us.***

Our regulators periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of our operations had become unsatisfactory, or that we were, or our management was, in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil money penalties against us, our officers or directors, to fine or remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate the Bank's FDIC deposit insurance and place the Bank into receivership or conservatorship. Any regulatory action against us could have an adverse effect on our business, financial condition and results of operations.

***If we fail to maintain sufficient capital under regulatory requirements, whether due to losses, an inability to raise additional capital or otherwise, that failure could adversely affect our financial condition, liquidity and results of operations, as well as our ability to maintain regulatory compliance.***

We must meet regulatory capital requirements and maintain sufficient liquidity. The Company's ability to raise additional capital, when and if needed to support the Bank, will depend on conditions in the capital markets, economic conditions and a number of other factors, including investor preferences regarding the banking industry and market condition and governmental activities, many of which are outside the Company's control, and on the Company's financial condition and performance. Accordingly, the Company may not be able to raise additional capital if needed or on terms acceptable to the Company. If we fail to meet these capital and other regulatory requirements, our financial condition, liquidity and results of operations could be materially and adversely affected.

***Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could have serious reputational consequences for us.***

The BSA, the USA PATRIOT Act, the National Defense Authorization Act and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal bank regulators, as well as the DOJ, Drug Enforcement Administration and IRS. There is also increased scrutiny of compliance with the rules enforced by the OFAC. If our policies, procedures and systems are deemed deficient, we could be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, which could negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

***Regulations relating to privacy, information security and data protection could increase our costs, affect or limit how we collect and use personal information and adversely affect our business opportunities.***

We are subject to various privacy, information security and data protection laws, including requirements concerning security breach notification, and we could be negatively impacted by these laws. Various state and federal banking regulators and states have also enacted data security breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in certain circumstances in the event of a security breach. Moreover, legislators and regulators in the U.S. are increasingly adopting or revising privacy, information security and data protection laws that potentially could have a significant impact on our current and planned privacy, data protection and information security-related practices, our collection, use, sharing, retention and safeguarding of consumer or employee information, and some of our current or planned business activities. This could also increase our costs of compliance and business operations and could reduce income from certain business initiatives. This includes increased privacy-related enforcement activity at the federal level by the Federal Trade Commission, as well as at the state level. Compliance with current or future privacy, data protection and information security laws (including those regarding security breach notification) affecting customer or employee data to which we are subject could result in higher compliance and technology costs and could restrict our ability to provide certain products and services, which could have a material adverse effect on our business, financial conditions or results of operations. Our failure to comply with privacy, data protection and information security laws could result in potentially significant regulatory or governmental investigations or actions, litigation, fines, sanctions and damage to our reputation, which could have a material adverse effect on our business, financial condition or results of operations.

***We face increased risk under the terms of the CRA, as we accept additional deposits in new geographic markets.***

Under the terms of the CRA, each appropriate federal bank regulatory agency is required, in connection with its examination of a bank, to assess such bank's record in assessing and meeting the credit needs of the communities served by that bank, including low- and moderate-income neighborhoods. During these examinations, the regulatory agency rates such bank's compliance with the CRA as "Outstanding," "Satisfactory," "Needs to Improve" or "Substantial Noncompliance." The regulatory agency's assessment of the institution's record is part of the regulatory agency's consideration of applications to acquire, merge or consolidate with another banking institution or its holding company, or to open or relocate a branch office. As we accept additional deposits in new geographic markets, we will be required to maintain an acceptable CRA rating. Maintaining an acceptable CRA rating may become more difficult as our deposits increase across new geographic markets.

***We are subject to federal and state fair lending laws, and failure to comply with these laws could lead to material penalties.***

Federal and state fair lending laws and regulations, such as the ECOA, and the FHA, impose nondiscriminatory lending requirements on financial institutions. The DOJ, CFPB and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to our performance under the fair lending laws and regulations could adversely impact our rating under the CRA and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact our reputation, business, financial condition and results of operations.

***Our financial condition, earnings and asset quality could be adversely affected if our consumer facing operations do not operate in compliance with applicable regulations.***

While all aspects of our operations are subject to detailed and complex compliance regimes, those portions of our lending operations which most directly deal with consumers pose particular challenges given the emphasis on consumer compliance by bank regulators at all levels. Residential mortgage lending raises significant compliance risks resulting from the detailed and complex nature of mortgage lending regulations imposed by federal regulatory agencies, and the relatively independent operating environment in which mortgage lending officers operate. In addition, some regulatory frameworks provide for the imposition of fines or penalties for noncompliance, even if noncompliance was inadvertent or unintentional. As a result, despite the education, compliance training, supervision and oversight we exercise in these areas, failure to comply with applicable laws and regulations, even if noncompliance is inadvertent or unintentional, could result in the Bank being strictly liable for restitution or damages to individual borrowers and could expose the Bank to other regulatory enforcement activity.

**Risks Related to Our Common Stock**

***An active public trading market may not be sustained.***

We completed the initial public offering, and the Company's common stock began trading on the NASDAQ Global Select Market, in May 2019. An active trading market for shares of our common stock may not be sustained. If an active trading market is not sustained, you may have difficulty selling your shares of our common stock at an attractive price, or at all. Consequently, you may not be able to sell your shares of our common stock at or above an attractive price at the time that you would like to sell.

***The market price of our common stock could be volatile and may fluctuate significantly, which could cause the value of an investment in our common stock to decline, result in losses to our shareholders and litigation against us.***

The market price of our common stock may be volatile and could be subject to wide fluctuations in price in response to various factors, some of which are beyond our control. In addition, if the market for stocks in our industry, or the stock market in general, experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to lawsuits. Despite unsuccessful, as in the past, securities class action lawsuits have been instituted against some companies following periods of volatility in the market price of its securities. We could in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources from our normal business, which could adversely affect our results of operation and financial condition.

***Future equity issuances, including through our current or any future equity compensation plans, could result in dilution, which could cause the price of our shares of common stock to decline.***

We may issue additional shares of our common stock in the future pursuant to current or future equity compensation plans, upon conversions of preferred stock or debt, upon exercise of warrants or in connection with future acquisitions or financings. We may seek to raise additional funds, finance acquisitions or develop strategic relationships by issuing additional shares of our common stock. If we choose to raise capital by selling shares of our common stock, or securities convertible into shares of our common stock, for any reason, the issuance could have a dilutive effect on the holders of our common stock and could have a material negative effect on the market price of our common stock.

***We may issue shares of preferred stock in the future, which could make it difficult for another company to acquire us or could otherwise adversely affect holders of our common stock.***

Although there are currently no shares of our preferred stock outstanding, our certificate of formation authorizes us to issue up to 1,000,000 shares of one or more series of preferred stock. The Board has the power to set the terms of any series of preferred stock that may be issued, including voting rights, conversion rights, preferences over our voting common stock with respect to dividends or in the event of a dissolution, liquidation or winding up and other terms. If we issue preferred stock in the future that has preference over our common stock with respect to payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of the holders of our common stock or the market price of our common stock could be adversely affected.

***Our directors and executive officers have significant control over our business.***

Due to the significant ownership interests of our directors and executive officers, our directors and executive officers are able to significantly affect our management, affairs and policies. For example, our directors and executive officers may be able to influence the outcome of the election of directors and the potential outcome of other matters submitted to a vote of our shareholders, such as mergers, the sale of substantially all of our assets and other extraordinary corporate matters. In addition, pursuant to a separate Board Representation Agreement, dated March 7, 2019, between the Company and James C. Henry, for so long as Mr. Henry or his spouse, or a lineal descendant of the Henry's, or an entity formed for their benefit, holds in aggregate 5.0% or more of our outstanding shares of common stock, the Company must nominate their representative to serve on the Board of each of the Company and the Bank, subject to any required regulatory and shareholder approvals. See "Certain Relationships and Related Transactions, and Director Independence" for additional information.

***Our bylaws have an exclusive forum provision, which could limit a shareholder's ability to obtain a favorable judicial forum for disputes with us or our directors, officers or other employees.***

Our bylaws have an exclusive forum provision providing that, unless we consent in writing to an alternative forum, the U.S. District Court for the Northern District of Texas, Lubbock Division, or in the event that such court lacks jurisdiction to hear the action, the District Courts of the County of Lubbock, Texas, are the sole and exclusive forum for certain causes of action, which may limit a shareholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other employees, which may discourage such lawsuits. Alternatively, if a court were to find the exclusive forum provision to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

***Our dividend policy may change without notice, and our future ability to pay dividends is subject to restrictions.***

Holders of our common stock are entitled to receive only such cash dividends as our Board may declare out of funds legally available for such payments. Any declaration and payment of dividends on our common stock will depend upon our earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate, our ability to service any equity or debt obligations senior to our common stock and other factors deemed relevant by our Board. Furthermore, consistent with our strategic plans, growth initiatives, capital availability, projected liquidity needs and other factors, we have made, and will continue to make, capital management decisions and policies that could adversely affect the amount of dividends, if any, paid to our common shareholders. The Federal Reserve has also issued guidance requiring that we inform and consult with the Federal Reserve prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in an adverse change to our capital structure, including interest on any debt obligations. Finally, if required payments on our debt obligations are not made, or dividends on any preferred stock we may issue are not paid, we will be prohibited from paying dividends on our common stock.

***We are a bank holding company and our only source of cash, other than issuances of securities, is distributions from the Bank.***

Our principal source of funds to pay distributions on our common stock and service any of our obligations, other than further issuances of securities, would be dividends received from the Bank. Furthermore, the Bank is not obligated to pay dividends to us, and any dividends paid to us would depend on the earnings or financial condition of the Bank and various business and regulatory considerations.

***We are an "emerging growth company," and the reduced reporting requirements applicable to emerging growth companies may make our common stock less attractive to investors.***

We are an "emerging growth company," as defined in The Jumpstart Our Business Startups Act ("JOBS Act"), and we have taken advantage of certain reduced regulatory and reporting requirements that are otherwise generally applicable to public companies that are not emerging growth companies. We may take advantage of these provisions for up to five years after the date of our initial public offering, unless we earlier cease to be an emerging growth company, which would occur if our annual gross revenues exceed $1.07 billion, if we issue more than $1.0 billion in non-convertible debt in a three-year period or if we become a "large accelerated filer," in which case we would no longer be an emerging growth company as of the following December 31. Investors and securities analysts may find it more difficult to evaluate our common stock because we may rely on one or more of these exemptions, and, as a result, investor confidence and the market price of our common stock may be materially and adversely affected.

***An investment in our common stock is not an insured deposit and is subject to risk of loss.***

An investment in our common stock is not a bank deposit and is not insured against loss or guaranteed by the FDIC, any deposit insurance fund or by any other public or private entity. As a result, you could lose some or all of your investment.

## Item 1B. Unresolved Staff Comments

None.

## Item 2. Properties

The Company's corporate offices are located at 5219 City Bank Parkway, Lubbock, Texas. The Company's corporate office space also serves as the main office of, and is owned by, the Bank. The Bank currently operates full-service banking branches and mortgage offices in the following markets:

| Lubbock/South Plains | | Dallas/Ft. Worth | |
|---|---|---|---|
| **Location** | **Branch or LPO** | **Location** | **Branch or LPO** |
| Lubbock | Main Branch | Plano | Branch |
| Lubbock | 4th Street Branch | Dallas | Uptown Branch |
| Lubbock | 50th and Indiana Branch | Forney | Branch |
| Lubbock | Kingsgate Branch | Arlington | LPO |
| Lubbock | Milwaukee Branch | Dallas | Hillcrest LPO |
| Lubbock | Overton Branch | Dallas | Lake Highlands LPO |
| Lubbock | University Branch | Dallas | Lakewood LPO |
| Morton | Branch | Ft. Worth | LPO |
| Idalou | Branch | Grand Prairie | LPO |
| Levelland | Branch | Southlake | LPO |
| | | Southlake | LPO |

| El Paso | |
|---|---|
| **Location** | **Branch or LPO** |
| El Paso | East Branch |
| El Paso | West Branch |
| El Paso | Mesa Hills LPO |

| Houston | |
|---|---|
| **Location** | **Branch or LPO** |
| Houston | Branch |

| Bryan/College Station | |
|---|---|
| **Location** | **Branch or LPO** |
| College Station | Branch |
| College Station | LPO |

| Ruidoso/Eastern New Mexico | |
|---|---|
| **Location** | **Branch or LPO** |
| Ruidoso | Gateway Branch |
| Ruidoso | River Crossing Branch |

| The Permian Basin | |
|---|---|
| **Location** | **Branch or LPO** |
| Odessa | University Branch |
| Odessa | Grandview Branch |
| Midland | Branch |
| Kermit | Branch |
| Fort Stockton | Branch |
| Monahans | Branch |

| Other Markets | |
|---|---|
| **Location** | **Branch or LPO** |
| Abilene, Texas | LPO |
| Austin, Texas | LPO |
| Beaumont, Texas | LPO |
| Dripping Springs, Texas | LPO |
| Waco, Texas | LPO |

We lease certain of our banking facilities and believe that the leases to which we are subject are generally on terms consistent with prevailing market terms, and none of the leases are with our directors, officers, beneficial owners of more than 5% of our voting securities or any affiliates of the foregoing. We believe that our facilities are in good condition and are adequate to meet our operating needs for the foreseeable future.

## Item 3. Legal Proceedings

In 2004, City Bank entered into a Software License and Maintenance Agreement with Kasasa, Ltd. f/k/a Moneyvue Financial, Inc., Bankvue Financial, Inc., and BancVue, Ltd. ("Kasasa"). Thereafter, in 2008, City Bank and Kasasa entered into a Trademark License Agreement. The contracts with Kasasa grant City Bank the exclusive right to market and use Kasasa's "Reward Checking" software and trademark in Lubbock and Hockley Counties, Texas. In July 2020, Kasasa served a Notice of Termination of the Software License and Trademark License agreements, claiming that City Bank had breached the Software License and Maintenance Agreement by failing to timely pay amounts allegedly due and owing. City Bank vigorously rejected any such non-payment contentions and, in response to the Notice, filed suit against Kasasa in Travis County, Texas, styled City Bank v. Kasasa, Ltd., Cause No. D-1-GN-20-003630, 53rd Judicial District, Travis County, Texas. With the lawsuit, City Bank sought, among other claims and relief, an injunction against Kasasa. After an evidentiary hearing, the Court entered a temporary injunction against Kasasa expressly prohibiting it from, among other things, terminating the Software License and Maintenance Agreement pending trial. Based upon discovery in the lawsuit, City Bank also filed a breach of contract claim against Kasasa alleging that Kasasa violated City Bank's contractual exclusivity rights. Kasasa has filed counterclaims, including for declaratory relief that the contracts should be declared unenforceable. In October 2021, Kasasa filed a counterclaim alleging that City Bank's attempted enforcement of its exclusivity rights contravenes the Texas Free Enterprise and Antitrust Act. Kasasa purports to seek actual damages, to treble such actual damages, attorney's fees and expenses. The case remains ongoing and trial is set for October 2022. City Bank intends to continue a vigorous pursuit of its claims against Kasasa. In addition, City Bank pursues a number of substantive factual and legal challenges to Kasasa's counterclaims and believes the counterclaims are without merit. At this time, the ultimate outcome is unknown and an estimated range of any loss cannot be made.

From time to time, the Company or the Bank is a party to claims and legal proceedings arising in the ordinary course of business. Except as described above, we are not presently involved in any other litigation, nor to our knowledge is any litigation threatened against us, that in management's opinion would result in any material adverse effect on our financial position or results of operations or that is not expected to be covered by insurance.

## Item 4. Mine Safety Disclosures

Not applicable.

## Part II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.

### Market Information for Common Stock

The Company's common stock is traded on the NASDAQ Global Select Market. Quotations of the sales volume and the closing sales prices of the Company's common stock are listed daily under the symbol "SPFI" in NASDAQ's listings.

### Holders of Record

As of March 3, 2022, there were approximately 170 holders of record of the Company's common stock.

### Dividends

The Company paid dividends of $0.05, $0.07, $0.09, and $0.09 per common share in the first, second, third, and fourth quarters of 2021, respectively. Additionally, the Company paid a dividend of $0.11 per common share in the first quarter of 2022. Also, see "Item 1. Business – Supervision and Regulation – Dividend Payments, Stock Redemptions and Repurchases" and "Item 7. Management's Discussion and Analysis of the Financial Condition and Results of Operations – Liquidity and Capital Resources – Capital Requirements" of this Report for restrictions on our present or future ability to pay dividends, particularly those restrictions arising under federal and state banking laws.

### Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth information at December 31, 2021 with respect to compensation plans under which shares of our common stock may be issued.

| Plan Category | Number of Shares to be Issued Upon Exercise of Outstanding Awards | Weighted-Average Exercise Price of Outstanding Awards | Number of Shares Available for Future Grants |
|---|---|---|---|
| Equity compensation plans approved by shareholders[(1)] | 1,644,795 | $ 15.02 | 1,221,206 |
| Equity compensation plans not approved by shareholders | — | — | — |
| Total | 1,644,795 | $ 15.02 | 1,221,206 |

(1) The number of shares available for future issuance includes 1,221,206 shares available under the Company's 2019 Equity Incentive Plan (which allows for the issuance of options, as well as various other stock-based awards).

### Issuer Purchases of Securities

On March 13, 2020, the Company approved a stock repurchase program pursuant to which the Company may, from time to time, purchase up to $10.0 million of its outstanding shares of common stock (the "Program"). The shares may be repurchased from time to time in privately negotiated transactions or the open market, including pursuant to Rule 10b5-1 trading plans, and in accordance with applicable regulations of the SEC. The timing and exact amount of any repurchases will depend on various factors including, the performance of the Company's stock price, general market and other conditions, applicable legal requirements and other factors. On November 2, 2020, the Company amended the Program to extend the original expiration date of April 15, 2021, to November 5, 2021, subject to certain limitations and conditions.

On October 29, 2021, the Company's board of directors approved a new stock repurchase program, effective November 6, 2021, pursuant to which the Company may, from time to time, purchase up to $10.0 million of its outstanding shares of common stock (the "New Repurchase Program"). The shares may be repurchased from time to time in privately negotiated transactions or the open market, including pursuant to a Rule 10b5-1 trading plan adopted by the Company, and in accordance with applicable regulations of the SEC. The Company is not obligated to purchase any shares of its common stock under the New Repurchase Program, and the timing and exact amount of any repurchases will depend on various factors, including the performance of the Company's stock price, general market and other conditions, applicable legal requirements and other factors. The New Repurchase Program has an expiration date of November 6, 2022. The New Repurchase Program may be terminated or amended by the Company's board of directors at any time prior to the expiration date. The stock repurchase program currently in place will expire prior to the New Repurchase Program becoming effective. Any remaining shares under such expiring stock repurchase program will not be rolled into the New Repurchase Program.

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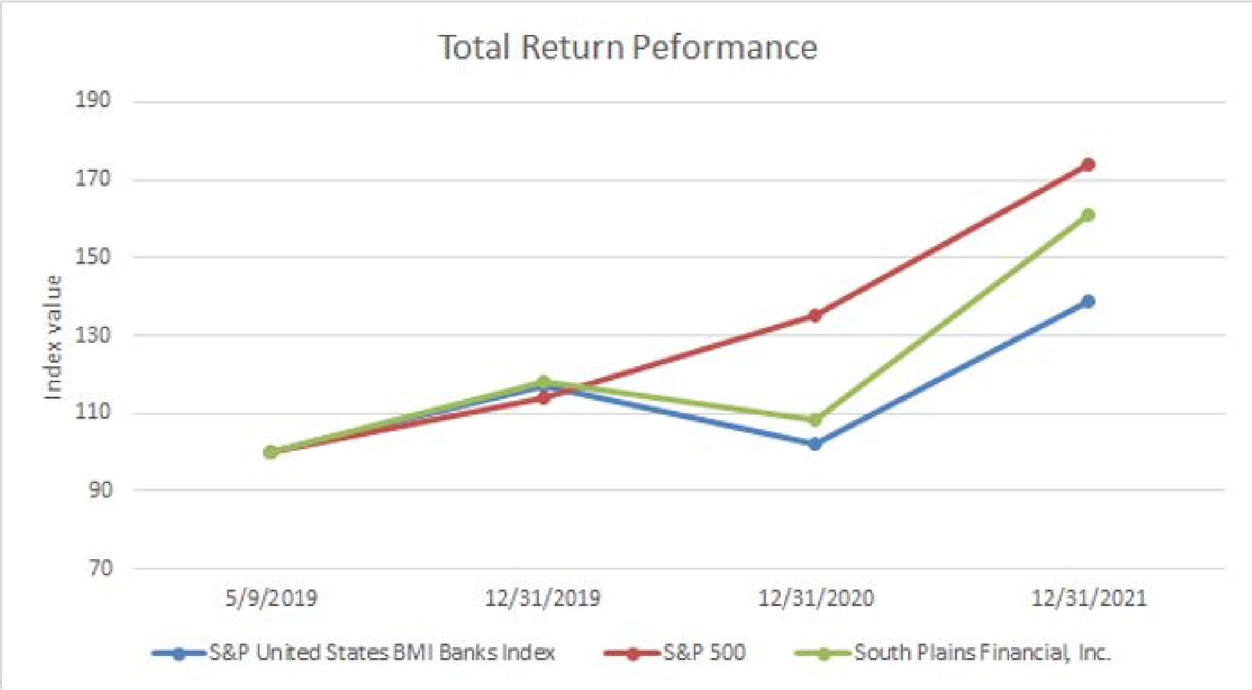
The following table summarizes the share repurchase activity for the three months ended December 31, 2021.

| | Total Shares Repurchased | Average Price Paid Per Share | Total Dollar Amount Purchased Pursuant to Publicly-Announced Plans | Maximum Dollar Amount Remaining Available for Repurchase Pursuant to Publicly-Announced Plans |
|---|---|---|---|---|
| **October 2021** | 34,902 | $ 24.68 | $ 861,453 | $ 3,629,152 |
| **November 2021** | 26,446 | 26.34 | 696,477 | 9,303,523 |
| **December 2021** | 59,359 | 26.75 | 1,588,093 | 7,715,430 |
| **Total** | 120,707 | | | |

**Stock Performance Graph**

The following performance graph compares total stockholders' return on the Company's common stock for the period beginning at the close of trading on May 9, 2019 and for the last trading date of each year from 2019 to 2021, with the cumulative total return of the S&P 500 and the S&P United States BMI Banks Index for the same periods. Cumulative total return is computed by dividing the difference between the Company's share price at the end and the beginning of the measurement period by the share price at the beginning of the measurement period. The performance graph assumes $100 is invested on May 9, 2019, in the Company's common stock, including reinvestment of any dividends, and each of the indices. Historical stock price performance is not necessarily indicative of future stock price performance. This performance graph and related information shall not be deemed "soliciting material" or to be "filed" with the SEC for purposes of Section 18 of the Exchange Act of 1934, or incorporated by reference into any future SEC filing, except as shall be expressly set forth by specific reference in such filing.




| **Dollars** | **5/9/19** | **12/19** | **12/20** | **12/21** |
|---|---|---|---|---|
| South Plains Financial, Inc. | 100.0 | 118.25 | 108.42 | 161.21 |
| S&P United States BMI Banks Index | 100.0 | 117.22 | 102.26 | 139.04 |
| S&P 500 | 100.0 | 114.03 | 135.01 | 173.77 |

Source: S&P Global Market Intelligence © 2021

**Item 6. [Reserved]**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the accompanying notes included elsewhere in this Report. This discussion and analysis contains forward-looking statements that are subject to certain risks and uncertainties and are based on certain assumptions that we believe are reasonable but may prove to be inaccurate. Certain risks, uncertainties and other factors, including those set forth under "Cautionary Note Regarding Forward-Looking Statements," "Risk Factors" and elsewhere in this Report, may cause actual results to differ materially from those projected results discussed in the forward-looking statements appearing in this discussion and analysis. Except as required by law, we assume no obligation to update any of these forward-looking statements.*

## Overview

We are a bank holding company headquartered in Lubbock, Texas, and our wholly-owned subsidiary, City Bank, is one of the largest independent banks in West Texas. We have additional banking operations in the Dallas, El Paso, Greater Houston, the Permian Basin, and College Station Texas markets, and the Ruidoso and Eastern New Mexico markets. Through City Bank, we provide a wide range of commercial and consumer financial services to small and medium-sized businesses and individuals in our market areas. Our principal business activities include commercial and retail banking, along with insurance, investment, trust and mortgage services.

## Acquisitions

The comparability of our consolidated results of operations for the year ended December 31, 2020 to the year ended December 31, 2019 is affected by the acquisition of West Texas State Bank ("WTSB") on November 12, 2019. Therefore, the results of the acquired operations of WTSB were included in our results of operations during all of 2020 and for a portion of 2019.

## Recent Developments

### ***COVID-19 Update***

The spread of COVID-19 continues to cause significant disruptions in the U.S. economy since it was declared a pandemic in March 2020 by the World Health Organization. In addition, the "Delta" and "Omicron" variants of COVID-19, which are the most transmissible variants identified to date, have spread in the U.S. in 2021. At this time, we cannot predict the impact or how long the economy or our impacted clients will be disrupted by the ongoing COVID-19 pandemic and any current or future variants of COVID-19, which could depend on numerous factors, including vaccination rates among the population, the effectiveness of COVID-19 vaccines against variants, and the response by governmental bodies and regulators. We are closely monitoring the current environment, given the rise in cases due to the "Delta" and "Omicron" variants, and are preparing to quickly make any necessary adjustments to protect our employees and customers.

The Bank also continues to utilize a rigorous enterprise risk management ("ERM") system that delivers a systematic approach to risk measurement and enhances the effectiveness of risk management across the Bank. The Bank's ERM system has allowed management to consistently and aggressively review the Bank's loan portfolio for signs of potential issues during the ongoing COVID-19 pandemic and the Bank continues to closely monitoring its loans to borrowers in the retail, hospitality and energy sectors.

While the duration of the COVID-19 pandemic and the scope of its impact on the economy is uncertain, the Bank continues to be proactive with its borrowers in those sectors most affected by the COVID-19 pandemic and offering loan modifications to borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. As part of the Bank's efforts to support its customers and protect the Bank, the Bank has offered varying forms of loan modifications including 90-day payment deferrals, 6-month interest only terms, or in certain select cases periods of longer than 6 months of interest only, to provide borrowers relief. As of December 31, 2021, total active loan modifications attributed to COVID-19 were approximately $15.9 million, or 0.7%, of the Company's loan portfolio. All active modifications are loans modified for either interest only periods longer than 6 months, primarily in the Bank's hotel portfolio. The Bank expects that these remaining loans on deferral will return to full payment status at the end of their respective deferral period.

The Paycheck Protection Program ("PPP") was created by the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") and implemented by the U.S. Small Business Administration (the "SBA") in March 2020. The PPP allows entities to apply for a 1.00% interest rate loan with payments generally deferred until the date the lender receives the applicable forgiveness amount from the SBA. The PPP loans may be partially or fully forgiven by the SBA if the entity meets certain conditions. The maturity term for any principal portion left unforgiven is either 2 or 5 years from the funding date, depending on when the loan was originated. For PPP loans that the SBA approved on or after June 5, 2020, the loan must have a maturity of at least 5 years. All PPP loans are fully guaranteed by the SBA and are included in total loans outstanding. The Economic Aid Act, signed into law on December 27, 2020, authorized an additional $284.5 billion in new PPP loan funding and extends the authority of lenders to make PPP loans through March 31, 2021. The PPP Extension Act of 2021 was subsequently signed into law on March 30, 2021 and extended the PPP application deadline to May 31, 2021.

The Bank assisted approximately 2,100 customers for a total of $218 million in the first round of PPP. There has been approximately $217 million in PPP loan forgiveness by the SBA and loan repayments by customers, leaving approximately $1 million outstanding as of December 31, 2021. The Bank began accepting new applications for PPP loans in January 2021 to assist customers with the new round of the PPP until funding for the PPP expired on May 31, 2021. For the year ended December 31, 2021, the Bank funded approximately 1,100 PPP loans for a total of $91 million. The SBA has forgiven approximately $52 million of PPP loans from this last round.

We are currently unable to fully assess or predict the extent of the effects of the COVID-19 pandemic, or any current or future variant of COVID-19, on our operations as the ultimate impact will depend on factors that are currently unknown and/or beyond our control. Please refer to Part I, Item 1A, "Risk Factors" in this Report.

**Selected Financial Data**

The following table sets forth certain of our selected financial data for, and as of the end of, each of the periods indicated. This information should be read in conjunction with "Item 8. Financial Statements and Supplementary Data" included elsewhere in this Report (dollars in thousands, except per share data).

| | As of or for the Year Ended December 31, | | |
|---|---|---|---|
| | **2021** | **2020** | **2019** |
| **Selected Income Statement Data:** | | | |
| Net interest income | $ 121,764 | $ 122,285 | $ 104,575 |
| Provision for loan losses | (1,918) | 25,570 | 2,799 |
| Noninterest income | 97,469 | 101,603 | 56,633 |
| Noninterest expense | 148,030 | 141,715 | 121,708 |
| Income tax expense (benefit) | 14,507 | 11,250 | 7,481 |
| Net income | 58,614 | 45,353 | 29,220 |
| **Share and Per Share Data:** | | | |
| Earnings per share (basic) | $ 3.26 | $ 2.51 | $ 1.74 |
| Earnings per share (diluted) | 3.17 | 2.47 | 1.71 |
| Dividends per share | 0.30 | 0.14 | 0.06 |
| Tangible book value per share(1) | 21.51 | 18.97 | 15.46 |
| **Selected Period End Balance Sheet Data:** | | | |
| Cash and cash equivalents | $ 486,821 | $ 300,307 | $ 158,099 |
| Investment securities | 724,504 | 803,087 | 707,650 |
| Gross loans held for investment | 2,437,577 | 2,221,583 | 2,143,623 |
| Allowance for loan losses | 42,098 | 45,553 | 24,197 |
| Total assets | 3,901,855 | 3,599,160 | 3,237,167 |
| Total deposits | 3,341,222 | 2,974,351 | 2,696,857 |
| Borrowings | 122,168 | 223,532 | 205,030 |
| Total stockholders' equity | 407,427 | 370,048 | 306,182 |
| **Performance Ratios:** | | | |
| Return on average assets | 1.56% | 1.31% | 1.04% |
| Return on average stockholders' equity | 15.08% | 13.40% | 10.94% |
| Net interest margin(2) | 3.51% | 3.84% | 3.98% |
| Efficiency ratio(3) | 67.14% | 62.99% | 75.29% |
| **Credit Quality Ratios:** | | | |
| Nonperforming assets to total assets(4) | 0.30% | 0.45% | 0.24% |
| Nonperforming loans to total loans held for investment | 0.43% | 0.67% | 0.28% |
| Allowance for loan losses to nonperforming loans(5) | 397.23% | 304.40% | 400.28% |
| Allowance for loan losses to total loans held for investment | 1.73% | 2.05% | 1.13% |
| Net loan charge-offs to average loans | 0.06% | 0.18% | 0.09% |
| **Capital Ratios:** | | | |
| Total stockholders' equity to total assets | 10.44% | 10.28% | 9.46% |
| Tangible common equity to tangible assets(1) | 9.85% | 9.60% | 8.69% |
| Common equity tier 1 capital ratio | 12.91% | 12.96% | 11.06% |
| Tier 1 leverage ratio | 10.77% | 10.24% | 10.74% |
| Tier 1 risk-based capital ratio | 14.49% | 14.78% | 12.85% |
| Total risk-based capital ratio | 18.40% | 19.08% | 14.88% |

(1) Represents a non-GAAP financial measure. See our reconciliation of non-GAAP financial measures to their most directly comparable GAAP financial measures under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations — Non-GAAP Financial Measures."
(2) Net interest margin is calculated as the annual net interest income, on a fully tax-equivalent basis, divided by average interest-earning assets.
(3) The efficiency ratio is calculated by dividing noninterest expense by the sum of net interest income on a tax-equivalent basis and noninterest income.
(4) Nonperforming assets consist of nonperforming loans plus OREO.
(5) Nonperforming loans include nonaccrual loans and loans past due 90 days or more.

### Results of Operations

Net income for the year ended December 31, 2021 was $58.6 million, or $3.17 per diluted share, compared to $45.4 million, or $2.47 per diluted share, for the year ended December 31, 2020. The increase in net income was primarily the result of a decrease of $27.5 million in provision for loan loss, offset by a decrease of $4.1 million in noninterest income, an increase of $6.3 million in noninterest expense and an increase of $3.3 million in income tax expense.

Return on average assets was 1.56% and return on average equity was 15.08% for the year ended December 31, 2021, compared to 1.31% and 13.40%, respectively, for the year ended December 31, 2020. The increase in return on average assets was primarily due to the increase in net income of 29.2%, relative to a smaller increase of 8.8% for total average assets.

Net income for the year ended December 31, 2020 was $45.4 million, or $2.47 per diluted share, compared to $29.2 million, or $1.71 per diluted share, for the year ended December 31, 2019. The increase in net income was primarily the result of an improvement of $17.7 million in net interest income and increased noninterest income of $45.0 million, offset by an increase of $20.0 million in noninterest expense, an increase of $22.8 million in the provision for loan losses and an increase of $3.8 million in income tax expense.

Return on average assets was 1.31% and return on average equity was 13.40% for the year ended December 31, 2020, compared to 1.04% and 10.94%, respectively, for the year ended December 31, 2019. The increase in return on average assets was primarily due to the increase in net income of 55.2%, relative to a smaller increase of 22.8% for total average assets.

#### *Net Interest Income*

Net interest income is the principal source of the Company’s net income and represents the difference between interest income (interest and fees earned on assets, primarily loans and investment securities) and interest expense (interest paid on deposits and borrowed funds). We generate interest income from interest-earning assets that we own, including loans and investment securities. We incur interest expense from interest-bearing liabilities, including interest-bearing deposits and other borrowings, notably FHLB advances and subordinated notes. To evaluate net interest income, we measure and monitor (i) yields on our loans and other interest-earning assets, (ii) the costs of our deposits and other funding sources, (iii) our net interest spread and (iv) our net interest margin. Net interest spread is the difference between rates earned on interest-earning assets and rates paid on interest-bearing liabilities. Net interest margin is calculated as the annualized net interest income on a fully tax-equivalent basis divided by average interest-earning assets.

Changes in the market interest rates and interest rates we earn on interest-earning assets or pay on interest-bearing liabilities, as well as the volume and types of interest-earning assets, interest-bearing and noninterest-bearing liabilities, are usually the largest drivers of periodic changes in net interest spread, net interest margin and net interest income.

The following table presents, for the periods indicated, information about: (i) weighted average balances, the total dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) average balances, the total dollar amount of interest expense on interest-bearing liabilities and the resultant average rates; (iii) net interest income; (iv) the interest rate spread; and (v) the net interest margin. For purposes of this table, interest income is shown on a fully tax-equivalent basis.

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2021 | | | 2020 | | | 2019 | | |
| | Average Balance | Interest | Yield/Rate | Average Balance | Interest | Yield/Rate | Average Balance | Interest | Yield/Rate |
| | (Dollars in thousands) | | | | | | | | |
| **Assets:** | | | | | | | | | |
| Interest-earning assets: | | | | | | | | | |
| Loans, excluding PPP (1) | $2,302,413 | $112,255 | 4.88% | $2,181,118 | $116,753 | 5.35% | $1,997,783 | $ 117,074 | 5.86% |
| Loans - PPP | 117,788 | 8,290 | 7.04% | 144,514 | 5,130 | 3.55% | — | — | — |
| Investment securities – taxable | 532,272 | 9,292 | 1.75% | 547,107 | 11,852 | 2.17% | 317,947 | 8,608 | 2.71% |
| Investment securities – non-taxable | 219,385 | 5,872 | 2.68% | 158,482 | 4,489 | 2.83% | 37,232 | 1,289 | 3.46% |
| Other interest-earning assets (2) | 336,081 | 565 | 0.17% | 184,262 | 1,100 | 0.60% | 284,031 | 6,412 | 2.26% |
| Total interest-earning assets | 3,507,939 | 136,274 | 3.88% | 3,215,483 | 139,324 | 4.33% | 2,636,993 | 133,383 | 5.06% |
| Noninterest-earning assets | 261,140 | | | 249,536 | | | 182,967 | | |
| Total assets | $3,769,079 | | | $3,465,019 | | | $2,819,960 | | |
| **Liabilities and Shareholders' Equity:** | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | |
| NOW, savings and money market deposits | 1,841,678 | 4,163 | 0.23% | 1,653,088 | 6,337 | 0.38% | 1,448,320 | 16,436 | 1.13% |
| Time deposits | 329,509 | 4,130 | 1.25% | 331,623 | 5,557 | 1.68% | 319,811 | 6,055 | 1.89% |
| Short-term borrowings | 8,045 | 5 | 0.06% | 19,404 | 104 | 0.54% | 16,231 | 290 | 1.79% |
| Notes payable & other longer-term borrowings | 19,641 | 38 | 0.19% | 107,045 | 558 | 0.52% | 95,054 | 2,024 | 2.13% |
| Subordinated debt securities | 75,699 | 4,056 | 5.36% | 38,747 | 2,223 | 5.74% | 26,786 | 1,616 | 6.03% |
| Junior subordinated deferrable interest debentures | 46,393 | 880 | 1.90% | 46,393 | 1,167 | 2.52% | 46,393 | 1,946 | 4.19% |
| Total interest-bearing liabilities | 2,320,965 | 13,272 | 0.57% | 2,196,300 | 15,946 | 0.73% | 1,952,595 | 28,367 | 1.45% |
| Noninterest-bearing liabilities: | | | | | | | | | |
| Noninterest-bearing deposits | 1,016,835 | | | 888,653 | | | 570,428 | | |
| Other liabilities | 42,654 | | | 41,573 | | | 29,891 | | |
| Total noninterest-bearing liabilities | 1,059,489 | | | 930,226 | | | 600,319 | | |
| Shareholders' equity | 388,625 | | | 338,493 | | | 267,046 | | |
| Total liabilities and shareholders' equity | $3,769,079 | | | $3,465,019 | | | $2,819,960 | | |
| Net interest income | | $123,002 | | | $123,378 | | | $ 105,016 | |
| Net interest spread | | | 3.31% | | | 3.61% | | | 3.61% |
| Net interest margin(3) | | | 3.51% | | | 3.84% | | | 3.98% |

(1) Average loan balances include nonaccrual loans and loans held for sale.
(2) Includes income and average balances for interest-earning deposits at other banks, nonmarketable securities, federal funds sold and other miscellaneous interest-earning assets.
(3) Net interest margin is calculated as the annual net interest income, on a fully tax-equivalent basis, divided by average interest-earning assets.

Increases and decreases in interest income and interest expense result from changes in average balances (volume) of interest-earning assets and interest-bearing liabilities, as well as changes in average interest rates. The following tables set forth the effects of changing rates and volumes on our net interest income during the period shown. Information is provided with respect to (i) effects on interest income attributable to changes in volume (change in volume multiplied by prior rate) and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume). Change applicable to both volume and rate have been allocated to volume.

| | Year Ended December 31, 2021 over 2020 | | | Year Ended December 31, 2020 over 2019 | | |
|---|---|---|---|---|---|---|
| | Change due to: | | | Change due to: | | |
| | Volume | Rate | Total Variance | Volume | Rate | Total Variance |
| | (Dollars in thousands) | | | | | |
| **Interest-earning assets:** | | | | | | |
| Loans, excluding PPP | $ 6,493 | $ (10,991) | $ (4,498) | $ 10,744 | $ (11,065) | $ (321) |
| Loans - PPP | (949) | 4,109 | 3,160 | — | 5,130 | 5,130 |
| Investment securities – taxable | (321) | (2,239) | (2,560) | 6,204 | (2,960) | 3,244 |
| Investment securities – non-taxable | 1,725 | (342) | 1,383 | 4,198 | (998) | 3,200 |
| Other interest-earning assets | 906 | (1,441) | (535) | (2,252) | (3,060) | (5,312) |
| Total increase (decrease) in interest income | 7,854 | (10,904) | (3,050) | 18,894 | (12,953) | 5,941 |
| **Interest-bearing liabilities:** | | | | | | |
| NOW, Savings, MMDAs | 723 | (2,897) | (2,174) | 2,324 | (12,423) | (10,099) |
| Time deposits | (35) | (1,392) | (1,427) | 224 | (722) | (498) |
| Short-term borrowings | (61) | (38) | (99) | 57 | (243) | (186) |
| Notes payable & other borrowings | (456) | (64) | (520) | 255 | (1,721) | (1,466) |
| Subordinated debt securities | 2,120 | (287) | 1,833 | 722 | (115) | 607 |
| Junior subordinated deferrable interest debentures | — | (287) | (287) | — | (779) | (779) |
| Total increase (decrease) interest expense: | 2,291 | (4,965) | (2,674) | 3,582 | (16,003) | (12,421) |
| Increase (decrease) in net interest income | $ 5,563 | $ (5,939) | $ (376) | $ 15,312 | $ 3,050 | $ 18,362 |

*Year Ended December 31, 2021 compared to Year Ended December 31, 2020*

Net interest income for the year ended December 31, 2021 was $121.8 million compared to $122.3 million for the year ended December 31, 2020, an decrease of $0.5 million, or 0.4%. The decrease in net interest income in 2021 was comprised of a $3.2 million, or 2.3%, decrease in interest income and a $2.7 million, or 16.8%, decrease in interest expense. The decrease in interest income was primarily attributable to a decrease in the yield on average interest-earning assets of 45 basis points offset by the growth of $292.5 million in these assets during the year ended December 31, 2021. During the years ended December 31, 2021 and 2020, the Company recognized $6.1 and 3.7 million, respectively, in deferred PPP-related SBA fees. When received, these fees are deferred and then accreted into interest income over the life of the applicable PPP loans. At the time of PPP loan forgiveness by the SBA, any remaining deferred fees are recognized immediately. At December 31, 2021 and 2020, there was $1.9 and $4.1 million, respectively, of deferred PPP-related SBA fees that have not been accreted to income. The Company expects that the majority of the remaining first and second rounds of PPP loans will continue to be forgiven by the SBA or repaid over the next several quarters.

The $2.7 million decrease in interest expense for the year ended December 31, 2021 was primarily related to a 16 basis points decrease in the rate paid on interest-bearing liabilities, partially offset by an increase of $124.7 million in average interest-bearing liabilities over the same period in 2020. The increase in average interest-bearing liabilities was mainly due to increased deposits from PPP loan funding, other government stimulus payments and programs during the period as well as organic growth, partially offset by the repayment of $75.0 million in long-term advances during 2021.

For the year ended December 31, 2021, net interest margin and net interest spread were 3.51% and 3.31%, respectively, compared to 3.84% and 3.61% for the same period in 2020, respectively, which reflects the changes in interest income and interest expense discussed above.

*Year Ended December 31, 2020 compared to Year Ended December 31, 2019*

Net interest income for the year ended December 31, 2020 was $122.3 million compared to $104.6 million for the year ended December 31, 2019, an increase of $17.7 million, or 16.9%. The increase in net interest income was comprised of a $5.3 million, or 4.0%, increase in interest income and a $12.4 million, or 43.8%, decrease in interest expense. The growth in interest income was primarily attributable to a $183.3 million, or 9.2%, increase in average non-PPP loans outstanding during the year ended December 31, 2020, compared to 2019, partially offset by a 51 basis points decrease in the yield on total loans. The increase in average loans outstanding was primarily the result of a complete year of loans acquired from WTSB and an increase of $44.2 million in average mortgage loans held for sale. The decline in yield was a result of the large drop in rates experienced in the first quarter of 2020 and its continued effects. As of December 31, 2020, the Company had originated approximately 2,100 PPP loans, totaling $218 million, and had received $7.8 million in PPP related SBA fees due to PPP loan forgiveness received from the SBA during the period. These fees were deferred and then accreted into interest income over the life of the applicable loans. During the year ended December 31, 2020, the Company recognized $3.7 million in PPP related SBA fees. At December 31, 2020, there was $4.1 million of deferred fees that had not been accreted to income.

The $12.4 million decrease in interest expense for the year ended December 31, 2020 was primarily related to a 72 basis points decrease in the rate paid on interest-bearing liabilities, partially offset by an increase of $243.7 million in average interest-bearing liabilities. The increase in average interest-bearing liabilities was largely due to a complete year of the deposits acquired from WTSB and growth in deposits from organic growth, customers depositing funds received from PPP loans and maintaining higher balances, and other government stimulus payments and programs. Additionally, the decrease in the rate paid on interest-bearing liabilities was the result of the decline in the overall rate environment experienced in the first quarter of 2020.

For the year ended December 31, 2020, net interest margin and net interest spread were 3.84% and 3.61%, respectively, compared to 3.98% and 3.61% for the same period in 2019, respectively, which reflects the changes in interest income and interest expense discussed above.

***Provision for Loan Losses***

Credit risk is inherent in the business of making loans. We establish an allowance for loan losses through charges to earnings, which are shown in the statements of income as the provision for loan losses. Specifically identifiable and quantifiable known losses are promptly charged off against the allowance. The provision for loan losses is determined by conducting a quarterly evaluation of the adequacy of our allowance for loan losses and charging the shortfall or excess, if any, to the current quarter's expense. This has the effect of creating variability in the amount and frequency of charges to our earnings. The provision for loan losses and level of allowance for each period are dependent upon many factors, including loan growth, net charge offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of the quality of the loan portfolio, the valuation of problem loans and the general economic conditions in our market areas. See "Financial Statements and Supplementary Data – Note 1. Summary of Significant Accounting Policies" in the notes to our consolidated financial statements included elsewhere in this Report for more detailed discussion.

*Year Ended December 31, 2021 compared to Year Ended December 31, 2020*

The provision for loan losses for the year ended December 31, 2021 was a credit of $1.9 million compared to $25.6 million for the year ended December 31, 2020. The decrease in the provision for loan losses for the year ended December 31, 2021 compared to the same period in 2020 is primarily a result of general improvement in the economy, a decline in the amount of loans actively under a modification, and a decrease in nonperforming loans. Net charge-offs decreased $2.7 million during 2021 as compared to 2020. The allowance for loan losses as a percentage of loans held for investment was 1.73% at December 31, 2021 and 2.05% at December 31, 2020. Further discussion of the allowance for loan losses is noted below.

*Year Ended December 31, 2020 compared to Year Ended December 31, 2019*

The provision for loan losses for the year ended December 31, 2020 was $25.6 million compared to $2.8 million for the year ended December 31, 2019. The higher provision in 2020 was primarily a result of the uncertain economic effects from the ongoing COVID-19 pandemic as well as the decline in oil and gas prices. Net charge-offs increased $2.5 million during 2020 as compared to 2019. The allowance for loan losses as a percentage of loans held for investment was 2.05% at December 31, 2020 and 1.13% at December 31, 2019. Further discussion of the allowance for loan losses is noted below.

***Noninterest Income***

While interest income remains the largest single component of total revenues, noninterest income is an important contributing component. The largest portion of our noninterest income is associated with our mortgage banking activities. Other sources of noninterest income include service charges on deposit accounts, bank card services and interchange fees, and income from insurance activities.

The following table sets forth the major components of our noninterest income for the periods indicated:

| | Year Ended December 31, 2021 over 2020 | | | Year Ended December 31, 2020 over 2019 | | |
|---|---|---|---|---|---|---|
| | 2021 | 2020 | Increase (decrease) | 2020 | 2019 | Increase (decrease) |
| | (Dollars in thousands) | | | | | |
| Noninterest income: | | | | | | |
| Service charges on deposit accounts | $ 6,963 | $ 7,032 | $ (69) | $ 7,032 | $ 8,129 | $ (1,097) |
| Income from insurance activities | 8,314 | 7,644 | 670 | 7,644 | 7,016 | 628 |
| Bank card services and interchange fees | 12,239 | 10,035 | 2,204 | 10,035 | 8,692 | 1,343 |
| Mortgage banking activities | 59,726 | 65,042 | (5,316) | 65,042 | 25,126 | 39,916 |
| Investment commissions | 1,934 | 1,698 | 236 | 1,698 | 1,710 | (12) |
| Fiduciary income | 2,917 | 3,185 | (268) | 3,185 | 2,306 | 879 |
| Gain on sale of securities | — | 2,318 | (2,318) | 2,318 | — | 2,318 |
| Other income and fess(1) | 5,376 | 4,649 | 727 | 4,649 | 3,654 | 995 |
| Total noninterest income | $ 97,469 | $ 101,603 | $ (4,134) | $ 101,603 | $ 56,633 | $ 44,970 |

(1) Other income and fees includes income and fees associated with the increase in the cash surrender value of life insurance, safe deposit box rental, check printing, collections, wire transfer and other miscellaneous services.

*Year Ended December 31, 2021 compared to Year Ended December 31, 2020*

Noninterest income for the year ended December 31, 2021 was $97.5 million compared to $101.6 million for the year ended December 31, 2020, a decrease of $4.1 million, or 4.1%. Income from mortgage banking activities decreased $5.3 million, or 8.2%, to $59.7 million for the December 31, 2021 from $65.0 million for the year ended December 31, 2020. The decrease was primarily the result of a reduction of $106.3 million in interest rate lock commitments and a decline in gain on sale margins, partially offset by an increase of $58.1 million in mortgage loan originations for the year ended December 31, 2021 compared to the year ended December 31, 2020. Our mortgage originations experienced another high level of volume in 2021 as the industry continued to benefit from historic low levels of interest rates through a majority of 2021. Refinance activity represented 54% of the 2021 originations as compared to 53% in 2020. Refinance activity is expected to taper off in 2022 and then return to more historically-consistent levels. Additionally, bank card services and interchange fee income increased $2.2 million and income from insurance activities increased $670 thousand for the year ended December 31, 2021 compared to the year ended December 31, 2020. The increase in bank card services and interchange fee income was primarily tied to the growth in deposits, increased consumer spending, and the expansion of credit card services. The increase in income from insurance activities is primarily related to increased premiums paid in 2021. Further, there was a $2.3 million gain on sale of securities in the first quarter of 2020.

*Year Ended December 31, 2020 compared to Year Ended December 31, 2019*

Noninterest income for the year ended December 31, 2020 was $101.6 million compared to $56.6 million for the year ended December 31, 2019, an increase of $45.0 million, or 79.4%. Income from mortgage banking activities increased $39.9 million, or 158.9%, to $65.0 million for the December 31, 2020 from $25.1 million for the year ended December 31, 2019. This increase was due primarily due to an increase of $802.2 million, or 125.2%, in mortgage loan originations for the year ended December 31, 2020, compared to the year ended December 31, 2019. Our mortgage originations experienced a record level of volume in 2020 as the industry benefited from historic low levels of interest rates. Refinance activity represented 53% of the 2020 originations as compared to 28% in 2019. Additionally, fiduciary income increased $879 thousand, and income from insurance activities increased $628 thousand for the year ended December 31, 2020 compared to the year ended December 31, 2019. The increase in fiduciary income was primarily due to new customer acquisition with estate executorship and trust management as the primary services in late third quarter 2019. It is expected that fiduciary fees will be $410 thousand per quarter lower beginning in the third quarter of 2021, prior to any organic growth, due to the fees on some estates being fully earned at end of the second quarter of 2021. The increase in income from insurance activities is related to new revenue generated from two businesses acquired since September 1, 2019. Further, there was a $2.3 million gain on sale of securities in the first quarter of 2020.

***Noninterest Expense***

The following table sets forth the major components of our noninterest expense for the periods indicated:

| | Year Ended December 31, 2021 over 2020 | | | Year Ended December 31, 2020 over 2019 | | |
|---|---|---|---|---|---|---|
| | **2021** | **2020** | **Increase (decrease)** | **2020** | **2019** | **Increase (decrease)** |
| | | | **(Dollars in thousands)** | | | |
| Noninterest expense: | | | | | | |
| Salaries and employee benefits | $ 93,360 | $ 89,220 | $ 4,140 | $ 89,220 | $ 75,392 | $ 13,828 |
| Occupancy expense, net | 14,560 | 14,658 | (98) | 14,658 | 13,572 | 1,086 |
| Professional services | 6,752 | 6,322 | 430 | 6,322 | 7,334 | (1,012) |
| Marketing and development | 3,225 | 3,088 | 137 | 3,088 | 3,017 | 71 |
| IT and data services | 4,007 | 3,574 | 433 | 3,574 | 2,830 | 744 |
| Bankcard expenses | 4,995 | 4,253 | 742 | 4,253 | 3,346 | 907 |
| Appraisal expenses | 3,248 | 2,782 | 466 | 2,782 | 1,625 | 1,157 |
| Other expenses(1) | 17,883 | 17,818 | 65 | 17,818 | 14,592 | 3,226 |
| Total noninterest expense | $ 148,030 | $ 141,715 | $ 6,315 | $ 141,715 | $ 121,708 | $ 20,007 |

(1) Other expenses include items such as telephone expenses, postage, courier fees, directors' fees, and insurance.

*Year Ended December 31, 2021 compared to Year Ended December 31, 2020*

Noninterest expense for 2021 was $148.0 million compared to $141.7 million for 2020, an increase of $6.3 million, or 4.5%. Salaries and employee benefits increased $4.1 million, or 4.6%, from $89.2 million for the December 31, 2020 to $93.4 million for the year ended December 31, 2021. This increase in salaries and employee benefits expense was predominately driven by increased commissions paid on the higher volume of mortgage loan originations and other personnel expenses to support mortgage activities. Additionally, salary expense increased due to expenses for incentive-based compensation related to the growth in loans held for investment in 2021 and for newly-hired commercial loan officers as part of our stated initiative. All other noninterest expenses increased $2.2 million for the year ended December 31, 2021, compared to the same period in 2020. This increase was primarily related to additional expenses incurred in 2021 for bankcard expenses as a result of increased consumer spending, growth in deposits, and credit card program expenses. Additionally, there were increases in appraisal expenses due to the high mortgage volume noted above and increased technology costs as part of the investment in planning our transition of computing and data storage to the cloud as well as further development of the new customer lead generation initiative.

*Year Ended December 31, 2020 compared to Year Ended December 31, 2019*

Noninterest expense for 2020 was $141.7 million compared to $121.7 million for 2019, an increase of $20.0 million, or 16.4%. Salaries and employee benefits increased $13.8 million, or 18.3%, from $75.4 million for the December 31, 2019 to $89.2 million for the year ended December 31, 2020. This increase in salaries and employee benefits expense was predominantly driven by $10.1 million of additional commissions paid on the higher volume of mortgage loan originations and from the full year of expenses for the personnel in the branches acquired from WTSB. All other noninterest expenses increased $6.2 million for the year ended December 31, 2020, compared to the same period in 2019. This increase was primarily due to the following: a $1.6 million increase in variable mortgage expenses as a result of increased production, a $1.4 million increase in core deposit intangible and other intangibles amortization expense, a $621 thousand increase in data conversion expenses related to the WTSB acquisition, and $701 thousand in computer equipment purchased in connection with upgrading the equipment at the acquired branches as well as at existing branches and a new phone system. The computer equipment purchases were expensed due to the individual items falling below the Company’s capitalization threshold.

## Financial Condition

Our total assets increased $302.7 million, or 8.4%, to $3.90 billion at December 31, 2021 as compared to $3.60 billion at December 31, 2020. Our loans held for investment increased $216.0 million, or 9.7%, to $2.44 billion at December 31, 2021, compared to $2.22 billion at December 31, 2020. Total deposits increased $366.9 million, or 12.3% to $3.34 billion at December 31, 2021, compared to $2.97 billion at December 31, 2020. The increase in total assets, loans, and deposits was primarily the result of organic growth of the Company, which included hiring new commercial lenders as part of a stated growth initiative.

### *Loan Portfolio*

Our loans represent the largest portion of earning assets, greater than the securities portfolio or any other asset category, and the quality and diversification of the loan portfolio is an important consideration when reviewing the Company’s financial condition. We originate substantially all of the loans in our portfolio, except certain loan participations that are independently underwritten by the Company prior to purchase.

Loans held for investments increased $216.0 million, or 9.7%, to $2.44 billion at December 31, 2021 as compared to $2.22 billion at December 31, 2020. We had net organic growth in non-PPP loans of $345.8 million during the year ended December 31, 2021. This increase occurred in a majority of loan segments, with the largest volume growth in residential construction, residential mortgage, consumer auto, direct energy, restaurant & retail, and multifamily property loans. These increases were partially offset by a decrease in aggregate principal amounts of PPP loans of $129.8 million as the Company funded $91.4 million in new PPP loans and received forgiveness payments from the SBA or repayments totaling $221.2 million on PPP loans during 2021.

The following table shows the contractual maturities of our loans held for investment portfolio at December 31, 2021:

| | Due in One Year or Less | Due after One Year Through Five Years | Due after Five Years Through Fifteen Years | Due after Fifteen Years | Total |
|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | |
| Commercial real estate | $ 88,513 | $ 334,496 | $ 202,825 | $ 129,610 | $ 755,444 |
| Commercial - specialized | 105,538 | 115,983 | 108,892 | 48,312 | 378,725 |
| Commercial - general | 68,015 | 165,597 | 134,798 | 91,614 | 460,024 |
| Consumer: | | | | | |
| 1-4 family residential | 43,928 | 66,942 | 71,376 | 205,444 | 387,690 |
| Auto loans | 2,175 | 141,693 | 96,851 | — | 240,719 |
| Other consumer | 5,009 | 39,431 | 23,596 | 77 | 68,113 |
| Construction | 132,396 | 6,051 | 747 | 7,668 | 146,862 |
| Total loans | $ 445,574 | $ 870,193 | $ 639,085 | $ 482,725 | $ 2,437,577 |

The following table shows the distribution between fixed and adjustable interest rate loans for maturities greater than one year as of December 31, 2021:

| | Fixed Rate | Adjustable Rate |
|---|---|---|
| | (Dollars in thousands) | |
| Commercial real estate | $ 273,308 | $ 393,623 |
| Commercial - specialized | 68,743 | 204,444 |
| Commercial - general | 155,024 | 236,985 |
| Consumer: | | |
| 1-4 family residential | 201,274 | 142,488 |
| Auto loans | 238,544 | — |
| Other consumer | 62,775 | 329 |
| Construction | 543 | 13,923 |
| Total loans | $ 1,000,211 | $ 991,792 |

The Bank is primarily involved in real estate, commercial, agricultural and consumer lending activities with customers throughout Texas and Eastern New Mexico. We have a collateral concentration as 69.4% of our loans were secured by real property as of December 31, 2021, compared to 66.5% as of December 31, 2020. We believe that these loans are not concentrated in any one single property type and that they are geographically dispersed throughout the areas we serve. Although the Bank has diversified portfolios, its debtors' ability to honor their contracts is substantially dependent upon the general economic conditions of the markets in which it operates, which consist primarily of agribusiness, wholesale/retail, oil and gas and related businesses, healthcare industries and institutions of higher education. Commercial real estate loans represent 36.7% of loans held for investment as of December 31, 2021 and represented 29.9% of loans held for investment as of December 31, 2020. Further, these loans are geographically diversified, primarily throughout the State of Texas as well as Eastern New Mexico.

We have established concentration limits in the loan portfolio for commercial real estate loans and unsecured lending, among other loan types. All loan types are within established limits. We use underwriting guidelines to assess the borrowers' historical cash flow to determine debt service, and we further stress test the debt service under higher interest rate scenarios. Financial and performance covenants are used in commercial lending to allow us to react to a borrower's deteriorating financial condition, should that occur.

*Commercial Real Estate*. Our commercial real estate portfolio includes loans for commercial property that is owned by real estate investors, construction loans to build owner-occupied properties, and loans to developers of commercial real estate investment properties and residential developments. Commercial real estate loans are subject to underwriting standards and processes similar to our commercial loans. These loans are underwritten primarily based on projected cash flows for income-producing properties and collateral values for non-income-producing properties. The repayment of these loans is generally dependent on the successful operation of the property securing the loans or the sale or refinancing of the property. Real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. The properties securing our real estate portfolio are diversified by type and geographic location. This diversity helps reduce the exposure to adverse economic events that affect any single market or industry.

Commercial real estate loans increased $92.1 million, or 13.9%, to $755.4 million as of December 31, 2021 from $663.3 million as of December 31, 2020. This increase was primarily driven by organic growth of $71.6 million in multifamily property loans and an increase of $21.2 million in other commercial tenant loans.

*Commercial – General and Specialized*. Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably. Underwriting standards have been designed to determine whether the borrower possesses sound business ethics and practices, to evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations, and to ensure appropriate collateral is obtained to secure the loan. Commercial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial loans are secured by the assets being financed or other business assets, such as real estate, accounts receivable, or inventory, and typically include personal guarantees. Owner-occupied real estate is included in commercial loans, as the repayment of these loans is generally dependent on the operations of the commercial borrower's business rather than on income-producing properties or the sale of the properties. Commercial loans are grouped into two distinct sub-categories: specialized and general. Commercial related loans that are considered "specialized" include agricultural production and real estate loans, energy loans, and finance, investment, and insurance loans. Commercial related loans that contain a broader diversity of borrowers, sub-industries, or serviced industries are grouped into the "general category." These include goods, services, restaurant & retail, construction, and other industries.

Commercial general loans decreased $58.3 million, or 11.2%, to $460.0 million as of December 31, 2021 from $518.3 million as of December 31, 2020. The decrease in commercial general loans was primarily due to a decrease in PPP loans of $129.8 million, partially offset by organic loan growth of $31.2 million in restaurant and retail loans.

Commercial specialized loans increased $67.0 million, or 21.5%, to $378.7 million as of December 31, 2021 from $311.7 million as of December 31, 2020. This increase was primarily due to organic growth in our direct energy sector of $54.8 million and an increase of $18.9 million in agricultural real estate loans.

*Consumer*. We utilize a computer-based credit scoring analysis to supplement our policies and procedures in underwriting consumer loans. Our loan policy addresses types of consumer loans that may be originated and the collateral, if secured, which must be perfected. The relatively smaller individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimize our risk. Residential real estate loans are included in consumer loans. We generally require mortgage title insurance and hazard insurance on these residential real estate loans.

Consumer and other loans increased $62.8 million, or 9.9%, to $696.5 million as of December 31, 2021, from $633.8 million as of December 31, 2020. The increase in these loans was primarily a result of a $27.4 million increase in residential mortgage loans and a $34.9 million increase in consumer auto loans as a result of increased auto and home buyer demand. As of December 31, 2021, our consumer loan portfolio was comprised of $387.7 million in 1-4 family residential loans, $240.7 million in auto loans, and $68.1 million in other consumer loans.

*Construction*. Loans for residential construction are for single-family properties to developers, builders, or end-users. These loans are underwritten based on estimates of costs and completed value of the project. Funds are advanced based on estimated percentage of completion for the project. Performance of these loans is affected by economic conditions as well as the ability to control costs of the projects.

Construction loans increased $52.4 million, or 55.4%, to $146.9 million as of December 31, 2021 from $94.5 million as of December 31, 2020. The increase resulted from continued higher demand for residential construction as a result of home shortages in many of our markets as lower mortgage interest rates increased the number of buyers for homes.

*Paycheck Protection Program*. In April 2020, we began originating loans to qualified small businesses under the PPP administered by the SBA under the provisions of the CARES Act. Loans covered by the PPP may be eligible for loan forgiveness for certain costs incurred related to payroll, group health care benefit costs and qualifying mortgage, rent and utility payments. The remaining loan balance after forgiveness of any amounts is still fully guaranteed by the SBA. Terms of the PPP loans include the following (i) maximum amount limited to the lesser of $10 million or an amount calculated using a payroll-based formula, (ii) maximum loan term of five years, (iii) interest rate of 1.00%, (iv) no collateral or personal guarantees are required, (v) no payments are required for six months following the loan disbursement date and (vi) loan forgiveness up to the full principal amount of the loan and any accrued interest, subject to certain requirements including that no more than 25% of the loan forgiveness amount may be attributable to non-payroll costs. In return for processing and booking the loan, the SBA paid the lender a processing fee tiered by the size of the loan (5% for loans of not more than $350 thousand; 3% for loans more than $350 thousand and less than $2 million; and 1% for loans of at least $2 million). At December 31, 2021, PPP loans totaled approximately $40.2 million which are included in commercial general loans.

We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. 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 to our customers is represented by the contractual or notional amount of those instruments. Commitments to extend credit and standby letters of credit are not recorded as an asset or liability by the Company until the instrument is exercised. The contractual or notional amounts of those instruments reflect the extent of involvement we have in particular classes of financial instruments.

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 dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments and conditional obligations as they do for on-balance sheet instruments. The amount and nature of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the potential borrower.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private short-term borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds collateral supporting those commitments for which collateral is deemed necessary.

The following table summarizes commitments we have made as of the dates presented.

| | December 31, 2021 | December 31, 2020 |
|---|---|---|
| | (Dollars in thousands) | |
| Commitments to grant loans and unfunded commitments under lines of credit | $ 542,338 | $ 417,798 |
| Standby letters of credit | 12,418 | 10,481 |
| Total | $ 554,756 | $ 428,279 |

***Allowance for Loan Losses***

The allowance for loan losses provides a reserve against which loan losses are charged as those losses become evident. Management evaluates the appropriate level of the allowance for loan losses on a quarterly basis. The analysis takes into consideration the results of an ongoing loan review process, the purpose of which is to determine the level of credit risk within the portfolio and to ensure proper adherence to underwriting and documentation standards. Additional allowances are provided to those loans which appear to represent a greater than normal exposure to risk. The quality of the loan portfolio and the adequacy of the allowance for loan losses is reviewed by regulatory examinations and the Company's auditors. The allowance for loan losses consists of two elements: (1) specific valuation allowances established for probable losses on specific loans and (2) historical valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends, judgmentally adjusted for general economic conditions and other qualitative risk factors internal and external to the Company.

To determine the adequacy of the allowance, the loan portfolio is broken into categories based on loan type. Historical loss experience factors by category, adjusted for changes in trends and conditions, are used to determine an indicated allowance for each portfolio category. These factors are evaluated and updated based on the composition of the specific loan portfolio. Other considerations include volumes and trends of delinquencies, nonaccrual loans, levels of bankruptcies, criticized and classified loan trends, expected losses on real estate secured loans, new credit products and policies, economic conditions, concentrations of credit risk, and the experience and abilities of the Company's lending personnel. In addition to the portfolio evaluations, impaired loans with a balance of $250 thousand or more are individually evaluated based on facts and circumstances of the loan to determine if a specific allowance amount may be necessary. Specific allowances may also be established for loans whose outstanding balances are below the above threshold when it is determined that the risk associated with the loan differs significantly from the risk factor amounts established for its loan category.

The allowance for loan losses was $42.1 million at December 31, 2021 compared to $45.6 million at December 31, 2020, an decrease of $3.5 million, or 7.6%. The decrease is primarily a result of a negative provision of $2.0 million being recorded in June 2021 based on general improvement in the economy, a decline in the amount of loans actively under a modification, and a decrease in nonperforming loans.

The following table provides an analysis of the allowance for loan losses and other data at the dates indicated.

| | As of December 31, 2021 | 2020 | 2019 |
|---|---|---|---|
| | | (Dollars in thousands) | |
| Average loans outstanding during period[(1)] | | | |
| Commercial real estate | $ 705,516 | $ 654,923 | $ 538,441 |
| Commercial – specialized | 336,754 | 318,141 | 296,910 |
| Commercial – general | 490,945 | 545,391 | 414,512 |
| Consumer: | | | |
| 1-4 family residential | 374,609 | 362,415 | 354,332 |
| Auto loans | 227,301 | 205,849 | 205,306 |
| Other consumer | 68,106 | 70,478 | 71,609 |
| Construction | 124,840 | 90,277 | 84,344 |
| Loans held for sale | 92,130 | 78,158 | 32,329 |
| Total average loans outstanding during period | $ 2,420,201 | $ 2,325,632 | $ 1,997,783 |
| | | | |
| Net charge-offs during the period | | | |
| Commercial real estate | $ (109) | $ (295) | $ (431) |
| Commercial – specialized | 11 | 1,041 | 231 |
| Commercial – general | 459 | 1,601 | (227) |
| Consumer: | | | |
| 1-4 family residential | 44 | (75) | 375 |
| Auto loans | 483 | 973 | 885 |
| Other consumer | 653 | 970 | 820 |
| Construction | (4) | (1) | 75 |
| Total net charge-offs during the period | $ 1,537 | $ 4,214 | $ 1,728 |
| | | | |
| Total loans held for investment outstanding | $ 2,437,577 | $ 2,221,583 | $ 2,143,623 |
| Nonaccrual loans | $ 9,518 | $ 13,718 | $ 4,693 |
| Allowance for loan losses | $ 42,098 | $ 45,553 | $ 24,197 |
| | | | |
| Ratio of allowance to total loans held for investment | 1.73% | 2.05% | 1.13% |
| Ratio of allowance to nonaccrual loans | 442.30% | 332.07% | 515.60% |
| Ratio of nonaccrual loans to total loans held for investment | 0.39% | 0.62% | 0.22% |
| | | | |
| Ratio of net charge-offs to average loans during the period | | | |
| Commercial real estate | (0.02)% | (0.05)% | (0.08)% |
| Commercial – specialized | — | 0.33% | 0.08% |
| Commercial – general | 0.09% | 0.29% | (0.05)% |

| | | | |
|---|---|---|---|
| Consumer: | | | |
| 1-4 family residential | 0.01% | (0.02)% | 0.11% |
| Auto loans | 0.21% | 0.47% | 0.43% |
| Other consumer | 0.96% | 1.38% | 1.15% |
| Construction | — | — | 0.09% |
| Total ratio of net charge-offs to average loans during the period | 0.06% | 0.18% | 0.09% |

(1) Average outstanding balances include loans held for sale.

Net charge-offs totaled $1.5 million and were 0.06% of average loans outstanding for the year ended December 31, 2021, compared to $4.2 million and 0.18% for the year ended December 31, 2020. The decrease in net charge-offs was primarily the result of a $518 thousand charge-off on a retail commercial relationship in the first quarter of 2020, a $822 thousand charge-off of an acquired direct energy relationship in the second quarter of 2020, and a $451 thousand charge-off of a commercial credit in the third quarter of 2020, as well as other smaller commercial-general charge-offs during 2020. The allowance for loan losses as a percentage of loans held for investment was 1.73% at December 31, 2021 and 2.05% at December 31, 2020.

While the entire allowance is available to absorb losses from any part of our loan portfolio, the following table sets forth the allocation of the allowance for loan losses for the years presented and the percentage of allowance in each classification to total allowance:

| | As of December, 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2021 | | 2020 | | 2019 | |
| | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| | (Dollars in thousands) | | | | | |
| Commercial real estate | $ 17,245 | 41.0% | $ 18,962 | 41.6% | $ 5,049 | 20.9% |
| Commercial – specialized | 4,363 | 10.4 | 5,760 | 12.6 | 2,287 | 9.5 |
| Commercial – general | 8,466 | 20.1 | 9,227 | 20.3 | 9,609 | 39.7 |
| Consumer: | | | | | | |
| 1-4 family residential | 5,268 | 12.5 | 4,646 | 10.2 | 2,093 | 8.6 |
| Auto loans | 3,653 | 8.7 | 4,226 | 9.3 | 3,385 | 14.0 |
| Other consumer | 1,357 | 3.2 | 1,671 | 3.7 | 1,341 | 5.5 |
| Construction | 1,746 | 4.1 | 1,061 | 2.3 | 433 | 1.8 |
| Total allowance for loan losses | $ 42,098 | 100.0% | $ 45,553 | 100.0% | $ 24,197 | 100.0% |

***Nonperforming Loans***

Loans are considered delinquent when principal or interest payments are past due 30 days or more. Delinquent loans may remain on accrual status between 30 days and 90 days past due. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Typically, the accrual of interest on loans is discontinued when principal or interest payments are past due 90 days or when, in the opinion of management, there is a reasonable doubt as to collectability in the normal course of business. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Loans are restored to accrual status when loans become well-secured and management believes full collectability of principal and interest is probable.

A loan is considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include loans on nonaccrual status and performing restructured loans. Income from loans on nonaccrual status is recognized to the extent cash is received and when the loan's principal balance is deemed collectible. Depending on a particular loan's circumstances, we measure impairment of a loan based upon either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral less estimated costs to sell if the loan is collateral dependent. A loan is considered collateral dependent when repayment of the loan is based solely on the liquidation of the collateral. Fair value, where possible, is determined by independent appraisals, typically on an annual basis. Between appraisal periods, the fair value may be adjusted based on specific events, such as if deterioration of quality of the collateral comes to our attention as part of our problem loan monitoring process, or if discussions with the borrower lead us to believe the last appraised value no longer reflects the actual market for the collateral. The impairment amount on a collateral-dependent loan is charged-off to the allowance if deemed not collectible and the impairment amount on a loan that is not collateral-dependent is set up as a specific reserve.

Real estate we acquire as a result of foreclosure or by deed-in-lieu of foreclosure is classified as other real estate owned ("OREO") until sold and is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis.

Nonperforming loans include nonaccrual loans and loans past due 90 days or more. Nonperforming assets consist of nonperforming loans plus OREO.

At December 31, 2021, our total nonaccrual loans were $9.5 million, or 0.39% of total loans held for investment, as compared to $13.7 million, or 0.62% of total loans held for investment, at December 31, 2020. These loans were reviewed for impairment and specific valuation allowances were established as necessary and included in the allowance for loan losses as of December 31, 2021 to cover any probable loss. The decrease in the year ended December 31, 2021 was primarily due to two nonaccrual commercial real estate loans totaling $3.7 million paying off in 2021. This reduction was partially offset by an increase of $1.2 million in six consumer 1-4 family residential loans being placed on nonaccrual in 2021.

Nonperforming loans were $10.6 million at December 31, 2021 and $15.0 million at December 31, 2020.

***Troubled Debt Restructurings***

In cases where a borrower experiences financial difficulties and we make certain concessionary modifications to contractual terms, the loan is classified as a troubled debt restructuring, or TDR. Included in certain loan categories of impaired loans are TDRs on which we have granted certain material concessions to the borrower as a result of the borrower experiencing financial difficulties. The concessions granted by us may include, but are not limited to: (1) a modification in which the maturity date, timing of payments or frequency of payments is modified, (2) an interest rate lower than the current market rate for new loans with similar risk, or (3) a combination of the first two factors.

If a borrower on a restructured accruing loan has demonstrated performance under the previous terms, is not experiencing financial difficulty and shows the capacity to continue to perform under the restructured terms, the loan will remain on accrual status. Otherwise, the loan will be placed on nonaccrual status until the borrower demonstrates a sustained period of performance, which generally requires six consecutive months of payments. Loans identified as TDRs are evaluated for impairment using the present value of the expected cash flows or the estimated fair value of the collateral, if the loan is collateral dependent. The fair value is determined, when possible, by an appraisal of the property less estimated costs related to liquidation of the collateral. The appraisal amount may also be adjusted for current market conditions. Adjustments to reflect the present value of the expected cash flows or the estimated fair value of collateral dependent loans are a component in determining an appropriate allowance for loan losses, and as such, may result in increases or decreases to the provision for loan losses in current and future earnings.

We had no loans restructured as TDRs during 2021, 2020, or 2019. TDRs are excluded from our nonperforming loans unless they otherwise meet the definition of nonaccrual loans or past due 90 days or more.

*COVID-19 Industry Exposures.* The Company's COVID-19 industry exposures at December 31, 2021 were:

- Restaurant and retail owner-occupied loans totaled $122.4 million, or 5.0% of total loans. The average loan size is $448 thousand. There was $1.9 million in classified loans, $6 thousand in loans past due 30 days or more, and $1.2 million in nonaccrual loans. The related allowance for loan losses to total restaurant and retail owner-occupied loans is 2.56%. As of December 31, 2021, none of these loans were active modifications as a result of the COVID-19 pandemic.
- Hospitality and assisted living center loans totaled $112.9 million, or 4.6% of total loans. The average loan size is $2.7 million. There was $39.0 million in classified loans, no loans past due 30 days or more, and $1.1 million in nonaccrual loans. The related allowance for loan losses to total hospitality and assisted living center loans is 7.81%. As of December 31, 2021, approximately 14% of these loans were active modifications as a result of the COVID-19 pandemic. All of these modifications have original modified terms that extended up to 18 months. The Company expects that these remaining modified loans will return to full payment status at the end of their respective modification period.

*Oil and Gas Exposures.* The Company's direct energy sector loans totaled $118.8 million (or 4.9% of total loans) at December 31, 2021. There was $5.6 million in classified loans, $9 thousand in loans past due 30 days or more, and $44 thousand in nonaccrual loans. Management has expanded the monitoring of the loans in this category. The related allowance for loan losses to direct energy loans is 1.76%. As of December 31, 2021, none of these loans were active modifications as a result of the COVID-19 pandemic.

***Securities Portfolio***

The securities portfolio is the second largest component of the Company's interest-earning assets, and the structure and composition of this portfolio is important to an analysis of the financial condition of the Company. The securities portfolio serves the following purposes: (i) it provides a source of pledged assets for securing certain deposits and borrowed funds, as may be required by law or by specific agreement with a depositor or lender; (ii) it provides liquidity to even out cash flows from the loan and deposit activities of customers; (iii) it can be used as an interest rate risk management tool, since it provides a large base of assets, the maturity and interest rate characteristics of which can be changed more readily than the loan portfolio to better match changes in the deposit base and other funding sources of the Company; and (iv) it is an alternative interest-earning asset when loan demand is weak or when deposits grow more rapidly than loans.

The securities portfolio consists of securities classified as either held-to-maturity or available-for-sale. Securities consist primarily of state and municipal securities, mortgage-backed securities and U.S. government sponsored agency securities. We determine the appropriate classification at the time of purchase. All held-to-maturity securities are reported at amortized cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. All available-for-sale securities are reported at fair value.

Total securities at December 31, 2021 were $724.5 million, representing an decrease of $78.6 million, or 9.8%, compared to $803.1 million at December 31, 2020. The decrease was primarily due to $120.3 million in maturities, prepayments, and calls, partially offset by $61.5 million in purchases and a $15.5 million decline in the unrealized gain at December 31, 2021 compared to December 31, 2020.

Certain securities have fair values less than amortized cost and, therefore, contain unrealized losses. At December 31, 2021, we evaluated the securities which had an unrealized loss for other-than-temporary impairment and determined all declines in value to be temporary. We anticipate full recovery of amortized cost with respect to these securities by maturity, or sooner in the event of a more favorable market interest rate environment. We do not intend to sell these securities and it is not probable that we will be required to sell them before recovery of the amortized cost basis, which may be at maturity.

The following table sets forth certain information regarding contractual maturities and the weighted average yields of our investment securities as of the date presented. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligation with or without call or prepayment penalties.

| | As of December 31, 2021 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Due in One Year or Less | | Due after One Year Through Five Years | | Due after Five Years Through Ten Years | | Due after Ten Years | |
| | Amortized Cost | Weighted Average Yield | Amortized Cost | Weighted Average Yield | Amortized Cost | Weighted Average Yield | Amortized Cost | Weighted Average Yield |
| | (Dollars in thousands) | | | | | | | |
| **Available-for-sale** | | | | | | | | |
| U.S. government and agencies | $ — | — | $ — | —% | $ — | —% | $ — | —% |
| State and municipal | 1,939 | 2.74 | 7,563 | 2.58 | 10,502 | 2.11 | 245,139 | 2.24 |
| Mortgage-backed securities | — | — | 1,476 | 1.43 | 59,116 | 2.20 | 242,381 | 1.86 |
| Collateralized mortgage obligations | — | — | — | — | 106,733 | 0 | — | — |
| Asset-backed and other amortizing securities | — | — | — | — | 2,328 | 2.90 | 23,718 | 2.82 |
| Other securities | — | — | — | — | 12,000 | 4.47 | — | — |
| Total available-for-sale | $ 1,939 | 2.74% | $ 9,039 | 2.39% | $ 190,679 | 1.43% | $ 511,238 | 2.09% |

***Deposits***

Deposits represent the Company's primary and most vital source of funds. We offer a variety of deposit products including demand deposits accounts, interest-bearing products, savings accounts and certificate of deposits. We put continued effort into gathering noninterest-bearing demand deposit accounts through loan production, customer referrals, marketing staffs, mobile and online banking and various involvements with community networks.

Total deposits at December 31, 2021 were $3.34 billion, representing an increase of $366.9 million, or 12.3%, compared to $2.97 billion at December 31, 2020. The increase in total deposits since December 31, 2020 is primarily due to organic growth, customers depositing funds received from PPP loans and maintaining higher balances, and other government stimulus payments and programs. We anticipate that as customers spend down their PPP loan funds, this may result in a reduction in deposits. As of December 31, 2021, 32.1% of total deposits were comprised of noninterest-bearing demand accounts, 57.8% of interest-bearing non-maturity accounts and 10.1% of time deposits.

The following table summarizes our average deposit balances and weighted average rates for the periods indicated:

| | 2021 | | 2020 | | 2019 | |
|---|---|---|---|---|---|---|
| | Average Balance | Weighted Average Rate | Average Balance | Weighted Average Rate | Average Balance | Weighted Average Rate |
| | (Dollars in thousands) | | | | | |
| Noninterest-bearing deposits | $ 1,016,835 | —% | $ 888,653 | —% | $ 570,428 | —% |
| Interest-bearing deposits: | | | | | | |
| NOW and interest-bearing demand accounts | 355,274 | 0.03 | 329,431 | 0.13 | 266,991 | 0.35 |
| Savings accounts | 132,426 | 0.09 | 113,681 | 0.09 | 71,754 | 0.20 |
| Money market accounts | 1,353,978 | 0.29 | 1,209,976 | 0.48 | 1,109,575 | 1.38 |
| Time deposits | 329,509 | 1.25 | 331,623 | 1.68 | 319,811 | 1.89 |
| Total interest-bearing deposits | 2,171,187 | 0.38 | 1,984,711 | 0.60 | 1,768,131 | 1.27 |
| Total deposits | $ 3,188,022 | 0.26% | $ 2,873,364 | 0.41% | $ 2,338,559 | 0.96% |

The scheduled maturities of uninsured certificates of deposits or other time deposits as of December 31, 2021 follows:

| (Dollars in thousands) | Three Months | Three to Six Months | Six to 12 Months | After 12 Months | Total |
|---|---|---|---|---|---|
| | $ 6,135 | $ 12,072 | $ 39,261 | $ 24,513 | $ 81,981 |

The estimated amount of uninsured deposits as of December 31, 2021 was $1.07 billion.

Time deposits issued in amounts of more than $250 thousand represent the type of deposit most likely to affect the Company's future earnings because of interest rate sensitivity. The effective cost of these funds is generally higher than other time deposits because the funds are usually obtained at premium rates of interest.

***Borrowed Funds***

In addition to deposits, we utilize advances from the FHLB and other borrowings as a supplementary funding source to finance our operations.

*FHLB Advances*. The FHLB allows us to borrow, both short and long-term, on a blanket floating lien status collateralized by first mortgage loans and commercial real estate loans as well as FHLB stock. At December 31, 2021 and December 31, 2020 we had total remaining borrowing capacity from the FHLB of $903.9 million and $512.5 million, respectively.

The following table sets forth our long-term FHLB borrowings as of and for the periods indicated:

| | As of and for the Year Ended December 31, 2021 | 2020 |
|---|---|---|
| | (Dollars in thousands) | |
| Amount outstanding at year-end | $ — | $ 75,000 |
| Weighted average interest rate at year-end | — | 0.21% |
| Maximum month-end balance during the year | $ 75,000 | $ 170,000 |
| Average balance outstanding during the year | $ 19,641 | $ 116,517 |
| Weighted average interest rate during the year | 0.19% | 0.44% |

*Federal Reserve Bank of Dallas*. The Bank has a line of credit with the FRB. The amount of the line is determined on a monthly basis by the Federal Reserve Bank. The line is collateralized by a blanket floating lien on all agriculture, commercial and consumer loans. The amount of the line was $593.6 million and $700.8 million at December 31, 2021 and 2020, respectively.

The Company has used FHLB letters of credit to pledge to certain public deposits. The balance of the FHLB letters of credit at December 31, 2020 was $199.0 million. These letters of credit expired in July 2021 and the Company began pledging securities to these public funds rather than renewing the letters of credit. As a result, there were no FHLB letters of credit outstanding at December 31, 2021.

The following table sets forth our FRB borrowings as of and for the periods indicated:

| | As of and for the Year Ended December 31, | |
|---|---|---|
| | 2021 | 2020 |
| | (Dollars in thousands) | |
| Amount outstanding at year-end | $ — | $ — |
| Weighted average interest rate at year-end | —% | —% |
| Maximum month-end balance during the year | $ — | $ — |
| Average balance outstanding during the year | $ — | $ 1,209 |
| Weighted average interest rate during the year | —% | 0.22% |

*Lines of Credit*. The Bank has uncollateralized lines of credit with multiple banks as a source of funding for liquidity management. The total amount of the lines was $160.0 million and $165.0 million as of December 31, 2021 and 2020. The lines were not used at December 31, 2021 and 2020.

*Subordinated Debt Securities*

In December 2018, the Company issued $26.5 million in subordinated debt securities. $12.4 million of the securities have a maturity date of December 2028 and an average fixed rate of 5.74% for the first five years. The remaining $14.1 million of securities have a maturity date of December 2030 and an average fixed rate of 6.41% for the first seven years. After the fixed rate periods, all securities will float at the Wall Street Journal prime rate, with a floor of 4.5% and a ceiling of 7.5%. These securities pay interest quarterly, are unsecured, and may be called by the Company at any time after the remaining maturity is five years or less. Additionally, these securities are intended to qualify for Tier 2 capital treatment, subject to regulatory limitations.

On September 29, 2020, the Company issued $50.0 million in subordinated debt securities. Proceeds were reduced by approximately $926 thousand in debt issuance costs. The securities have a maturity date of September 2030 with a fixed rate of 4.50% for the first five years. After the expiration of the fixed rate period, the securities will reset quarterly at a variable rate equal to the then current three-month Secured Overnight Financing Rate, as published by the Federal Reserve Bank of New York, plus 438 basis points. These securities pay interest semi-annually, are unsecured, and may be called by the Company at any time after the remaining maturity is five years or less. Additionally, these securities are intended to qualify for Tier 2 capital treatment, subject to regulatory limitations.

As of December 31, 2021, the total amount of subordinated debt securities outstanding was $76.5 million less approximately $697 thousand of remaining debt issuance costs for a total balance of $75.8 million.

*Junior Subordinated Deferrable Interest Debentures and Trust Preferred Securities*. Between March 2004 and June 2007, the Company formed three wholly-owned statutory business trusts solely for the purpose of issuing trust preferred securities, the proceeds of which were invested in junior subordinated deferrable interest debentures. The trusts are not consolidated and the debentures issued by the Company to the trusts are reflected in the Company's consolidated balance sheets. The Company records interest expense on the debentures in its consolidated financial statements. The amount of debentures outstanding was $46.4 million at December 31, 2021 and 2020. Company has the right, as has been exercised in the past, to defer payments of interest on the securities for up to twenty consecutive quarters. During such time, corporate dividends may not be paid.

The chart below indicates certain information, as of December 31, 2021, about each of the statutory trusts and the junior subordinated deferrable interest debentures, including the date the junior subordinated deferrable interest debentures were issued, outstanding amounts of trust preferred securities and junior subordinated deferrable interest debentures, the maturity date of the junior subordinated deferrable interest debentures, the interest rates on the junior subordinated deferrable interest debentures and the investment banker.

| Name of Trust | Issue Date | Amount of Trust Preferred Securities | | Amount of Debentures | | Stated Maturity Date of Trust Preferred Securities and Debentures(1) | Interest Rate of Trust Preferred Securities and Debentures(2)(3) |
|---|---|---|---|---|---|---|---|
| | | | | (Dollars in thousands) | | | |
| South Plains Financial Capital Trust III | 2004 | $ | 10,000 | $ | 10,310 | 2034 | 3-mo. LIBOR + 265 bps; 2.77% |
| South Plains Financial Capital Trust IV | 2005 | | 20,000 | | 20,619 | 2035 | 33-mo. LIBOR + 139 bps; 1.59% |
| South Plains Financial Capital Trust V | 2007 | | 15,000 | | 15,464 | 2037 | 3-mo. LIBOR + 150 bps; 1.70% |
| Total | | $ | 45,000 | $ | 46,393 | | |

(1) May be redeemed at the Company's option.
(2) Interest payable quarterly with principal due at maturity.
(3) Rate as of last reset date, prior to December 31, 2021.

**Liquidity and Capital Resources**

***Liquidity***

Liquidity refers to the measure of our ability to meet the cash flow requirements of depositors and borrowers, while at the same time meeting our operating, capital and strategic cash flow needs, all at a reasonable cost. We continuously monitor our liquidity position to ensure that assets and liabilities are managed in a manner that will meet all short-term and long-term cash requirements. We manage our liquidity position to meet the daily cash flow needs of customers, while maintaining an appropriate balance between assets and liabilities to meet the return on investment objectives of our shareholders.

Interest rate sensitivity involves the relationships between rate-sensitive assets and liabilities and is an indication of the probable effects of interest rate fluctuations on the Company's net interest income. Interest rate-sensitive assets and liabilities are those with yields or rates that are subject to change within a future time period due to maturity or changes in market rates. The model is used to project future net interest income under a set of possible interest rate movements. The Company's Investment/Asset Liability Committee reviews this information to determine if the projected future net interest income levels would be acceptable. The Company attempts to stay within acceptable net interest income levels.

Our liquidity position is supported by management of liquid assets and access to alternative sources of funds. Our liquid assets include cash, interest-bearing deposits in correspondent banks, federal funds sold, and fair value of unpledged investment securities. Other available sources of liquidity include wholesale deposits, and additional borrowings from correspondent banks, FHLB advances, and the Federal Reserve discount window.

Our short-term and long-term liquidity requirements are primarily met through cash flow from operations, redeployment of prepaying and maturing balances in our loan and investment portfolios, and increases in customer deposits. Other alternative sources of funds will supplement these primary sources to the extent necessary to meet additional liquidity requirements on either a short-term or long-term basis.

We believe that we will be able to meet our contractual obligations as they come due through the maintenance of adequate cash levels. We expect to maintain adequate cash levels through profitability, loan and securities repayment and maturity activity and continued deposit gathering activities. We have in place various borrowing mechanisms for both short-term and long-term liquidity needs.

***Capital Requirements***

Total shareholders' equity increased to $407.4 million as of December 31, 2021, compared to $370.0 million as of December 31, 2020. The increase from December 31, 2020 was primarily the result of $58.6 million in net earnings for the year ended December 31, 2021, partially offset by a decrease in accumulated other comprehensive gain of $7.6 million, net of tax, and by $5.4 million in dividends paid.

We are subject to various regulatory capital requirements administered by the federal and state banking regulators. Failure to meet regulatory capital requirements may 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. The capital amounts and classifications are subject to qualitative judgments by the federal banking regulators about components, risk weightings and other factors. Qualitative measures established by regulation to ensure capital adequacy required us to maintain minimum amounts and ratio of CET1 capital, tier 1 capital and total capital to risk-weighted assets and of tier 1 capital to average consolidated assets, referred to as the "leverage ratio."

The risk-based capital ratios measure the adequacy of a bank's capital against the riskiness of its assets and off-balance sheet activities. Failure to maintain adequate capital is a basis for "prompt corrective action" or other regulatory enforcement action. In assessing a bank's capital adequacy, regulators also consider other factors such as interest rate risk exposure; liquidity, funding and market risks; quality and level of earnings; concentrations of credit, quality of loans and investments; risks of any nontraditional activities; effectiveness of bank policies; and management's overall ability to monitor and control risks.

At December 31, 2021, both we and the Bank met all the capital adequacy requirements to which we and the Bank were subject. At December 31, 2021, we and the Bank were "well capitalized" under the regulatory framework for prompt corrective action. Management believes that no conditions or events have occurred since December 31, 2021 that would materially adversely change such capital classifications. From time to time, we may need to raise additional capital to support our and the Bank's further growth and to maintain our "well capitalized" status.

The table below also summarizes the capital requirements applicable to us and the Bank in order to be considered "well-capitalized" from a regulatory perspective, as well as our and the Bank's capital ratios as of the dates indicated. We and the Bank exceeded all regulatory capital requirements under Basel III and the Bank was considered to be "well-capitalized" as of the dates reflected in the table below.

| | Actual | | Minimum Capital Requirement with Capital Buffer | | Minimum To be Considered Well Capitalized | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | (Dollars in Thousands) | | | |
| **As of December 31, 2021**: | | | | | | |
| Total capital (to risk-weighted assets) | | | | | | |
| Consolidated | $ 524,836 | 18.40% | $ 299,521 | 10.50% | N/A | N/A |
| Bank | 425,748 | 14.93% | 299,465 | 10.50% | $ 285,205 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | | | | | | |
| Consolidated | 413,322 | 14.49% | 242,469 | 8.50% | N/A | N/A |
| Bank | 390,015 | 13.67% | 242,424 | 8.50% | 228,164 | 8.00% |
| CET 1 capital (to risk-weighted assets) | | | | | | |
| Consolidated | 368,322 | 12.91% | 199,681 | 7.00% | N/A | N/A |
| Bank | 390,015 | 13.67% | 199,644 | 7.00% | 185,383 | 6.50% |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | 413,322 | 10.77% | 154,592 | 4.00% | N/A | N/A |
| Bank | 390,015 | 10.16% | 154,503 | 4.00% | 191,859 | 5.00% |

| | Actual | | Minimum Capital Requirement with Capital Buffer | | Minimum To be Considered Well Capitalized | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | (Dollars in Thousands) | | | |
| **As of December 31, 2020**: | | | | | | |
| Total capital (to risk-weighted assets) | | | | | | |
| Consolidated | $ 473,425 | 19.08% | $ 260,531 | 10.50% | N/A | N/A |
| Bank | 404,138 | 16.29% | 260,481 | 10.50% | $ 248,077 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | | | | | | |
| Consolidated | 366,639 | 14.78% | 210,906 | 8.50% | N/A | N/A |
| Bank | 372,947 | 15.03% | 210,866 | 8.50% | 198,462 | 8.00% |
| CET 1 capital (to risk-weighted assets) | | | | | | |
| Consolidated | 321,639 | 12.96% | 173,688 | 7.00% | N/A | N/A |
| Bank | 372,947 | 15.03% | 173,654 | 7.00% | 161,250 | 6.50% |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | 366,639 | 10.24% | 144,347 | 4.00% | N/A | N/A |
| Bank | 372,947 | 10.42% | 144,282 | 4.00% | 178,999 | 5.00% |

***Treasury Stock***

We repurchased stock in accordance with its stock repurchase programs during 2021 and 2020. In 2021, we repurchased 393,529 shares of common stock for a total of $9.2 million. In 2020, we repurchased 19,035 shares of common stock for a total of $293 thousand. See Part II, Item 5, "Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities", of this Report for further information.

**Interest Rate Sensitivity and Market Risk**

As a financial institution, our primary component of market risk is interest rate volatility. Our interest rate risk policy provides management with the guidelines for effective funds management, and we have established a measurement system for monitoring our net interest rate sensitivity position. We have historically managed our sensitivity position within our established guidelines.

Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of our assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which have a short term to maturity. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

We manage our exposure to interest rates by structuring our balance sheet in the ordinary course of business. Based upon the nature of our operations, we are not subject to foreign exchange or commodity price risk. We do not own any trading assets.

Our exposure to interest rate risk is managed by the Investment/Asset/Liability Committee, or the ALCO Committee, in accordance with policies approved by the Bank's Board. The ALCO Committee formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the ALCO Committee considers the impact on earnings and capital on the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The ALCO Committee meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the ALCO Committee reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity. Management employs methodologies to manage interest rate risk, which include an analysis of relationships between interest-earning assets and interest-bearing liabilities and an interest rate shock simulation model.

We use interest rate risk simulation models and shock analyses to test the interest rate sensitivity of net interest income and fair value of equity, and the impact of changes in interest rates on other financial metrics. Contractual maturities and re-pricing opportunities of loans are incorporated in the model. The average lives of non-maturity deposit accounts are based on decay assumptions and are incorporated into the model. All of the assumptions used in our analyses are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

On a quarterly basis, we run a simulation model for a static balance sheet and other scenarios. These models test the impact on net interest income from changes in market interest rates under various scenarios. Under the static model, rates are shocked instantaneously and ramped rates change over a 12-month and 24-month horizon based upon parallel and non-parallel yield curve shifts. Parallel shock scenarios assume instantaneous parallel movements in the yield curve compared to a flat yield curve scenario. Non-parallel simulation involves analysis of interest income and expense under various changes in the shape of the yield curve. Our internal policy regarding internal rate risk simulations currently specifies that for gradual parallel shifts of the yield curve, estimated net interest income at risk for the subsequent one-year period should not decline by more than 7.5% for a 100 basis point shift, 15% for a 200 basis point shift, and 22.5% for a 300 basis point shift.

The following tables summarize the simulated change in net interest income over a 12-month horizon as of the dates indicated:

| | As of December 31, | |
|---|---|---|
| | 2021 | 2020 |
| Change in Interest Rates (Basis Points) | Percent Change in Net Interest Income | Percent Change in Net Interest Income |
| +300 | 6.89 | 5.33 |
| +200 | 4.53 | 2.90 |
| +100 | 2.02 | 1.06 |
| -100 | (1.05) | (1.24) |

***Impact of Inflation***

Our consolidated financial statements and related notes included elsewhere in this Report have been prepared in accordance with GAAP. These require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative value of money over time due to inflation or recession.

The Company's asset and liability structure is substantially different from that of an industrial company in that virtually all assets and liabilities of the Company are monetary in nature. Management believes the impact of inflation on financial results depends upon the Company's ability to react to changes in interest rates and by such reaction, reduce the inflationary impact on performance. Interest rates do not necessarily move in the same direction, or at the same magnitude, as the prices of other goods and services. However, other operating expenses do reflect general levels of inflation. Management seeks to manage the relationship between interest rate-sensitive assets and liabilities in order to protect against wide net interest income fluctuations, including those resulting from inflation. Various information shown elsewhere in this Report will assist in the understanding of how well the Company is positioned to react to changing interest rates and inflationary trends. In particular, additional information related to the Company's interest rate-sensitive assets and liabilities is contained in this Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Report under the heading "Interest Rate Sensitivity and Market Risk."

**Non-GAAP Financial Measures**

Our accounting and reporting policies conform to GAAP and the prevailing practices in the banking industry. However, we also evaluate our performance based on certain additional financial measures discussed in this Report as being non-GAAP financial measures. We classify a financial measure as being a non-GAAP financial measure if that financial measure excludes or includes amounts, or is subject to adjustments that have the effect of excluding or including amounts, that are included or excluded, as the case may be, in the most directly comparable measure calculated and presented in accordance with GAAP as in effect from time to time in the U.S. in our statements of income, balance sheets or statements of cash flows. Non-GAAP financial measures do not include operating and other statistical measures or ratios or statistical measures calculated using exclusively either financial measures calculated in accordance with GAAP, operating measures or other measures that are not non-GAAP financial measures or both.

The non-GAAP financial measures that we discuss in this Report should not be considered in isolation or as a substitute for the most directly comparable or other financial measures calculated in accordance with GAAP. Moreover, the manner in which we calculate the non-GAAP financial measures that we discuss in this Report may differ from that of other companies reporting measures with similar names. It is important to understand how other banking organizations calculate their financial measures with names similar to the non-GAAP financial measures we have discussed in this Report when comparing such non-GAAP financial measures.

*Tangible Book Value Per Common Share*. Tangible book value per share is a non-GAAP measure generally used by investors, financial analysts and investment bankers to evaluate financial institutions. The most directly comparable GAAP financial measure for tangible book value per common share is book value per common share. We believe that the tangible book value per common share measure is important to many investors in the marketplace who are interested in changes from period to period in book value per common share exclusive of changes in intangible assets. Goodwill and other intangible assets have the effect of increasing total book value while not increasing our tangible book value.

*Tangible Common Equity to Tangible Assets*. Tangible common equity to tangible assets is a non-GAAP measure generally used by investors, financial analysts and investment bankers to evaluate financial institutions. We calculate tangible common equity, as described above, and tangible assets as total assets less goodwill, core deposit intangibles and other intangible assets, net of accumulated amortization. The most directly comparable GAAP financial measure for tangible common equity to tangible assets is total common shareholders' equity to total assets. We believe that this measure is important to many investors in the marketplace who are interested in the relative changes from period to period of tangible common equity to tangible assets, each exclusive of changes in intangible assets. Goodwill and other intangible assets have the effect of increasing both total shareholders' equity and assets while not increasing our tangible common equity or tangible assets.

The following table reconciles, as of the dates set forth below, total stockholders' equity to tangible common equity and total assets to tangible assets and then presents book value per common share, tangible book value per common share, total stockholders' equity to total assets, and tangible common equity to tangible assets:

| | As of December 31, | | |
|---|---|---|---|
| | 2021 | 2020 | 2019 |
| | (Dollars in thousands) | | |
| Total stockholders' equity | $ 407,427 | $ 370,048 | $ 306,182 |
| Less: Goodwill and other intangibles | (25,403) | (27,070) | (27,389) |
| Tangible common equity | $ $ 382,024 | $ 342,978 | $ 278,793 |
| | | | |
| Total assets | $ 3,901,855 | $ 3,599,160 | $ 3,237,167 |
| Less: Goodwill and other intangibles | (25,403) | (27,070) | (27,389) |
| Tangible assets | $ 3,876,452 | $ 3,572,090 | $ 3,209,778 |
| Shares outstanding | 17,760,243 | 18,076,364 | 18,036,115 |
| Total stockholders' equity to total assets | 10.44% | 10.28% | 9.46% |
| Tangible common equity to tangible assets | 9.85% | 9.60% | 8.69% |
| Book value per share | $ 22.94 | $ 20.47 | $ 16.98 |
| Tangible book value per share | $ 21.51 | $ 18.97 | $ 15.46 |

## Critical Accounting Policies and Estimates

Our accounting and reporting policies conform to GAAP and conform to general practices within the industry in which we operate. To prepare financial statements in conformity with GAAP, management makes estimates, assumptions and judgments based on available information. These estimates, assumptions and judgments affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements and, as this information changes, actual results could differ from the estimates, assumptions and judgments reflected in the financial statement. In particular, management has identified several accounting policies that, due to the estimates, assumptions and judgments inherent in those policies, are critical in understanding our financial statements.

The Jumpstart Our Business Startups Act (the "JOBS Act") permits us an extended transition period for complying with new or revised accounting standards affecting public companies. We have elected to take advantage of this extended transition period, which means that the financial statements included in this Report, as well as any financial statements that we file in the future, will not be subject to all new or revised accounting standards generally applicable to public companies for the transition period for so long as we remain an emerging growth company or until we affirmatively and irrevocably opt out of the extended transition period under the JOBS Act.

The following is a discussion of the critical accounting policies and significant estimates that we believe require us to make the most complex or subjective decisions or assessments. Additional information about these policies can be found in Note 1 of the Company's consolidated financial statements as of December 31, 2021.

*Basis of Presentation and Consolidation.* The consolidated financial statements include the accounts of the Company and its wholly owned consolidated subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

*Cash and Cash Equivalents.* The Company includes all cash on hand, balances due from other banks, and Federal funds sold, all of which have original maturities within three months, as cash and cash equivalents.

*Securities.* Investment securities may be classified into trading, held-to-maturity, or available-for-sale portfolios. Securities that are held principally for resale in the near term are classified as trading. Securities that management has the ability and positive intent to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as trading or held-to-maturity are available-for-sale and are reported at fair value with unrealized gains and losses excluded from earnings, but included in the determination of other comprehensive income. Management uses these assets as part of its asset/liability management strategy; they may be sold in response to changes in liquidity needs, interest rates, resultant prepayment risk changes, and other factors. Management determines the appropriate classification of securities at the time of purchase. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain or loss on sale of securities. The cost of securities sold is based on the specific identification method.

*Loans.* Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances net of any unearned income, charge-offs, unamortized deferred fees and costs on originated loans, and premiums or discounts on purchased loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the straight-line method, which is not materially different from the effective interest method required by GAAP.

Loans are placed on non-accrual status when, in management's opinion, collection of interest is unlikely, which typically occurs when principal or interest payments are more than ninety days past due. When interest accrual is discontinued, all unpaid accrued interest 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.

*Allowance for Loan Losses.* The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The Company's allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and general valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends, judgmentally adjusted for general economic conditions and other qualitative risk factors internal and external to the Company.

The allowance for loan losses is evaluated on a quarterly basis by management and is based upon management's review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral. The Bank's loans are generally secured by specific items of collateral including real property, crops, livestock, consumer assets, and other business assets.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on various factors. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

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. All loans rated substandard or worse and greater than $250 thousand are specifically reviewed to determine if they are impaired. Factors considered by management in determining whether a loan is impaired include payment status and the sources, amounts, and probabilities of estimated cash flow available to service debt in relation to amounts due according to contractual terms. 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 reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Loans that are determined to be impaired are then evaluated to determine estimated impairment, if any. GAAP allows impairment to be 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. Loans that are not individually determined to be impaired or are not subject to the specific review of impaired status are subject to the general valuation allowance portion of the allowance for loan loss.

*Loans Held for Sale.* Loans held for sale are comprised of residential mortgage loans. Loans that are originated for best efforts delivery are carried at the lower of aggregate cost or fair value as determined by aggregate outstanding commitments from investors or current investor yield requirements. All other loans held for sale are carried at fair value. Loans sold are typically subject to certain indemnification provisions with the investor; management does not believe these provisions will have any significant consequences.

*Mortgage Servicing Rights Asset.* When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in net gain on sale of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates present value of estimated future servicing income.

Under the fair value measurement method, the Company measures servicing rights at fair value at each reporting date and reports change in fair value of servicing assets in earnings in the period in which the changes occur, and are included with other noninterest income in the CFS. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

*Goodwill and Other Intangible Assets.* Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill is not amortized, but is tested for impairment at least annually or more frequently if events and circumstances exist that indicate that an impairment test should be performed. Intangible assets with definite lives are amortized over their estimated useful lives.

**Recently Issued Accounting Pronouncements**

See Note 1, Summary of Significant Accounting Policies, in the notes to the consolidated financial statements included elsewhere in this Report regarding the impact of new accounting pronouncements which we have adopted.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Interest Rate Sensitivity and Market Risk" of this Report for discussion on how the Company manages market risk.

## Item 8. Financial Statements and Supplementary Data

***SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES***
***CONSOLIDATED FINANCIAL STATEMENTS***
***Years Ended December 31, 2021 and 2020***

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## Report of Independent Registered Public Accounting Firm

The Board of Directors
South Plains Financial, Inc.
Lubbock, Texas

**Opinion on the Consolidated Financial Statements**

We have audited the accompanying consolidated balance sheets of South Plains Financial, Inc. and Subsidiaries (the "Company") as of December 31, 2021 and 2020, and the related consolidated statements of comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2021, and the related notes to the consolidated financial statements (collectively referred to as the "financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2021, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These consolidated financial statements are the responsibility of the entity's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. South Plains Financial, Inc. is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ WEAVER AND TIDWELL, L.L.P.

We have served as South Plains Financial, Inc.'s auditor since 2018.

Fort Worth, Texas
March 7, 2022

***SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES***

***CONSOLIDATED BALANCE SHEETS***
***(Dollars in thousands, except per share data)***

| | December 31, 2021 | December 31, 2020 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 68,425 | $ 76,146 |
| Interest-bearing deposits in banks | 418,396 | 224,161 |
| Cash and cash equivalents | 486,821 | 300,307 |
| | | |
| Securities available for sale | 724,504 | 803,087 |
| Loans held for sale | 76,507 | 111,477 |
| Loans held for investment | 2,437,577 | 2,221,583 |
| Allowance for loan losses | (42,098) | (45,553) |
| Loans held for investment, net | 2,395,479 | 2,176,030 |
| | | |
| Accrued interest receivable | 13,900 | 15,233 |
| Premises and equipment, net | 57,699 | 60,331 |
| Bank-owned life insurance | 71,978 | 70,731 |
| Goodwill | 19,508 | 19,508 |
| Intangible assets, net | 5,895 | 7,562 |
| Mortgage servicing rights | 19,700 | 9,049 |
| Deferred tax asset, net | 3,038 | 2,461 |
| Other assets | 26,826 | 23,384 |
| Total assets | $ 3,901,855 | $ 3,599,160 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| | | |
| Deposits: | | |
| Noninterest-bearing | $ 1,071,367 | $ 917,322 |
| Interest-bearing | 2,269,855 | 2,057,029 |
| Total deposits | 3,341,222 | 2,974,351 |
| | | |
| Short-term borrowings | — | 26,550 |
| Accrued expenses and other liabilities | 31,038 | 31,229 |
| Notes payable & other borrowings | — | 75,000 |
| Subordinated debt securities | 75,775 | 75,589 |
| Junior subordinated deferrable interest debentures | 46,393 | 46,393 |
| Total liabilities | 3,494,428 | 3,229,112 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, $1 par value, 30,000,000 shares authorized; 17,760,243 issued in 2021 and 18,076,364 issued in 2020 | 17,760 | 18,076 |
| Additional paid-in capital | 133,215 | 141,112 |
| Retained earnings | 242,750 | 189,521 |
| Accumulated other comprehensive income | 13,702 | 21,339 |
| Total stockholders' equity | 407,427 | 370,048 |
| Total liabilities and stockholders' equity | $ 3,901,855 | $ 3,599,160 |

The accompanying notes are an integral part of these consolidated financial statements.

**SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**(Dollars in thousands, except per share data)**

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2021** | **2020** | **2019** |
| Interest income: | | | |
| Loans, including fees | $ 120,540 | $ 121,733 | $ 116,904 |
| Securities: | | | |
| Taxable | 9,445 | 12,267 | 8,890 |
| Non taxable | 4,639 | 3,546 | 1,018 |
| Federal funds sold and interest-bearing deposits in banks | 412 | 685 | 6,130 |
| Total interest income | 135,036 | 138,231 | 132,942 |
| Interest expense: | | | |
| Deposits | 8,293 | 11,894 | 22,491 |
| Notes payable & other borrowings | 43 | 662 | 2,314 |
| Subordinated debt securities | 4,056 | 2,223 | 1,616 |
| Junior subordinated deferrable interest debentures | 880 | 1,167 | 1,946 |
| Total interest expense | 13,272 | 15,946 | 28,367 |
| Net interest income | 121,764 | 122,285 | 104,575 |
| Provision for loan losses | (1,918) | 25,570 | 2,799 |
| Net interest income, after provision for loan losses | 123,682 | 96,715 | 101,776 |
| Noninterest income: | | | |
| Service charges on deposit accounts | 6,963 | 7,032 | 8,129 |
| Income from insurance activities | 8,314 | 7,644 | 7,016 |
| Net gain on sales of loans | 51,184 | 63,531 | 23,521 |
| Bank card services and interchange fees | 12,239 | 10,035 | 8,692 |
| Realized gain on sale of securities | — | 2,318 | — |
| Investment commissions | 1,934 | 1,698 | 1,710 |
| Fiduciary fees | 2,917 | 3,185 | 2,306 |
| Other | 13,918 | 6,160 | 5,259 |
| Total noninterest income | 97,469 | 101,603 | 56,633 |
| Noninterest expense: | | | |
| Salaries and employee benefits | 93,360 | 89,220 | 75,392 |
| Occupancy and equipment, net | 14,560 | 14,658 | 13,572 |
| Professional services | 6,752 | 6,322 | 7,334 |
| Marketing and development | 3,225 | 3,088 | 3,017 |
| IT and data services | 4,007 | 3,574 | 2,830 |
| Bank card expenses | 4,995 | 4,253 | 3,346 |
| Appraisal expenses | 3,248 | 2,782 | 1,625 |
| Other | 17,883 | 17,818 | 14,592 |
| Total noninterest expense | 148,030 | 141,715 | 121,708 |
| Income before income taxes | 73,121 | 56,603 | 36,701 |
| Income tax expense | 14,507 | 11,250 | 7,481 |
| Net income | $ 58,614 | $ 45,353 | $ 29,220 |

The accompanying notes are an integral part of these consolidated financial statements.

*SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES*

*CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (CONTINUED)*
***(Dollars in thousands, except per share data)***

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2021** | **2020** | 2019 |
| Earnings per share: | | | |
| Basic | $ 3.26 | $ 2.51 | $ 1.74 |
| Diluted | $ 3.17 | $ 2.47 | $ 1.71 |
| | | | |
| Net income | $ 58,614 | $ 45,353 | $ 29,220 |
| Other comprehensive income: | | | |
| Change in net unrealized gain (loss) on securities available for sale | (15,479) | 28,193 | 4,025 |
| Change in net gain (loss) on cash flow hedges | 5,812 | (76) | — |
| Reclassification adjustment for (gain) loss included in net income | — | (2,318) | 28 |
| Tax effect | 2,030 | (5,418) | (852) |
| Other comprehensive income (loss) | (7,637) | 20,381 | 3,201 |
| Comprehensive income | $ 50,977 | $ 65,734 | $ 32,421 |

The accompanying notes are an integral part of these consolidated financial statements.

*SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES*

*CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY*
*(Dollars in thousands, except per share data)*

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Less: ESOP Owned Shares | Total |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2018 | 14,771,520 | $ 14,772 | $ 80,412 | $ 119,834 | $ (2,243) | $ (58,195) | $ 154,580 |
| Issuance of common stock, net | 3,207,000 | 3,207 | 48,185 | — | — | — | 51,392 |
| Net income | — | — | — | 29,220 | — | — | 29,220 |
| Cash dividends declared - $0.06 per share | — | — | — | (1,079) | — | — | (1,079) |
| Other comprehensive income, (net of tax) | — | — | — | — | 3,201 | — | 3,201 |
| Terminated ESOP put option | — | — | — | — | — | 58,195 | 58,195 |
| Exercise of employee stock options, net of 111,011 shares for cashless exercise and net of 18,894 shares for taxes | 57,595 | 57 | (408) | — | — | — | (351) |
| Stock based compensation | — | — | 853 | — | — | — | 853 |
| Share-based liability awards modified to equity awards | — | — | 11,450 | — | — | — | 11,450 |
| Cumulative change in accounting principle | — | — | — | (1,279) | — | — | (1,279) |
| Balance at December 31, 2019 | 18,036,115 | 18,036 | 140,492 | 146,696 | 958 | — | 306,182 |
| Net income | — | — | — | 45,353 | — | — | 45,353 |
| Cash dividends declared - $0.14 per share | — | — | — | (2,528) | — | — | (2,528) |
| Other comprehensive income, (net of tax) | — | — | — | — | 20,381 | — | 20,381 |
| Exercise of employee stock options, net of 69,855 shares for cashless exercise and net of 17,762 shares for taxes | 59,284 | 59 | (378) | — | — | — | (319) |
| Repurchases of common stock | (19,035) | (19) | (274) | — | — | — | (293) |
| Stock-based compensation | — | — | 1,272 | — | — | — | 1,272 |
| Balance at December 31, 2020 | 18,076,364 | 18,076 | 141,112 | 189,521 | 21,339 | — | 370,048 |
| Net income | — | — | — | 58,614 | — | — | 58,614 |
| Cash dividends declared - $0.30 per share | — | — | — | (5,385) | — | — | (5,385) |
| Other comprehensive loss, (net of tax) | — | — | — | — | (7,637) | — | (7,637) |
| Exercise of employee stock options, net of 82,004 shares for cashless exercise and net of 23,559 shares for taxes | 77,408 | 77 | (702) | — | — | — | (625) |
| Repurchases of common stock | (393,529) | (393) | (8,834) | — | — | — | (9,227) |
| Stock-based compensation | — | — | 1,639 | — | — | — | 1,639 |
| Balance at December 31, 2021 | 17,760,243 | $ 17,760 | $ 133,215 | $ 242,750 | $ 13,702 | $ — | $ 407,427 |

The accompanying notes are an integral part of these consolidated financial statements.

***SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES***

***CONSOLIDATED STATEMENTS OF CASH FLOWS***
***(Dollars in thousands, except per share data)***

| | Years Ended December 31, 2021 | 2020 | 2019 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $ 58,614 | $ 45,353 | $ 29,220 |
| Adjustments to reconcile net income to net cash from operating activities: | | | |
| Provision for loan losses | (1,918) | 25,570 | 2,799 |
| Depreciation and amortization | 6,436 | 6,575 | 5,225 |
| Net amortization of premium on investment securities | 4,513 | 3,166 | 252 |
| Other gains, net | (729) | (2,539) | 40 |
| Net gain on sales of loans | (51,184) | (63,531) | (23,521) |
| Proceeds from sales of loans held for sale | 1,577,953 | 1,434,173 | 652,216 |
| Loans originated for sale | (1,500,995) | (1,442,913) | (640,680) |
| Earnings on bank-owned life insurance | (1,247) | (1,334) | (1,293) |
| Stock-based compensation | 1,639 | 1,272 | 853 |
| Change in valuation of mortgage servicing rights | (1,455) | 2,834 | 548 |
| Net change in: | | | |
| Accrued interest receivable and other assets | 244 | (4,610) | 321 |
| Accrued expenses and other liabilities | 4,400 | 1,611 | 4,504 |
| Net cash from operating activities | 96,271 | 5,627 | 30,484 |
| | | | |
| Cash flows from investing activities: | | | |
| Activity in securities available for sale: | | | |
| Purchases | (61,548) | (279,727) | (489,032) |
| Sales | — | 94,514 | 52,495 |
| Maturities, prepayments, and calls | 120,325 | 114,850 | 139,255 |
| Loan originations and principal collections, net | (218,458) | (84,991) | 5,572 |
| Cash paid for acquisition | — | (687) | — |
| Net cash received in business combinations | — | — | 78,171 |
| Goodwill adjustment related to litigation settlement | — | 460 | — |
| Purchases of premises and equipment, net | (2,920) | (3,310) | (3,997) |
| Proceeds from sales of premises and equipment | 1,458 | 222 | 208 |
| Proceeds from sales of foreclosed assets | 1,302 | 2,441 | 3,835 |
| Net cash from investing activities | (159,841) | (156,228) | (213,493) |
| | | | |
| Cash flows from financing activities: | | | |
| Net change in deposits | 366,871 | 277,494 | 33,227 |
| Net change in short-term borrowings | (26,550) | (10,615) | 19,460 |
| Proceeds from common stock issuance, net | — | — | 51,392 |
| Proceeds from subordinated debt issuance, net | — | 49,070 | — |
| Proceeds from notes payable and other borrowings | — | 75,000 | (351) |
| Payments to tax authorities for stock-based compensation | (625) | (319) | — |
| Payments made on notes payable and other borrowings | (75,000) | (95,000) | (7,530) |
| Cash dividends on common stock | (5,385) | (2,528) | (1,079) |
| Payments to repurchase common stock | (9,227) | (293) | — |
| Net cash from financing activities | 250,084 | 292,809 | 95,119 |
| | | | |
| Net change in cash and cash equivalents | $ 186,514 | $ 142,208 | $ (87,890) |
| Beginning cash and cash equivalents | 300,307 | 158,099 | 245,989 |
| Ending cash and cash equivalents | $ 486,821 | $ 300,307 | $ 158,099 |
| | | | |
| Supplemental disclosures of cash flow information: | | | |
| Interest paid on deposits and borrowed funds | $ 13,471 | $ 16,116 | $ 28,125 |
| Income taxes paid | 12,400 | 13,513 | 6,474 |
| Supplemental schedule of noncash activities: | | | |
| Loans transferred to foreclosed assets | 927 | 1,867 | 2,452 |
| Business combination measurement period adjustment | — | 1,211 | — |
| Additions to mortgage servicing rights | 9,196 | 9,829 | 1,332 |

The accompanying notes are an integral part of these consolidated financial statements.

**_SOUTH PLAINS FINANCIAL, INC. AND SUBSIDIARIES_**

**_NOTES TO CONSOLIDATED FINANCIAL STATEMENTS_**
**_(Dollar in thousands except per share data)_**

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

_Nature of Operations_ – South Plains Financial, Inc. ("SPFI") is a Texas corporation and registered bank holding company that conducts its principal activities through its subsidiaries from offices located throughout Texas and Eastern New Mexico. Principal activities include commercial and retail banking, along with insurance, investment, trust, and mortgage services. The following are subsidiaries of SPFI:

| | |
|---|---|
| Wholly-Owned, Consolidated Subsidiaries: | |
| City Bank | Bank subsidiary |
| Windmark Insurance Agency, Inc. | Non-bank subsidiary |
| Ruidoso Retail, Inc. | Non-bank subsidiary |
| CB Provence, LLC | Non-bank subsidiary |
| CBT Brushy Creek, LLC | Non-bank subsidiary |
| CBT Properties, LLC | Non-bank subsidiary |
| Wholly-Owned, Equity Method Subsidiaries: | |
| South Plains Financial Capital Trusts (SPFCT) III-V | Non-bank subsidiaries |

_Basis of Presentation and Consolidation_ – The consolidated financial statements ("CFS") include the accounts of SPFI and its wholly-owned consolidated subsidiaries (collectively referred to as the "Company") identified above. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company's CFS are prepared and presented in accordance with generally accepted accounting principles ("GAAP") in the U.S. _Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC")_ constitutes U.S. GAAP for nongovernmental entities.

The Company evaluated subsequent events for potential recognition and/or disclosure through the date the CFS were available to be issued.

_Use of Estimates_ – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Determination of the adequacy of the allowance for loan losses is a material estimate that is particularly susceptible to significant change in the near term; the valuation of foreclosed assets, stock-based compensation and fair values of financial instruments can also involve significant management estimates.

_Change in Capital Structure_ – On March 11, 2019, the Company amended and restated its Certificate of Formation. The Amended and Restated Certificate of Formation increased the number of authorized shares of common stock, par value $1.00 per share, from 1,000,000 to 30,000,000.

The Company completed a 29-to-1 stock split of the Company's outstanding shares of common stock for shareholders of record as of March 11, 2019. The stock split was payable in the form of a dividend on or about March 11, 2019. Shareholders received 29 additional shares for each share held as of the record date. All share and per share amounts in the CFS have been retroactively adjusted to reflect this stock split for all periods presented.

_Stock Offering_ – The Company consummated the underwritten initial public offering of its common stock in May 2019. In connection with the initial public offering, the Company issued and sold 3,207,000 shares of its common stock, including 507,000 shares of common stock pursuant to the underwriters' full exercise of their option to purchase additional shares at a public offering price of $17.50 per share, for aggregate gross proceeds of $56.1 million before deducting underwriting discounts and offering expenses, for aggregate net proceeds of $51.4 million.

_Concentration of Credit Risk_ – The bank subsidiary is primarily involved in real estate, commercial, agricultural, and consumer lending activities with customers throughout Texas and Eastern New Mexico. Although the bank subsidiary has a diversified portfolio, its debtors' ability to honor their contracts is substantially dependent upon the general economic conditions of the region which consist primarily of agribusiness, wholesale/retail, oil and gas and related business, healthcare industries, and institutions of higher education.

*Risks and Uncertainties* – The full extent of the operational and financial impact the ongoing COVID-19 pandemic may have on the Company is not known and is dependent on its duration and spread, any related operational restrictions and the overall economy. The Company is unable to accurately predict how COVID-19 will affect the results of its operations because the virus's severity and the duration of the pandemic are uncertain.

*Comprehensive Income* – Comprehensive income is comprised of net income or loss and other comprehensive income or loss ("OCI"). Relevant examples of OCI items are unrealized holding gains and losses on securities available for sale, subsequent decreases (if not an other-than-temporary impairment) or increases in the fair value of securities available for sale previously written down as impaired, and net gains and losses on cash flow hedges.

*Cash and Cash Equivalents* – The Company includes all cash on hand, balances due from other banks, and federal funds sold, all of which have original maturities within three months, as cash and cash equivalents in the accompanying CFS. Federal regulations require the bank subsidiary to set aside specified amounts of cash as reserves against transaction and time deposits, which fluctuate daily. These reserves may be held as cash on hand or on deposit with a district Federal Reserve Bank. Management believes that the bank subsidiary complies with these requirements.

*Securities* – Investment securities may be classified into trading, held to maturity ("HTM") or available for sale ("AFS") portfolios. Securities that are held principally for resale in the near term are classified as trading. Securities that management has the ability and positive intent to hold to maturity are classified as HTM and recorded at amortized cost. Securities not classified as trading or HTM are AFS and are reported at fair value with unrealized gains and losses excluded from earnings, but included in the determination of OCI. Management uses these assets as part of its asset/liability management strategy; they may be sold in response to changes in liquidity needs, interest rates, resultant prepayment risk changes, and other factors. Management determines the appropriate classification of securities at the time of purchase. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain (loss) on sale of securities. The cost of securities sold is based on the specific identification method.

When the fair value of a security is below its amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exists. The analysis considers (i) whether there is intent to sell securities prior to recovery and/or maturity, (ii) whether it is more likely than not that securities will have to be sold prior to recovery and/or maturity, and (iii) whether there is a credit loss component to the impairment. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of a security may be different than previously estimated, which could have a material effect on the Company's results of operations and financial condition.

*Nonmarketable Equity Securities* – Securities with limited marketability, such as stock in the Federal Home Loan Bank of Dallas ("FHLB"), are carried at cost and are reported in other assets. The Company monitors its investment in FHLB stock for impairment through a review of recent financial results of the FHLB including reviewing the capital adequacy and liquidity position. The Company has not identified any indicators of impairment of FHLB stock.

*Loans* – Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances net of any unearned income, charge-offs, unamortized deferred fees and costs on originated loans, and premiums or discounts on purchased loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the straight-line method, which is not materially different from the effective interest method required by GAAP.

Loans are placed on nonaccrual status when, in management's opinion, collection of interest is unlikely, which typically occurs when principal or interest payments are more than ninety days past due. When interest accrual is discontinued, all unpaid accrued interest 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.

*Allowance for Loan Losses* – The allowance for loan losses is established by management as an estimate to cover probable credit losses through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The Company's allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and general valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends, judgmentally adjusted for general economic conditions and other qualitative risk factors internal and external to the Company.

The allowance for loan losses is evaluated on a quarterly basis by management and is based upon management's review of the collectability of the loans in the Company's loan portfolio in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral. Loans originated by the bank subsidiary are generally secured by specific items of collateral including real property, crops, livestock, consumer assets, and other business assets.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on various factors. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the bank subsidiary to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

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. All loans rated substandard or worse and greater than $250 thousand are specifically reviewed to determine if they are impaired. Factors considered by management in determining whether a loan is impaired include payment status and the sources, amounts, and probabilities of estimated cash flow available to service debt in relation to amounts due according to contractual terms. 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 reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Loans that are determined to be impaired are then evaluated to determine estimated impairment, if any. GAAP allows impairment to be 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. Loans that are not individually determined to be impaired or are not subject to the specific review of impaired status are subject to the general valuation allowance portion of the allowance for loan loss.

The Company may modify its loan agreement with a borrower. The modification will be considered a troubled debt restructuring ("TDR") if the following criteria are met: (1) the borrower is experiencing a financial difficulty and (2) the Company makes a concession that it would not otherwise make. Concessions may include debt forgiveness, interest rate change, or maturity extension. Each of these loans is impaired and is evaluated for impairment, with a specific reserve recorded as necessary based on probable losses related to collateral and cash flow. A loan will no longer be required to be reported as restructured in calendar years following the restructure if the interest rate at the time of restructure is greater than or equal to the rate the Company was willing to accept for a new extension of credit with similar risk and the loan is in compliance with its modified terms.

*Acquired Loans* – Loans that the Company acquires in connection with business combinations are recorded at fair value with no carryover of the acquired entity's related allowance for loan losses. The fair value of the acquired loans involves estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest.

The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable discount. These loans are accounted for under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality.* The nonaccretable discount includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows will require the Company to evaluate the need for an additional allowance. Subsequent improvement in expected cash flows will result in the reversal of a corresponding amount of the nonaccretable discount which the Company will then reclassify as accretable discount that will be recognized into interest income over the remaining life of the loan.

Loans acquired through business combinations that meet the specific criteria of ASC 310-30 are individually evaluated each period to analyze expected cash flows. To the extent that the expected cash flows of a loan have decreased due to credit deterioration, the Company then establishes an allowance.

Loans acquired through business combinations that do not meet the specific criteria of ASC 310-30 are accounted for under ASC 310-20. These loans are initially recorded at fair value, and include credit and interest rate marks associated with acquisition accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. An allowance for loan losses is recorded for any credit deterioration in these loans subsequent to acquisition.

Acquired loans that met the criteria for impaired or nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company expects to fully collect the new carrying value (i.e. fair value) of the loans. As such, the Company may no longer consider the loan to be nonaccrual or nonperforming at the date of acquisition and may accrue interest on these loans, including the impact of any accretable discount. In addition, charge-offs on such loans would be first applied to the nonaccretable difference portion of the fair value adjustment.

*Mortgage Servicing Rights* – When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in net gain on sale of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates present value of estimated future servicing income.

Under the fair value measurement method, the Company measures servicing rights at fair value at each reporting date and reports change in fair value of servicing assets in earnings in the period in which the changes occur, and are included with other noninterest income in the CFS. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported in the CFS as other noninterest income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and recorded when income is earned. Servicing income was $3.1 million, $781 thousand, and $325 thousand for the years ended December 31, 2021, 2020, and 2019, respectively.

*Transfers of Financial Assets* – Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before maturity.

*Loans Held for Sale* – Loans held for sale are comprised of residential mortgage loans. Loans that are originated for best efforts delivery are carried at the lower of aggregate cost or fair value as determined by aggregate outstanding commitments from investors or current investor yield requirements. All other loans held for sale are carried at fair value. Loans sold are typically subject to certain indemnification provisions with the investor; management does not believe these provisions will have any significant consequences.

*Premises and Equipment* – Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation computed on the straight-line method. Buildings and improvements are depreciated on a useful life up to 40 years. Furniture and equipment are depreciated on a useful life between 3 to 10 years.

*Foreclosed Assets* – Assets acquired through, or in lieu of, loan foreclosure or repossession are held for sale and are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the cost basis or fair value less estimated costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense.

*Bank-Owned Life Insurance* – The bank subsidiary has purchased life insurance policies on various officers and also is the beneficiary. These policies are issued by third party insurance companies. Assets are carried at the cash surrender value and changes in the cash surrender values are recognized in other noninterest income in the accompanying CFS.

*Goodwill and Other Intangible Assets* – Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill is not amortized, but is tested for impairment on October 31 each year or more frequently if events and circumstances exist that indicate that an impairment test should be performed. There was no impairment recorded for the years ended December 31, 2021, 2020 and 2019, respectively.

Core deposit intangible (“CDI”) is a measure of the value of checking and savings deposit relationships acquired in a business combination. The fair value of the CDI stemming from any given business combination is based on the present value of the expected cost savings attributable to the core deposit funding relative to an alternative source of funding. CDI is amortized over the estimated useful lives of the existing deposit relationships acquired, but does not exceed 10 years. Significantly all CDI is amortized using the sum of the years’ digits method.

The remaining other intangible assets consist of customer relationship and employment agreement intangible assets and are amortized over their estimated useful lives of 5 years using the straight-line method.

*Mortgage Banking Derivatives* – Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market, forward commitments for the future delivery of these mortgage loans, and forward sales of mortgage-backed securities are accounted for as free standing derivatives. At the time of the interest rate lock, the Company determines whether the loan will be sold through a best efforts contract or a mandatory delivery contract.

In order to hedge the change in interest rates resulting from the commitments to fund the loans that will be sold through a best efforts contract, the Company enters into forward loans sales commitments for the future delivery of mortgage loans when interest rate locks are entered. At inception, these interest rate locks and the related forward loan sales commitments, adjusted for the expected exercise of the commitment before the loan is funded, are recorded with a zero value. Subsequent changes in fair value are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked.

In order to hedge the change in interest rates resulting from all other mortgage commitments to funds loans, the Company enters into forward sales of mortgage-backed securities contracts. At inception, these interest rate locks are recorded at fair value and are adjusted for the expected exercise of the commitment before the loan is funded. Subsequent changes in fair value are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. Changes in the fair values of these derivatives are included in net gain on sales of loans in the CFS.

*Derivatives* – At the inception of a derivative contract, the Company designates the derivative as one of three types based on the Company's intentions and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), or (3) an instrument with no hedging designation ("stand-alone derivative"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Company formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

*Revenue Recognition* – The majority of the Company's revenues come from interest income and other sources, including loans, securities and derivatives, that are outside the scope of ASC 606. The Company's services that fall within the scope of Topic 606 are presented within Noninterest Income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of Topic 606 include service charges on deposit accounts, bank card services and interchange fees, investment commissions, fiduciary fees, and the sale of OREO. However, the recognition of these revenue streams did not change significantly upon the adoption of Topic 606. Substantially all of the Company's revenue is generated from contracts with customers. Noninterest income streams within the scope of Topic 606 are discussed below.

*Service Charges on Deposit Accounts*
The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

*Bank Card Services and Interchange Fees*
The Company earns bank card service and interchange fees from debit and credit cardholder transactions conducted through card payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. Bank card services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees and service fees such as ATM use fees and are recognized at the time the transaction is executed.

*Investment Commissions and Fiduciary Trust Fees*
The Company earns investment commissions and fiduciary trust fees from its contracts with trust customers to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Company provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management (AUM) at month-end. Fees that are transaction based, including trade execution services, are recognized at the point in time that the transaction is executed, i.e., the trade date. Other related services provided include financial planning services and the fees the Company earns, which are based on a fixed fee schedule, are recognized when the services are rendered.

In addition, certain trust customers have contracted with the Company to provide trust dissolution services, which are based on a unitary management fee treated as a single performance obligation. The Company's performance obligation is satisfied over time based on the customer simultaneously receiving and consuming the benefits of the Company's service. The unitary management fee is treated as variable consideration and is evaluated and included in the transaction price at the end of each reporting period (quarterly). Revenue is recognized based on a reasonable time based measure of progress towards the Company's complete satisfaction of the performance obligation at the end of each respective reporting period, with the unearned amount based on progress measure being included in deferred contract liability. This variable consideration and the amount of revenue recognized is evaluated quarterly until the Company has entirely fulfilled its performance obligation, at which time the remaining unearned revenue is recognized.

*Gains/Losses on Sales of OREO*
The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

*Contract Balances*
A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. The Company did not have any significant contract balances at December 31, 2021 and 2020.

*Contract Acquisition Costs*
In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition cost.

*Insurance Activities*
The Company's primary source of revenues for insurance activities are commissions from underwriting enterprises, based on a percentage of premiums paid by clients. These commissions and fees revenues are substantially recognized at a point in time on the effective date of the associated policies when control of the policy transfers to the client. Commissions are fixed at the contract effective date and generally are based on a percentage of premiums for insurance coverage. Commissions depend upon a large number of factors, including the type of risk being placed, the particular underwriting enterprise's demand, the expected loss experience of the particular risk of coverage, and historical benchmarks surrounding the level of effort necessary for us to place and service the insurance contract.

Stock-Based Compensation – The Company sponsors an equity incentive plan under which options to acquire shares of the Company's common stock may be granted periodically to all full-time employees and directors of the Company or its affiliates at a specific exercise price. Shares are issued out of authorized and unissued common shares that have been reserved for issuance under such plan. Compensation cost is measured based on the estimated fair value of the award at the grant date and is recognized in earnings on a straight-line basis over the requisite service period. The fair value of stock options is estimated at the date of grant using a closed form option valuation ("Black-Scholes") option pricing model. This model requires assumptions as to the expected stock volatility, dividends, terms and risk-free rates. The expected volatility is based on the combination of the Company's historical volatility and the volatility of comparable peer banks. The expected term represents the period of time that options are expected to be outstanding from the grant date. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the appropriate life of each stock option.

*Advertising* – Advertising costs are recognized when incurred. Advertising costs during 2021, 2020, and 2019 were approximately $2.6 million, $2.6 million, and $2.2 million, respectively.

*Income Taxes* – The Company files a consolidated federal income tax return including the results of its wholly owned subsidiary, the Bank. The Company estimates income taxes payable based on the amount it expects to owe. 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 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. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized. Interest and/or penalties related to income taxes are reported as a component of income tax expense.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The State of Texas franchise tax is an income tax for financial reporting purposes under GAAP and the Company and its subsidiaries are subject to the modified tax as a combined group.

*Earnings per Share* – Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for this calculation unless unearned. Diluted earnings per share includes the dilutive effect of unearned ESOP shares, if applicable. Diluted earnings per share includes the dilutive effect of additional potential shares issuable under stock options. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

*Fair Values of Financial Instruments* – Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully described in Note 21. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect estimates.

*Trust Assets* – Custodial assets of City Bank’s trust department, other than cash on deposit at City Bank, if any, are not included in the accompanying CFS because they are not assets of City Bank.

*Segment Information* – The Company has two reportable segments: banking and insurance. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company’s reportable segments are strategic business units that offer different products and services. Operations are managed and financial performance is evaluated on a Company-wide basis.

*Reclassification* – Certain amounts in the 2019 and 2020 CFS have been reclassified to conform to the 2021 presentation.

*Change in Accounting Principle* – Prior to January 1, 2019, the Company accounted for its cash-settled stock appreciation rights ("SARs") using the intrinsic value method, as permitted by ASC 718. As a result of the Company listing its common stock on the NASDAQ Global Select Market and becoming a reporting company with the SEC, the Company was then required to use the fair value method for those SARs. The Company's calculation of the fair value of the SARs, as of January 1, 2019, exceeded the recorded intrinsic value by $1.6 million. ASC 250 states that an "entity shall report a change in accounting principle through retrospective application of the new accounting principle to all prior periods, unless it is impracticable to do so." Retrospective application of the effects of a change from the intrinsic value to fair value would be impracticable due to the need to objectively determine assumptions that would be used in prior periods without using current information. Additionally, SEC Staff Accounting Bulletin Topic 14.B states that entities changing from nonpublic to public status are not permitted to apply the fair-value-based method retrospectively. Therefore, the Company recorded a cumulative-effect adjustment to retained earnings for $1.3 million ($1.6 million net of $340 thousand in tax) effective January 1, 2019 and applied this change prospectively.

*Recent Accounting Pronouncements* – *Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC")* constitutes GAAP for nongovernmental entities. Updates to ASC are prescribed in Accounting Standards Updates ("ASU"), which are not authoritative until incorporated into ASC.

*ASU 2021-01, Reference Rate Reform (Topic 848)*. In January 2021, the FASB issued ASU No. 2021-01 to clarify the scope of Topic 848 so that derivatives affected by the discounting transition are explicitly eligible for certain optional expedients and exceptions in Topic 848. This update additionally clarified that a receive-variable-rate, pay-variable-rate cross-currency interest rate swap may be considered an eligible hedging instrument in a net investment hedge if both legs of the swap do not have the same repricing intervals and dates as a result of reference rate reform. This update was effective upon issuance and generally can be applied through December 31, 2022. See the discussion regarding the adoption of ASU 2020-04 below.

*ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.* In March 2020, the FASB issued ASU No. 2020-04 and it provides optional expedients and exceptions for accounting related to contracts, hedging relationships and other transactions affected by reference rate reform if certain criteria are met. This update applies only to contracts, hedging relationships and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform and do not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022, except for hedging relationships existing as of December 31, 2022, that an entity has elected certain optional expedients for and that are retained through the end of the hedging relationship. The expedients and exceptions in this update are available to all entities starting March 12, 2020 through December 31, 2022. The adoption of ASU 2020-04 did not significantly impact the Company's consolidated financial statements.

*ASU 2019-12, Income Taxes, Simplifying the Accounting for Income Taxes (Topic 740).* In December 2019, the FASB issued ASU 2019-12 to simplify the accounting for income taxes by removing certain exceptions to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The adoption of ASU 2019-12 did not have a material effect on the Company's financial statements.

*ASU 2017-04, Intangibles - Goodwill and Other (Topic 350).* This ASU simplifies the accounting for goodwill impairment for all entities by eliminating Step 2 from the current provisions. Under the new guidance, an entity should perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying value and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The Company elected to early adopt ASU 2017-04 on January 1, 2020, and it did not have a material impact on its financial statements.

*ASU 2016-13 Financial Instruments - Credit Losses (Topic 326).* The FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held to maturity securities, and debt securities. ASU 2016-13 is effective for the Company for annual periods beginning after December 15, 2022, including interim periods within those fiscal years. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is currently evaluating the impact adoption of ASU 2016-13 and the CECL methodology for estimating the allowance for credit losses will have on its consolidated operating results and financial condition.

*ASU 2016-02 Leases (Topic 842).* The FASB amended existing guidance that requires that lessees recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. These amendments are effective for the Company for annual periods beginning after December 15, 2021, and interim periods beginning after December 15, 2022. Based upon an analysis performed, the Company estimates that the right-of-use asset and corresponding lease liability at adoption will be between $9.8 million and $10.7 million.

## 2. SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, at year-end follow:

| 2021 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale: | | | | |
| U.S. government and agencies | $ — | $ — | $ — | $ — |
| State and municipal | 265,143 | 10,615 | (86) | 275,672 |
| Mortgage-backed securities | 302,973 | 4,230 | (4,114) | 303,089 |
| Collateralized mortgage obligations | 106,733 | — | (413) | 106,320 |
| Asset-backed and other amortizing securities | 26,046 | 1,108 | (218) | 26,936 |
| Other securities | 12,000 | 487 | — | 12,487 |
| | $ 712,895 | $ 16,440 | $ (4,831) | $ 724,504 |

| 2020 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale: | | | | |
| U.S. government and agencies | $ 4,750 | $ 3 | $ — | $ 4,753 |
| State and municipal | 261,023 | 11,704 | (120) | 272,607 |
| Mortgage-backed securities | 359,542 | 14,014 | (194) | 373,362 |
| Collateralized mortgage obligations | 107,175 | — | (460) | 106,715 |
| Asset-backed and other amortizing securities | 31,509 | 2,063 | — | 33,572 |
| Other securities | 12,000 | 91 | (13) | 12,078 |
| | $ 775,999 | $ 27,875 | $ (787) | $ 803,087 |

The amortized cost and fair value of securities at December 31, 2021 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Other securities are shown separately since they are not due at a single maturity date.

| | Available for Sale | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Within 1 year | $ 1,939 | $ 1,959 |
| After 1 year through 5 years | 7,563 | 7,941 |
| After 5 years through 10 years | 22,502 | 23,426 |
| After 10 years | 245,139 | 254,833 |
| Other | 435,752 | 436,345 |
| | $ 712,895 | $ 724,504 |

At year-end 2021 and 2020, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

Securities with a carrying value of approximately $474.5 million and $292.2 million at December 31, 2021 and 2020, respectively, were pledged to collateralize public deposits and for other purposes as required or permitted by law.

The following table segregates securities with unrealized losses at year-end, by the period they have been in a loss position:

| | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| 2021 | | | | | | |
| U.S. government and agencies | $ — | $ — | $ — | $ — | $ — | $ — |
| State and municipal | 21,255 | 86 | — | — | 21,255 | 86 |
| Mortgage-backed securities | 56,398 | 1,197 | 64,764 | 2,917 | 121,162 | 4,114 |
| Collateralized mortgage obligations | 106,320 | 413 | — | — | 106,320 | 413 |
| Asset-backed and other amortizing securities | 1,624 | 218 | — | — | 1,624 | 218 |
| Other securities | — | — | — | — | — | — |
| | $ 185,597 | $ 1,914 | $ 64,764 | $ 2,917 | $ 250,361 | $ 4,831 |
| 2020 | | | | | | |
| U.S. government and agencies | $ — | $ — | $ — | $ — | $ — | $ — |
| State and municipal | — | 120 | — | — | — | 120 |
| Mortgage-backed securities | 93,482 | 194 | — | — | 93,482 | 194 |
| Collateralized mortgage obligations | 106,715 | 460 | — | — | 106,715 | 460 |
| Asset-backed and other amortizing securities | 3,486 | — | — | — | 3,486 | — |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other securities | — | 13 | — | — | — | 13 |
| | $ 203,683 | $ 787 | $ — | $ — | $ 203,683 | $ 787 |

There were 23 securities with an unrealized loss at December 31, 2021. Management does not believe that these losses are other than temporary as there is no intent to sell any of these securities before recovery and it is not probable that we will be required to sell any of these securities before recovery, and credit loss, if any, is not material. Any unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of December 31, 2021, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Company's CFS.

### *3. LOANS HELD FOR INVESTMENT*

Loans are summarized by category at year-end as follows:

| | 2021 | 2020 |
|---|---|---|
| Commercial real estate | $ 755,444 | $ 663,344 |
| Commercial - specialized | 378,725 | 311,686 |
| Commercial - general | 460,024 | 518,309 |
| Consumer: | | |
| 1-4 family residential | 387,690 | 360,315 |
| Auto loans | 240,719 | 205,840 |
| Other consumer | 68,113 | 67,595 |
| Construction | 146,862 | 94,494 |
| | | |
| | 2,437,577 | 2,221,583 |
| Allowance for loan losses | (42,098) | (45,553) |
| Loans, net | $ 2,395,479 | $ 2,176,030 |

The Company has certain lending policies, underwriting standards, and procedures in place that are designed to maximize loan income with an acceptable level of risk. Management reviews and approves these policies, underwriting standards, and procedures on a regular basis and makes changes as appropriate. Management receives frequent reports related to loan originations, quality, concentrations, delinquencies, non-performing, and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions, both by type of loan and geography.

*Commercial – General and Specialized* – Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably. Underwriting standards have been designed to determine whether the borrower possesses sound business ethics and practices, evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations, as agreed and ensure appropriate collateral is obtained to secure the loan. Commercial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial loans are secured by the assets being financed or other business assets, such as real estate, accounts receivable, or inventory, and include personal guarantees. Owner-occupied real estate is included in commercial loans, as the repayment of these loans is generally dependent on the operations of the commercial borrower's business rather than on income-producing properties or the sale of the properties. Commercial loans are grouped into two distinct sub-categories: specialized and general. Commercial related segments that are considered "specialized" include agricultural production and real estate loans, energy loans, and finance, investment, and insurance loans. Commercial related segments that contain a broader diversity of borrowers, sub-industries, or serviced industries are grouped into the "general category." These include goods, services, restaurant & retail, construction, and other industries.

*Commercial Real Estate* – Commercial real estate loans are also subject to underwriting standards and processes similar to commercial loans. These loans are underwritten primarily based on projected cash flows for income-producing properties and collateral values for non-income-producing properties. The repayment of these loans is generally dependent on the successful operation of the property securing the loans or the sale or refinancing of the property. Real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's real estate portfolio are diversified by type and geographic location. This diversity helps reduce the exposure to adverse economic events that affect any single market or industry.

*Construction* – Loans for residential construction are for single-family properties to developers, builders, or end-users. These loans are underwritten based on estimates of costs and completed value of the project. Funds are advanced based on estimated percentage of completion for the project. Performance of these loans is affected by economic conditions as well as the ability to control costs of the projects.

Consumer – Loans to consumers include 1-4 family residential loans, auto loans, and other loans for recreational vehicles or other purposes. The Company utilizes a computer-based credit scoring analysis to supplement its policies and procedures in underwriting consumer loans. The Company's loan policy addresses types of consumer loans that may be originated and the collateral, if secured, which must be perfected. The relatively smaller individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimizes the Company's risk. The Company generally requires mortgage title insurance and hazard insurance on 1-4 family residential loans.

The allowance for loan losses was $42.1 million at December 31, 2021, compared to $45.6 million at December 31, 2020. The ratio of allowance for loan losses to loans held for investment was 1.73% at December 31, 2021 and 2.05% at December 31, 2020. The decrease in the allowance for loan losses at December 31, 2021 compared to December 31, 2020 was primarily the result of the Company recording a negative provision for loan losses in the second quarter of 2021 of $2.0 million. The negative provision was primarily due to the general improvement in the economy, a decline in the amount of loans actively under a modification, and a decrease in nonperforming loans.

The following table details the activity in the allowance for loan losses during 2021 and 2020. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

| | Beginning Balance | Provision for Loan Losses | Charge-offs | Recoveries | Ending Balance |
|---|---|---|---|---|---|
| 2021 | | | | | |
| Commercial real estate | $ 18,962 | $ (1,826) | $ — | $ 109 | $ 17,245 |
| Commercial - specialized | 5,760 | (1,386) | (172) | 161 | 4,363 |
| Commercial - general | 9,227 | (302) | (677) | 218 | 8,466 |
| Consumer: | | | | | |
| 1-4 family residential | 4,646 | 666 | (52) | 8 | 5,268 |
| Auto loans | 4,226 | (90) | (598) | 115 | 3,653 |
| Other consumer | 1,671 | 339 | (903) | 250 | 1,357 |
| Construction | 1,061 | 681 | — | 4 | 1,746 |
| Total | $ 45,553 | $ (1,918) | $ (2,402) | $ 865 | $ 42,098 |
| 2020 | | | | | |
| Commercial real estate | $ 5,049 | $ 13,618 | $ (7) | $ 302 | $ 18,962 |
| Commercial - specialized | 2,287 | 4,514 | (1,162) | 121 | 5,760 |
| Commercial - general | 9,609 | 1,219 | (1,811) | 210 | 9,227 |
| Consumer: | | | | | |
| 1-4 family residential | 2,093 | 2,478 | (56) | 131 | 4,646 |
| Auto loans | 3,385 | 1,814 | (1,165) | 192 | 4,226 |
| Other consumer | 1,341 | 1,300 | (1,358) | 388 | 1,671 |
| Construction | 433 | 627 | — | 1 | 1,061 |
| Total | $ 24,197 | $ 25,570 | $ (5,559) | $ 1,345 | $ 45,553 |
| 2019 | | | | | |
| Commercial real estate | $ 5,579 | $ (961) | $ — | $ 431 | $ 5,049 |
| Commercial - specialized | 2,516 | 2 | (355) | 124 | 2,287 |
| Commercial - general | 8,173 | 1,209 | (306) | 533 | 9,609 |
| Consumer: | | | | | |
| 1-4 family residential | 2,249 | 219 | (436) | 61 | 2,093 |
| Auto loans | 2,994 | 1,276 | (1,067) | 182 | 3,385 |
| Other consumer | 1,192 | 969 | (1,034) | 214 | 1,341 |
| Construction | 423 | 85 | (75) | — | 433 |
| Total | $ 23,126 | $ 2,799 | $ (3,273) | $ 1,545 | $ 24,197 |

The following table shows the Company's investment in loans disaggregated based on the method of evaluating impairment:

| | Recorded Investment | | Allowance for Loan Losses | |
|---|---|---|---|---|
| | Individually Evaluated | Collectively Evaluated | Individually Evaluated | Collectively Evaluated |
| 2021 | | | | |
| Commercial real estate | $ 1,101 | $ 754,343 | $ 584 | $ 16,661 |
| Commercial - specialized | — | 378,725 | — | 4,363 |
| Commercial - general | 5,078 | 454,946 | 585 | 7,881 |
| Consumer: | | | | |
| 1-4 family residential | 1,592 | 386,098 | 175 | 5,093 |
| Auto loans | — | 240,719 | — | 3,653 |
| Other consumer | — | 68,113 | — | 1,357 |
| Construction | — | 146,862 | — | 1,746 |
| Total | $ 7,771 | $ 2,429,806 | $ 1,344 | $ 40,754 |
| 2020 | | | | |
| Commercial - | $ 6,273 | $ 657,071 | $ 580 | $ 18,382 |
| Commercial - specialized | — | 311,686 | — | 5,760 |

| | | | | |
|---|---|---|---|---|
| Commercial - general | 4,626 | 513,683 | 515 | 8,712 |
| Consumer: | | | | |
| 1-4 family residential | 2,122 | 358,193 | — | 4,646 |
| Auto loans | — | 205,840 | — | 4,226 |
| Other consumer | — | 67,595 | — | 1,671 |
| Construction | — | 94,494 | — | 1,061 |
| Total | $ 13,021 | $ 2,208,562 | $ 1,095 | $ 44,458 |

Impaired loan information at year-end follows:

| | Unpaid Contractual Principal Balance | Recorded Investment With No Allowance | Recorded Investment With Allowance | Total Recorded Investment | Related Allowance | Average Recorded Investment |
|---|---|---|---|---|---|---|
| 2021 | | | | | | |
| Commercial real estate | $ 1,101 | $ — | $ 1,101 | $ 1,101 | $ 584 | $ 3,687 |
| Commercial -specialized | — | — | — | — | — | — |
| Commercial - general | 5,078 | 1,143 | 3,935 | 5,078 | 585 | 4,852 |
| Consumer: | | | | | | |
| 1-4 family | 1,592 | 880 | 712 | 1,592 | 175 | 1,857 |
| Auto loans | — | — | — | — | — | — |
| Other consumer | — | — | — | — | — | — |
| Construction | — | — | — | — | — | — |
| Total | $ 7,771 | $ 2,023 | $ 5,748 | $ 7,771 | $ 1,344 | $ 10,396 |
| 2020 | | | | | | |
| Commercial real estate | $ 6,273 | $ 3,673 | $ 2,600 | $ 6,273 | $ 580 | $ 3,666 |
| Commercial specialized | — | — | — | — | — | 673 |
| Commercial general | 4,626 | 3,364 | 1,262 | 4,626 | 515 | 3,400 |
| Consumer: | | | | | | |
| 1-4 family | 2,541 | 2,122 | — | 2,122 | — | 2,155 |
| Auto loans | — | — | — | — | — | — |
| Other consumer | — | — | — | — | — | — |
| Construction | — | — | — | — | — | — |
| Total | $ 13,440 | $ 9,159 | $ 3,862 | $ 13,021 | $ 1,095 | $ 9,894 |

All impaired loans $250 thousand and greater were specifically evaluated for impairment. Interest income recognized using a cash-basis method on impaired loans for 2021, 2020 and 2019 was not significant. Additional funds committed to be advanced on impaired loans are not significant.

The table below provides an age analysis on accruing past-due loans and nonaccrual loans at year-end:

| | 30-89 Days Past Due | 90 Days or More Past Due | Nonaccrual |
|---|---|---|---|
| 2021 | | | |
| Commercial real estate | $ 393 | $ 45 | $ 1,101 |
| Commercial - specialized | 265 | 20 | 156 |
| Commercial - general | 4,032 | 97 | 5,236 |
| Consumer: | | | |
| 1-4 Family residential | 2,496 | 903 | 2,815 |
| Auto loans | 332 | — | — |
| Other consumer | 538 | 15 | 44 |
| Construction | 937 | — | 166 |
| Total | $ 8,993 | $ 1,080 | $ 9,518 |
| 2020 | | | |
| Commercial real estate | $ 914 | $ 34 | $ 6,311 |
| Commercial - specialized | 241 | — | 272 |
| Commercial - general | 1,891 | 149 | 5,489 |
| Consumer: | | | |
| 1-4 Family residential | 2,089 | 906 | 1,595 |
| Auto loans | 738 | 38 | — |
| Other consumer | 481 | 119 | 51 |
| Construction | 206 | — | — |
| Total | $ 6,560 | $ 1,246 | $ 13,718 |

The Company grades its loans on a thirteen-point grading scale. These grades fit in one of the following categories: (i) pass, (ii) special mention, (iii) substandard, (iv) doubtful, or (v) loss. Loans categorized as loss are charged-off immediately. The grading of loans reflect a judgment by the Company about the risks of default associated with the loan. The Company reviews the grades on loans as part of our on-going monitoring of the credit quality of our loan portfolio.

Pass loans have financial factors or nature of collateral that are considered reasonable credit risks in the normal course of lending and encompass several grades that are assigned based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to watch credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of monitoring.

Special mention loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of repayment prospects for the loans at some future date.

Substandard loans are inadequately protected by the current net worth and paying capacity of the borrower or by the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize collection and present the distinct possibility that some loss will be sustained if the deficiencies are not corrected. A protracted workout on these credits is a distinct possibility. Prompt corrective action is therefore required to strengthen the Company's position, and/or to reduce exposure and to assure that adequate remedial measures are taken by the borrower. Credit exposure becomes more likely in such credits and a serious evaluation of the secondary support to the credit is performed. Substandard loans can be accruing or can be nonaccrual depending on the circumstances of the individual loans.

Doubtful loans have all the weaknesses inherent in substandard loans with the added characteristics that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. All doubtful loans are on nonaccrual.

The following table summarizes the internal classifications of loans at year-end:

| | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| 2021 | | | | | |
| Commercial real estate | $ 713,852 | $ — | $ 41,592 | $ — | $ 755,444 |
| Commercial - specialized | 372,797 | — | 5,928 | — | 378,725 |
| Commercial - general | 450,790 | 1,676 | 7,558 | — | 460,024 |
| Consumer: | | | | | |
| 1-4 family residential | 379,458 | — | 8,232 | — | 387,690 |
| Auto loans | 239,869 | — | 850 | — | 240,719 |
| Other consumer | 67,822 | — | 291 | — | 68,113 |
| Construction | 146,696 | — | 166 | — | 146,862 |
| Total | $ 2,371,284 | $ 1,676 | $ 64,617 | $ — | $ 2,437,577 |
| | | | | | |
| 2020 | | | | | |
| Commercial real estate | $ 602,250 | $ — | $ 61,094 | $ — | $ 663,344 |
| Commercial - specialized | 303,831 | — | 7,855 | — | 311,686 |
| Commercial - general | 510,543 | — | 7,766 | — | 518,309 |
| Consumer: | | | | | |
| 1-4 family residential | 352,930 | — | 7,385 | — | 360,315 |
| Auto loans | 204,301 | — | 1,539 | — | 205,840 |
| Other consumer | 67,216 | — | 379 | — | 67,595 |
| Construction | 94,494 | — | — | — | 94,494 |
| Total | $ 2,135,565 | $ — | $ 86,018 | $ — | $ 2,221,583 |

Under section 4013 of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), banks may elect to deem that loan modifications do not result in a classification as a TDR if they are (1) related to the COVID-19 pandemic; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (A) 60 days after the date of termination of the national emergency or (B) December 31, 2020. Under section 540 of the Consolidated Appropriations Act, 2021 (the “Act”), section 4013 of the CARES Act was amended and the period for loan modifications was extended to the earlier of (1) January 1, 2022, or (2) 60 days after the date of termination of the national emergency. The Company elected to adopt the provisions of the CARES Act, as amended by the Act.

Additionally, other short-term modifications made on a good faith basis in response to the COVID-19 pandemic to borrowers who were current prior to any relief are not TDRs under ASC Subtopic 310-40 and the interagency statement released by the federal banking regulators on April 7, 2020 in response to the COVID-19 pandemic (the “Joint Interagency Regulatory Guidance”). This includes short-term (e.g., up to six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented.

In response to the COVID-19 pandemic, the Company implemented a short-term deferral modification program that complies with ASC Subtopic 310-40 and the Joint Interagency Regulatory Guidance. As of December 31, 2021, the Company had no loans under an active modification that comply with ASC Subtopic 310-40 and the Joint Interagency Regulatory Guidance. As of December 31, 2020, the Company had an outstanding principal balance of modified loans of $3.0 million in loans that complied with ASC Subtopic 310-40 and the Joint Interagency Regulatory Guidance. These modifications included: $1.0 million in six months of interest-only payments, $300 thousand in 90 day commercial payment deferrals, and $1.7 million in consumer one to four month payment deferrals. The total of all of these short-term modifications represented 0.14% of outstanding loans held for investment at December 31, 2020.

Beginning in April 2020, the Company began offering additional COVID-19 related deferral and modification of principal and/or interest payments to selected borrowers on a case-by-case basis that were outside the scope of the short-term deferral modification program. These additional modifications comply with the provisions of section 4013 of the CARES Act and section 501 of the Act. As of December 31, 2021 the Company had 3 loans totaling approximately $15.9 million subject to these deferral and modification agreements, representing 0.65% of outstanding loans held for investment. As of December 31, 2020 the Company had 25 loans totaling approximately $61.0 million subject to these deferral and modification agreements, representing 2.75% of outstanding loans held for investment.

There were no TDRs during 2021, 2020, and 2019.

### *4. FORECLOSED ASSETS*

Foreclosed assets activity was as follows:

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Beginning balance | $ 1,353 | $ 1,883 | $ 2,285 |
| Additions | 927 | 1,867 | 3,469 |
| Sales, net | (1,248) | (2,397) | (3,871) |
| Current year valuation write-down | — | — | — |
| Ending balance | $ 1,032 | $ 1,353 | $ 1,883 |

Activity in the valuation allowance was as follows:

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Beginning balance | $ — | $ — | $ — |
| Current year valuation write-down | — | — | — |
| Reductions from sales | — | — | — |
| Ending balance | $ — | $ — | $ — |

Net expenses related to foreclosed assets include:

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Net loss (gain) on sales | $ (44) | $ (40) | $ 37 |
| Current year valuation write-down | — | — | — |
| Operating expenses, net of rental income | 57 | 75 | 71 |
| Foreclosed assets expense, net | $ 13 | $ 35 | $ 108 |

### 5. *PREMISES AND EQUIPMENT*

Detail of premises and equipment at year-end follows:

| | 2021 | 2020 |
|---|---|---|
| Land | $ 10,065 | $ 10,825 |
| Buildings and improvements | 65,986 | 65,840 |
| Furniture and equipment | 48,281 | 46,443 |
| Construction in process | 659 | 29 |
| | 124,991 | 123,137 |
| Less accumulated depreciation | (67,292) | (62,806) |
| Premises and equipment, net | $ 57,699 | $ 60,331 |

Depreciation expense was approximately $4.8 million in 2021, $4.8 million in 2020, and $4.9 million in 2019.

### 6. *GOODWILL AND INTANGIBLES*

Goodwill and other intangible assets, which consist of CDI, customer lists, and employment agreements are summarized below:

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Beginning goodwill | $ 19,508 | $ 18,757 | $ — |
| Arising from business combinations | — | — | 18,757 |
| Measurement period acquisition adjustment | — | 751 | — |
| Ending goodwill | $ 19,508 | $ 19,508 | $ 18,757 |
| | | | |
| Amortized intangible assets: | | | |
| Customer relationship intangibles | $ 6,679 | $ 6,679 | $ 6,679 |
| Less: Accumulated amortization | (2,469) | (1,396) | (202) |
| | 4,210 | 5,283 | 6,477 |
| | | | |
| Other intangibles | 2,972 | 2,309 | 2,309 |
| Arising from business combinations | — | 663 | — |
| Less: Accumulated amortization | (1,287) | (693) | (154) |
| | 1,685 | 2,279 | 2,155 |
| | | | |
| Other intangible assets, net | $ 5,895 | $ 7,562 | $ 8,632 |

Amortization expense for other intangibles for the years ended December 31, 2021, December 31, 2020, and December 31, 2019 totaled $1.7 million, $1.7 million, and $356 thousand, respectively. The estimated amount of amortization expense for core deposit intangible and other intangible assets to be recognized over the next five years is as follows:

| | CDI | Other Intangible | Total |
|---|---|---|---|
| 2022 | $ 951 | $ 594 | $ 1,545 |
| 2023 | 830 | 595 | 1,425 |
| 2024 | 708 | 441 | 1,149 |
| 2025 | 587 | 55 | 642 |
| 2026 | 466 | — | 466 |

### 7. *MORTGAGE SERVICING RIGHTS*

The following table reflects the changes in fair value of the Company’s mortgage servicing rights asset included in the Consolidated Balance Sheets, and other information related to the serviced portfolio:

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Beginning balance | $ 9,049 | $ 2,054 | $ 1,270 |
| Additions | 9,196 | 9,829 | 1,332 |
| Valuation adjustment | 1,455 | (2,834) | (548) |
| Ending balance | $ 19,700 | $ 9,049 | $ 2,054 |
| | | | |
| Mortgage loans serviced for others | $ 1,953,095 | $ 1,203,687 | $ 247,326 |
| Mortgage servicing rights asset as a percentage of serviced mortgage loans | 1% | 1% | 1% |

The following table reflects the key assumptions used in measuring the fair value of the Company's mortgage servicing rights:

| | 2021 | 2020 |
|---|---|---|
| Weighted average constant prepayment rate | 12.35% | 18.16% |
| Weighted average discount rate | 9.14% | 9.72% |
| Weighted average life in years | 6.03 | 4.48 |

## 8. *DEPOSITS*

Time deposits that met or exceeded the FDIC Insurance limit of $250,000 were $163.4 million and $147.0 at December 31, 2021 and 2020, respectively.

The scheduled maturities of time deposits at December 31, 2021 follows:

| | | |
|---|---|---|
| 2022 | $ | 258,584 |
| 2023 | | 66,613 |
| 2024 | | 8,154 |
| 2025 | | 3,272 |
| 2026 | | 2,910 |
| Thereafter | | 205 |
| | $ | 339,738 |

## 9. *BORROWING ARRANGEMENTS*

Short-term borrowings

The following table summarizes our short-term borrowings at year-end:

| | | 2021 | | 2020 |
|---|---|---|---|---|
| Federal funds purchased | $ | — | $ | 26,550 |
| FHLB advances - short-term | | — | | — |
| Total | $ | — | $ | 26,550 |

Federal funds purchased are short-term borrowings that generally have one-day maturities.

Lines of credit

The bank subsidiary has a line of credit with FHLB. The amount of the line is determined by FHLB on a quarterly basis. The line is primarily used to purchase Federal funds or to secure letters of credit to pledge as collateral against certain public deposits. The line is collateralized by a blanket floating lien on all first mortgage loans and commercial real estate loans as well as all FHLB stock, which has a carrying amount of $2.8 million at December 31, 2021. The available capacity of the line was $903.9 million and $512.5 million at December 31, 2021 and 2020, respectively.

The bank subsidiary also has a line of credit with the Federal Reserve Bank of Dallas ("FRB"). The amount of the line is determined on a monthly basis by FRB. The line is collateralized by a blanket floating lien on all agriculture, commercial, and consumer loans. The amount of the line was $593.6 million and $700.8 million at December 31, 2021 and 2020, respectively. This line was not used at December 31, 2021 or 2020.

The bank subsidiary also has uncollateralized lines of credit with multiple banks. The total amount of the lines was $160.0 million and $165.0 million as of December 31, 2021 and 2020, respectively. These lines were not used at December 31, 2021 or 2020.

Notes payable and other borrowings

The bank subsidiary has multiple advances from FHLB. The advances are collateralized through the line of credit with FHLB with interest payable monthly and principal due at maturity. The following table is a detail of the advances as of December 31:

| Issue Date | | Original Amount of Advance | | 2021 Balance | | 2020 Balance | Maturity Date | Interest Rate at December 31, 2020 |
|---|---|---|---|---|---|---|---|---|
| 2013 | $ | 20,000 | $ | — | $ | — | 2020 | Fixed; 1.50% |
| 2015 | | 25,000 | | — | | 25,000 | 2025 | Variable; 0.19% |
| 2015 | | 25,000 | | — | | 25,000 | 2025 | Variable; 0.19% |
| 2015 | | 25,000 | | — | | 25,000 | 2025 | Variable; 0.23% |
| | $ | 95,000 | $ | — | $ | 75,000 | | |

At December 31, 2020, City Bank had three advances from the FHLB totaling $75.0 million. Advances are collateralized through the line of credit with FHLB with interest payable monthly and principal due at maturity. In March 2021, City Bank repaid two of the advances for a total of $50 million and then repaid the remaining advance of $25 million in April 2021. As of December 31, 2021, City Bank had no outstanding advances from the FHLB.

In April 2020, City Bank borrowed $75 million from FHLB, on a term of three months, for liquidity needs. The three month advance matured in July 2020 and was repaid.

Junior subordinated deferrable interest debentures and trust preferred securities

The Company established grantor trusts ("trusts") that issued obligated mandatorily redeemable preferred securities ("TPS"); the Company issued junior subordinated deferrable interest debentures (debentures) to the trusts. The trusts are not consolidated and the debentures issued by the Company to the trusts are reflected in the Company's consolidated balance sheets. The Company records interest expense on the debentures in its CFS.

The common capital securities issued by the trusts ($1.4 million) are included in other assets in the Company's consolidated balance sheets under the equity method of accounting. The amount of the capital securities represents the Company's maximum exposure to loss.

The Company is required by the Board of Governors of the Federal Reserve System ("Federal Reserve") to maintain certain levels of capital for bank regulatory purposes. The debentures issued by the trusts to the Company, less the common capital securities of the trusts, continue to qualify as Tier 1 capital, subject to limitation to 25% of Tier 1 capital, under guidance issued by the Federal Reserve.

Although the trusts are not consolidated in these CFS, the TPS remain outstanding with terms substantially the same as the debentures. The Company's interest payments on its debentures are the sole source of repayment for the TPS. Additionally, the Company guarantees payment of interest and principal on the TPS.

The terms of the debentures and TPS allow for interest to be deferred for up to five years consecutively. During this time, shareholder dividends are not allowed to be paid.

The following table is a detail of the debentures and TPS at December 31, 2021:

| | Issue Date | Amount of TPS | Amount of Debentures | Stated Maturity Date of TPS and Debentures(1) | Interest Rate of TPS and Debentures(2)(3) |
|---|---|---|---|---|---|
| South Plains Financial Capital Trust III | 2004 | $ 10,000 | $ 10,310 | 2034 | 3-mo. LIBOR + 265bps; 2.77% |
| South Plains Financial Capital Trust IV | 2005 | 20,000 | 20,619 | 2035 | 3-mo. LIBOR + 139bps; 1.59% |
| South Plains Financial Capital Trust V | 2007 | 15,000 | 15,464 | 2037 | 3-mo. LIBOR + 150bps; 1.70% |
| Total | | $ 45,000 | $ 46,393 | | |

(1) May be redeemed five years from the issue date, the Company has no current plans to redeem; (2) Interest payable quarterly with principal due at maturity; (3) Rate as of last reset date.

Subordinated debt securities

In December 2018, the Company issued $26.5 million in subordinated debt securities. $12.4 million of the securities have a maturity date of December 2028 and a weighted average fixed rate of 5.74% for the first five years. The remaining $14.1 million of securities have a maturity date of December 2030 and a weighted average fixed rate of 6.41% for the first seven years. After the fixed rate periods, all securities will float at the *Wall Street Journal* prime rate, with a floor of 4.5% and a ceiling of 7.5%. These securities pay interest quarterly, are unsecured, and may be called by the Company at any time after the remaining maturity is five years or less. Additionally, these securities qualify for Tier 2 capital treatment, subject to regulatory limitations.

On September 29, 2020, the Company issued $50.0 million in subordinated debt securities. Proceeds were reduced by approximately $926 thousand in debt issuance costs. The securities have a maturity date of September 2030 with a fixed rate of 4.50% for the first five years. After the expiration of the fixed rate period, the securities will reset quarterly at a variable rate equal to the then current three-month Secured Overnight Financing Rate, as published by the Federal Reserve Bank of New York, plus 438 basis points. These securities pay interest semi-annually, are unsecured, and may be called by the Company at any time after the remaining maturity is five years or less. Additionally, these securities qualify for Tier 2 capital treatment, subject to regulatory limitations.

As of December 31, 2021, the total amount of subordinated debt securities outstanding was $76.5 million less approximately $697,000 of remaining debt issuance costs for a total balance of $75.8 million.

## 10. EMPLOYEE BENEFITS

The Company sponsors the South Plains Financial, Inc. Employee Stock Ownership Plan ("ESOP"). Effective May 9, 2019, the ESOP was restated and amended. The 401(k) related assets, which consisted of participants' elective and rollover accounts, were transferred to the newly formed City Bank 401(k) Plan. The ESOP covers all employees who have completed one month of service.

The ESOP may be leveraged to purchase shares of SPFI stock. Shares are released from collateral and allocated to active employees, in proportion to annual debt service. The Company recognizes any debt of the ESOP as notes payable and the shares pledged as collateral are deducted from the stockholders' equity as unearned ESOP shares in the accompanying consolidated balance sheets. All ESOP shares were allocated as of December 31, 2021 and 2020.

Through 2019, the Company made contributions to the ESOP as approved by the Board of Directors on an annual basis. These contributions, plus dividends received, were used to service any ESOP debt and repurchase allocated shares from participants and terminating vested participants. Company contributions to the ESOP in 2019 were $1.8 million. There were no Company contributions made to the ESOP in 2021 or 2020.

As of December 31, 2021 and 2020, the number of shares held by the ESOP were 2,795,762 and 2,876,419, respectively. During 2019, the Company did not repurchase any shares from ESOP participants prior to the Company's shares being publicly traded.

In accordance with applicable provisions of Code, the terms of the ESOP, for so long as SPFI was a privately held company, ESOP participants would have the right, for a specified period of time, to require SPFI to repurchase shares of its common stock that were distributed to such participants by the ESOP. This repurchase obligation terminated upon the consummation of our initial public offering and listing of our common stock on the NASDAQ Global Select Market in May 2019. However, because we were privately held at December 31, 2018, the value of ESOP- owned shares have been deducted from stockholders' equity in our consolidated changes in stockholders' equity statement as of December 31, 2018. For all periods following our initial public offering and continued listing of our common stock on the NASDAQ Global Select Market, the ESOP-owned shares are and will be included in stockholders' equity. At December 31, 2018, the fair value of all ESOP-owned shares subject to this repurchase obligation totaled $58.2 million.

Under the provisions of the 401(k) Plan, participants may elect to contribute pre-tax salary deferrals and direct investment of those salary deferrals among investments offered in the 401(k) Plan. The Company may elect to contribute a safe harbor match equal to 100% of the first 5% of the participants' compensation contributed. The expense for Company contributions to the 401(k) Plan was $1.8 million in 2021, $1.7 million in 2020, and $0 in 2019.

*Employee Health Benefits* – The Company has a self-insured welfare benefit plan which provides health and dental benefits. For officers of the Company, there is no waiting period to be eligible, while there is a 60-day waiting period for all other employees. In addition, to be eligible, an employee must be scheduled to work on a full-time basis (at least 30 hours per week). The Company periodically evaluates the costs of the plan and determines the amount to be contributed by the Company and the amount, if any, to be contributed by the employee. Welfare benefit expense was approximately $4.5 million, $4.4 million, and $4.8 million for the years ending December 31, 2021, 2020, and 2019, respectively. In addition, benefit obligations have been accrued and include reported claims payable and claims incurred but not reported, for approximately $825 thousand and $823 thousand as of December 31, 2021 and 2020, respectively. The Company has limited its risk exposure for these benefits through a stop-loss policy with an independent third party insurer which reimburses benefits paid that exceed $100 thousand per participant per year.

*Non-Qualified Plans* – Certain Company executives, as determined by the Company's Board from time-to-time, were granted SARs based on grant date values. The rights had varying vesting provisions. Exercise and payment options for the rights varied and were governed by the program they were issued under as well as the specific award agreement. See further discussion in Note 11 for conversion of SARs to stock options.

Certain Company executives, as determined by the Company's Board from time-to-time, have post-retirement salary continuation agreements under an Executive Salary Continuation Plan. Retirement ages and retirement salary amounts are specified in each agreement. The Company accrues actuarial estimates of the costs of these benefits over the respective service periods; approximately $12.5 million and $12.1 million was accrued at December 31, 2021 and 2020, respectively. This plan is nonqualified, noncontributory, and unfunded. The charge to income for this plan during 2021, 2020, and 2019 was approximately $1.0 million, $1.1 million and, $1.1 million, respectively.

## *11. STOCK-BASED COMPENSATION*

Equity Incentive Plan

The 2019 Equity Incentive Plan ("Plan") was approved by the Company's Board of Directors on January 16, 2019 and by its shareholders on March 6, 2019. The purpose of the Plan is to: (i) attract and retain the best available personnel for positions of substantial responsibility, (ii) provide additional incentive to employees, directors and consultants, and (iii) promote the success of the Company's business. This Plan permits the grant of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, performance shares, and other stock-based awards. The maximum aggregate number of shares of common stock that may be issued pursuant to all awards under the Plan was 3,383,373 at December 31, 2021. The maximum aggregate number of shares that may be issued under the Plan may be increased annually by up to 3% of the total issued and outstanding common shares of the Company at the beginning of each fiscal year.

The fair value of each option award is estimated on the date of grant using the Black-Scholes model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock and similar peer company averages. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted represents the period of time that options granted are expected to be outstanding, which takes in to account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on U.S. Treasury yield curve in effect at the time of the grant.

Options

A summary of activity in the Plan during the year ended December 31, 2021 is presented in the table below:

| | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life in Years | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Year Ended December 31, 2021 | | | | |
| Outstanding at beginning of year: | 1,554,894 | $ 14.77 | | $ 20,274 |
| Granted | 214,452 | 19.46 | | 1,790 |
| Exercised | (158,166) | 14.38 | | (2,124) |
| Forfeited | (9,152) | 18.37 | | (86) |
| Expired | — | — | | — |
| Outstanding at end of year | 1,602,028 | $ 15.42 | 6.02 | $ 19,854 |
| Exercisable at end of period | 1,038,018 | $ 13.34 | 5.14 | $ 15,024 |
| Vested at end of period | 1,038,018 | $ 13.34 | 5.14 | $ 15,024 |

A summary of assumptions used to calculate the fair values of the awards is presented below:

| | December 31, 2021 | December 31, 2020 | December 31, 2019 |
|---|---|---|---|
| Expected volatility | 41.20% to 41.32% | 27.46% | 24.88% to 31.54% |
| Expected dividend yield | 1.00% | 0.70% | 0.70% |
| Expected term (years) | 6.1 to 6.2 | 6.2 | 0.5 - 7.0 |
| Risk-free interest rate | 0.52% to 0.83% | 1.44% | 1.46% to 2.63% |
| Weighted average grant date fair value | $ 7.07 | $ 5.68 | 7.98 |

The total intrinsic value of options exercised during the years ended December 31, 2021, December 31, 2020, and December 31, 2019 was $2.1 million, $1.1 million, and $1.4 million, respectively.

On January 16, 2019, the Company approved the conversion of its previously issued SARs to stock options. There were 1,401,000 outstanding SARs that were converted effective as of May 6, 2019, which are included in the tables above. The fair value of the SARs was $11.5 million at the conversion date. During the modification of these awards from liabilities to equity, the Company accelerated the expiration date, between two and four years, on 750 thousand of the stock options. As a result, the fair value of the stock options after modification was $11.2 million. However, since the fair value of the new equity awards was less than the fair value of the liability awards, no adjustment was made to the Company's income statement. The $11.5 million was reclassified from liabilities to equity.

*Restricted Stock Awards and Units*

A summary of activity in the Plan during the year ended December 31, 2021 is presented in the table below:

| | Number of Shares | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Year Ended December 31, 2021 | | |
| Outstanding at beginning of year: | 62,476 | $ 19.47 |
| Granted | 6,370 | 19.62 |
| Exercised | (24,805) | 19.70 |
| Forfeited | (1,274) | 19.62 |
| Outstanding at end of year | 42,767 | $ 19.35 |

Restricted stock units granted under the Plan typically vest from one to four years, but vesting periods may vary. Compensation expense for these grants will be recognized over the vesting period of the awards based on the fair value of the stock at the issue date.

For the years ended December 31, 2021, December 31, 2020, and December 31, 2019 the Company recorded stock-based compensation expense related to the Plan of $1.6 million, $1.3 million and $853, thousand, respectively.

The total unrecognized compensation cost for the awards outstanding under the Plan at December 31, 2021 was $2.7 million and will be recognized over a weighted average remaining period of 1.47 years. The total fair value of restricted stock units vested during the years ended December 31, 2021, December 31, 2020, and December 31, 2019 was $489 thousand, $489 thousand, and $0, respectively.

### *12. INCOME TAXES*

The components of income tax expense (benefit) was as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2021 | 2020 | 2019 |
| Current expense | | | |
| Federal | $ 12,834 | $ 12,590 | $ 6,923 |
| State | 220 | 248 | 224 |
| Deferred expense | | | |
| Federal | 1,453 | (1,588) | 334 |
| Total | $ 14,507 | $ 11,250 | $ 7,481 |

Effective tax rates differ from the federal statutory rate of 21% applied to income before income taxes due to the following:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2021 | 2020 | 2019 |
| Federal statutory rate times financial statement income | $ 15,355 | $ 11,887 | $ 7,707 |
| Effect of: | | | |
| Tax-exempt income | (978) | (863) | (348) |
| State taxes, net of federal benefit | 174 | 196 | 177 |
| Earnings from bank owned life insurance | (262) | (280) | (272) |
| Non-deductible expenses | 281 | 248 | 190 |
| Other, net | (63) | 62 | 27 |
| Total | $ 14,507 | $ 11,250 | $ 7,481 |

Year-end deferred tax assets and liabilities were due to the following:

| | December 31, | |
|---|---|---|
| | 2021 | 2020 |
| Deferred tax assets | | |
| Allowance for loan loss | $ 8,840 | $ 9,566 |
| Deferred compensation | 5,772 | 5,215 |
| Other real estate owned | — | 251 |
| Nonaccrual loans | 21 | 59 |
| Other | 202 | 221 |
| Total deferred tax assets | 14,835 | 15,312 |
| Deferred tax liabilities | | |
| Depreciation | (2,496) | (2,432) |
| Intangibles | (586) | (847) |
| Prepaid expenses | (547) | (439) |
| Mortgage servicing rights | (4,137) | (1,900) |
| Unrealized gain on available-for-sale securities | (2,438) | (5,688) |
| Other | (1,593) | (1,545) |
| Total deferred tax liabilities | (11,797) | (12,851) |
| Net deferred tax asset | $ 3,038 | $ 2,461 |

### *13. RELATED-PARTY TRANSACTIONS*

Direct and indirect loans to executive officers, directors, significant stockholders and their related affiliates as of December 31, 2021 and 2020 aggregated approximately $12.2 million and $8.9 million, respectively. There were no charge-offs related to these loans in 2021 or 2020 and advance and repayment activity was routine. Deposits from these related parties in the CFS were not significant.

### *14. OFF-BALANCE-SHEET ACTIVITIES, COMMITMENTS AND CONTINGENCIES*

*Financial instruments with off-balance-sheet risk* – 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. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Company's consolidated financial statements. The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for recorded instruments.

Financial instruments whose contract amounts represent credit risk outstanding at year-end follow:

| | 2021 | 2020 |
|---|---|---|
| Commitments to grant loans and unfunded commitments under lines of credit | $ 542,338 | $ 417,798 |
| Standby letters-of-credit | 12,418 | 10,481 |

Commitments to grant loans and 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 dates or other termination clauses and may require payment of a fee. The commitments for lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company requires collateral supporting those commitments if deemed necessary.

*Litigation* – In July 2020, a vendor claimed that City Bank had breached a contract by failing to timely pay amounts allegedly due and owing. City Bank vigorously rejected any such non-payment contentions and filed suit against the vendor. With the lawsuit, City Bank sought, among other claims and relief, an injunction against the vendor. After an evidentiary hearing, the court entered a temporary injunction against the vendor expressly prohibiting it from, among other things, terminating the contract pending trial. Based upon discovery in the lawsuit, City Bank also filed a breach of contract claim against the vendor alleging that the vendor violated City Bank's contractual exclusivity rights. The vendor has filed counterclaims, including for declaratory relief that the contracts should be declared unenforceable. In October 2021, the vendor filed a counterclaim alleging that City Bank's attempted enforcement of its exclusivity rights contravenes the Texas Free Enterprise and Antitrust Act. The vendor purports to seek actual damages, to treble such actual damages, attorney's fees and expenses. The case remains ongoing and trial is set for October 2022. City Bank intends to continue a vigorous pursuit of its claims against the vendor. In addition, City Bank pursues a number of substantive factual and legal challenges to the vendor's counterclaims and believes the counterclaims are without merit. At this time, the ultimate outcome is unknown and an estimated range of any loss cannot be made.

The Company is a defendant in legal actions arising from time to time in the normal course of business. Management believes that the ultimate liability, if any, arising from these matters will not materially affect the CFS, based on information known as of the date the CFS were available to be issued.

*FHLB Letters of Credit* – The Company has used FHLB letters of credit to pledge to certain public deposits. The balance of the FHLB letters of credit at December 31, 2020 was $199.0 million. These letters of credit expired in July 2021 and the Company began pledging securities to these public funds rather than renewing the letters of credit. As a result, there were no FHLB letters of credit outstanding at December 31, 2021.

*Lease Commitments* – The Company leases certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled approximately $2.5 million in 2021, $2.4 million in 2020, and $2.0 million in 2019. Occupancy expense was reduced by approximately $890 thousand, $856 thousand, and $891 thousand for rental income during 2021, 2020, and 2019, respectively. Future minimum lease payments due under non-cancelable operating leases as of December 31, 2021 are as follows:

| | |
|---|---|
| 2022 | $ 1,938 |
| 2023 | 1,739 |
| 2024 | 1,325 |
| 2025 | 978 |
| 2026 | 1,030 |
| Thereafter | 5,982 |
| | $ 12,992 |

### *15. CAPITAL AND REGULATORY MATTERS*

The Company and its bank subsidiary are subject to various regulatory capital requirements administered by its banking regulators. 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 Company's and its bank subsidiary's financial statements. Under capital guidelines and the regulatory framework for prompt corrective action, the Company and its bank subsidiary must meet specific capital guidelines that involve quantitative measures of their 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. Prompt corrective action provisions are not applicable to bank holding companies.

In July 2013, the Federal Reserve published final rules for the adoption of the Basel III regulatory capital framework (Basel III). Basel III, among other things, (i) introduces a new capital measure called Common Equity Tier 1 ("CET1"), (ii) specifies that Tier 1 capital consists of CET1 and Additional Tier 1 Capital instruments meeting specified requirements, (iii) defines Common Equity Tier 1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expands the scope of the deductions/adjustments as compared to existing regulations. Basel III became effective for the Company and its bank subsidiary on January 1, 2016 with certain transition provisions fully phased-in on January 1, 2019. The Company was in compliance with the fully phased in requirements at December 31, 2021.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its bank subsidiary to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2021 and 2020, that the Company and its bank subsidiary met all capital adequacy requirements to which they are subject.

As of December 31, 2021, the bank subsidiary was well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since December 31, 2021 that management believes have changed the bank subsidiary's category.

The Company and its bank subsidiary's actual capital amounts and ratios follow:

| | Actual | | Minimum Required Under BASEL III Fully Phased-In | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **December 31, 2021:** | | | | | | |
| Total Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | $ 524,836 | 18.40% | $ 299,521 | 10.50% | N/A | N/A |
| City Bank | 425,748 | 14.93% | 299,465 | 10.50% | $ 285,205 | 10.00% |
| Tier I Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | 413,322 | 14.49% | 242,469 | 8.50% | N/A | N/A |
| City Bank | 390,015 | 13.67% | 242,424 | 8.50% | 228,164 | 8.00% |
| Common Tier 1 (CET1): | | | | | | |
| Consolidated | 368,322 | 12.91% | 199,681 | 7.00% | N/A | N/A |
| City Bank | 390,015 | 13.67% | 199,644 | 7.00% | 185,383 | 6.50% |
| Tier I Capital to Average Assets: | | | | | | |
| Consolidated | 413,322 | 10.77% | 154,592 | 4.00% | N/A | N/A |
| City Bank | 390,015 | 10.16% | 154,503 | 4.00% | 191,859 | 5.00% |
| **December 31, 2020:** | | | | | | |
| Total Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | $ 473,425 | 19.08% | $ 260,531 | 10.50% | N/A | N/A |
| City Bank | 404,138 | 16.29% | 260,481 | 10.50% | $ 248,077 | 10.00% |
| Tier I Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | 366,639 | 14.78% | 210,906 | 8.50% | N/A | N/A |
| City Bank | 372,947 | 15.03% | 210,866 | 8.50% | 198,462 | 8.00% |
| Common Tier 1 (CET1): | | | | | | |
| Consolidated | 321,639 | 12.96% | 173,688 | 7.00% | N/A | N/A |
| City Bank | 372,947 | 15.03% | 173,654 | 7.00% | 161,250 | 6.50% |
| Tier I Capital to Average Assets: | | | | | | |
| Consolidated | 366,639 | 10.24% | 144,347 | 4.00% | N/A | N/A |
| City Bank | 372,947 | 10.42% | 144,282 | 4.00% | 178,999 | 5.00% |

State banking regulations place certain restrictions on dividends paid by banks to their shareholders. Dividends paid by the Company's bank subsidiary would be prohibited if the effect thereof would cause the bank subsidiary's capital to be reduced below applicable minimum capital requirements.

## *16. DERIVATIVES*

The Company utilizes interest rate and cash flow swap agreements as part of its asset-liability management strategy to help manage its interest rate and cash flow risk position. The notional amount of the interest rate and cash flow swaps do not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amounts and the other terms of the individual interest rate and cash flow swap agreements.

The following table reflects the changes in fair value hedges included in the Consolidated Statements of Comprehensive Income as of December 31:

| Interest Rate Contracts | Location | 2021 | 2020 | 2019 |
|---|---|---|---|---|
| Change in fair value on interest rate swaps hedging fixed rate loans | Interest income | $ 498 | $ (576) | $ (520) |
| Change in fair value on fixed rate loans - hedged item | Interest income | $ (512) | $ 580 | $ 511 |

The following table reflects the fair value hedges included in the Consolidated Balance Sheets as of December 31:

| | 2021 | | 2020 | |
|---|---|---|---|---|
| | Notional Amount | Fair Value | Notional Amount | Fair Value |
| Included in other liabilities: | | | | |
| Interest rate swaps related to fixed rate loans | $ 9,775 | $ 429 | $ 10,178 | $ 927 |

The following table reflects the cash flow hedges included in the consolidated balance sheets:

| | 2021 | | 2020 | |
|---|---|---|---|---|
| | Notional Amount | Fair Value | Notional Amount | Fair Value |
| Included in other liabilities: | | | | |
| Cash flow swaps related to state and municipal securities | $ — | $ — | $ 68,485 | $ 1,643 |
| Included in other assets: | | | | |
| Cash flow swaps related to state and municipal securities | $ 123,760 | $ 5,686 | $ 55,275 | $ 1,618 |

Mortgage banking derivatives

The net gains (losses) relating to free standing derivative instruments used for risk management are summarized below as of December 31:

| | Location | 2021 | 2020 | 2019 |
|---|---|---|---|---|
| Forward contracts related to mortgage loans held for sale | Net gain (loss) on sales of loans | $ (3,473) | $ (754) | $ 672 |
| Interest rate lock commitments | Net gain (loss) on sales of loans | $ 1,681 | $ 3,409 | $ (249) |

The following table reflects the amount and fair value of mortgage banking derivatives in the Consolidated Balance Sheets as of December 31:

| | 2021 | | 2020 | |
|---|---|---|---|---|
| | Notional Amount | Fair Value | Notional Amount | Fair Value |
| Included in other assets: | | | | |
| Forward contracts related to mortgage loans held for sale | $ — | $ — | $ — | $ — |
| Interest rate lock commitments | 104,437 | 1,642 | 210,716 | 5,115 |
| Total included in other assets | $ 104,437 | $ 1,642 | $ 210,716 | $ 5,115 |
| Included in other liabilities: | | | | |
| Forward contracts related to mortgage loans held for sale | $ 93,120 | $ 106 | $ 203,669 | $ 1,787 |
| Interest rate lock commitments | — | — | — | — |
| Total included in other liabilities | $ 93,120 | $ 106 | $ 203,669 | $ 1,787 |

## *17. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION*

Condensed financial information of South Plains Financial, Inc. follows:

### *CONDENSED BALANCE SHEETS*

| | December 31, 2021 | December 31, 2020 |
|---|---|---|
| ASSETS | | |
| Cash and cash equivalents | $ 96,243 | $ 67,890 |
| Investment in banking subsidiary | 429,119 | 421,355 |
| Investment in other subsidiary | 51 | 51 |
| Other assets | 6,013 | 4,248 |
| Total assets | $ 531,426 | $ 493,544 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Debt | $ 122,168 | $ 121,982 |
| Accrued expenses and other liabilities | 1,831 | 1,514 |
| Stockholders' equity | 407,427 | 370,048 |
| Total liabilities and stockholders' equity | $ 531,426 | $ 493,544 |

### *CONDENSED STATEMENTS OF INCOME*

| | Years Ended December 31, 2021 | 2020 | 2019 |
|---|---|---|---|
| Dividends | $ 48,250 | $ 20,500 | $ 10,000 |
| Other income | 26 | 115 | 64 |
| ESOP Contribution | — | — | (1,800) |
| Interest expense | (4,936) | (3,390) | (3,562) |
| Other expense | (1,466) | (1,572) | (2,221) |
| Income before income tax and undistributed subsidiary income | 41,874 | 15,653 | 2,481 |
| Income tax (benefit) | (1,339) | (1,018) | (1,498) |
| Equity in undistributed subsidiary income | 15,401 | 28,682 | 25,241 |
| Net Income | $ 58,614 | $ 45,353 | $ 29,220 |

*CONDENSED STATEMENTS OF CASH FLOWS*

| | Years Ended December 31, 2021 | 2020 | 2019 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $ 58,614 | $ 45,353 | $ 29,220 |
| Adjustments: | | | |
| Equity in undistributed subsidiary income | (15,401) | (28,682) | (25,241) |
| Amortization of debt issuance costs | 186 | 47 | — |
| Stock based compensation | 1,639 | 1,272 | 853 |
| Change in other assets | (1,765) | (342) | (1,601) |
| Change in other liabilities | 317 | 131 | 541 |
| Net cash from operating activities | 43,590 | 17,779 | 3,772 |
| | | | |
| Cash flows from investing activities: | | | |
| Cash paid in business combination | — | — | (76,100) |
| Net cash from investing activities | — | — | (76,100) |
| | | | |
| Cash flows from financing activities: | | | |
| Proceeds from long-term borrowings | — | 49,070 | — |
| Repayments of long-term borrowings | — | — | (7,530) |
| Issuance of common stock | — | — | 51,392 |
| Payments to tax authorities for stock-based compensation | (625) | (319) | (351) |
| Payments to repurchase common stock | (9,227) | (293) | — |
| Share based liability conversion | — | — | 11,450 |
| Cash dividends on common stock | (5,385) | (2,528) | (1,079) |
| Net cash from financing activities | (15,237) | 45,930 | 53,882 |
| | | | |
| Net change in cash and cash equivalents | 28,353 | 63,709 | (18,446) |
| Beginning cash and cash equivalents | 67,890 | 4,181 | 22,627 |
| Ending cash and cash equivalents | $ 96,243 | $ 67,890 | $ 4,181 |

### *18. EARNINGS PER SHARE*

The factors used in the earnings per share computation follow:

| | December 31, 2021 | 2020 | 2019 |
|---|---|---|---|
| Net income | $ 58,614 | $ 45,353 | $ 29,220 |
| | | | |
| Weighted average common shares outstanding - basic | 17,953,624 | 18,054,373 | 16,818,697 |
| Weighted average common shares outstanding - diluted | 18,492,218 | 18,339,033 | 17,040,550 |
| | | | |
| Basic earnings per share | $ 3.26 | $ 2.51 | $ 1.74 |
| Diluted earnings per share | $ 3.17 | $ 2.47 | $ 1.71 |

### *19. SEGMENT INFORMATION*

Financial results by reportable segment are detailed below:

| | Banking | Insurance | Consolidated |
|---|---|---|---|
| 2021 | | | |
| Net interest income | $ 121,764 | $ — | $ 121,764 |
| Provision for loan loss | 1,918 | — | 1,918 |
| Noninterest income | 89,334 | 8,135 | 97,469 |
| Noninterest expense | (142,111) | (5,919) | (148,030) |
| Income before income taxes | 70,905 | 2,216 | 73,121 |
| Income tax (expense) benefit | (14,091) | (416) | (14,507) |
| Net income | $ 56,814 | $ 1,800 | $ 58,614 |
| Total assets | $ 3,890,751 | $ 11,104 | $ 3,901,855 |

| 2020 | Banking | Insurance | Consolidated |
|---|---|---|---|
| Net interest income (expense) | $ 122,285 | $ — | $ 122,285 |
| Provision for loan loss | (25,570) | — | (25,570) |
| Noninterest income | 94,010 | 7,593 | 101,603 |
| Noninterest expense | (135,985) | (5,730) | (141,715) |
| Income before income taxes | 54,740 | 1,863 | 56,603 |
| Income tax (expense) benefit | (10,804) | (446) | (11,250) |
| Net income | $ 43,936 | $ 1,417 | $ 45,353 |
| Total assets | $ 3,584,828 | $ 14,332 | $ 3,599,160 |

| 2019 | Banking | Insurance | Consolidated |
|---|---|---|---|
| Net interest income (expense) | $ 104,575 | $ — | $ 104,575 |
| Provision for loan loss | (2,799) | — | (2,799) |
| Noninterest income | 49,834 | 6,799 | 56,633 |
| Noninterest expense | (117,160) | (4,548) | (121,708) |
| Income before income taxes | 34,450 | 2,251 | 36,701 |
| Income tax (expense) benefit | (7,097) | (384) | (7,481) |
| Net income | $ 27,353 | $ 1,867 | $ 29,220 |
| Total assets | $ 3,224,396 | $ 12,771 | $ 3,237,167 |

## *20. ACCUMULATED OTHER COMPREHENSIVE INCOME*

The following table details the changes in accumulated other comprehensive income (loss) by component, net of tax:

| | Gains and (Losses) on Cash Flow Hedges | Unrealized Gains and (Losses) on Securities Available for Sale | Total |
|---|---|---|---|
| 2021 | | | |
| Beginning balance | $ (60) | $ 21,399 | $ 21,339 |
| Other comprehensive income (loss) before reclassification | 4,592 | (12,229) | (7,637) |
| Amounts reclassified from other comprehensive | — | — | — |
| Net current period other comprehensive income | 4,592 | (12,229) | (7,637) |
| Ending balance | $ 4,532 | $ 9,170 | $ 13,702 |
| 2020 | | | |
| Beginning balance | $ — | $ 958 | $ 958 |
| Other comprehensive income before reclassification | (60) | 22,272 | 22,212 |
| Amounts reclassified from other comprehensive | — | (1,831) | (1,831) |
| Net current period other comprehensive income | (60) | 20,441 | 20,381 |
| Ending balance | $ (60) | $ 21,399 | $ 21,339 |

Amounts reclassified are shown on the Consolidated Statements of Comprehensive Income.

## *21. FAIR VALUE DISCLOSURES*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

Valuation techniques that are consistent with the market approach, the income approach and/or the cost approach are required by GAAP. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset. Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy for valuation inputs 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* - Significant 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.

The following table summarizes fair value measurements as of December 31:

| | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| 2021 | | | | |
| Assets (liabilities) measured at fair value on a recurring basis: | | | | |
| Securities available for sale: | | | | |
| U.S. government and agencies | $ — | $ — | $ — | $ — |
| State and municipal | — | 275,672 | — | 275,672 |
| Mortgage-backed securities | — | 303,089 | — | 303,089 |
| Collateralized mortgage obligations | — | 106,320 | — | 106,320 |
| Asset-backed and other amortizing securities | — | 26,936 | — | 26,936 |
| Other securities | — | 12,487 | — | 12,487 |
| Loans held for sale (mandatory) | — | 47,593 | — | 47,593 |
| Mortgage servicing rights | — | — | 19,700 | 19,700 |
| Asset derivatives | — | 7,328 | — | 7,328 |
| Liability derivatives | — | (535) | — | (535) |
| | | | | |
| Assets measured at fair value on a non-recurring basis: | | | | |
| Impaired loans | — | — | 6,427 | 6,427 |
| Other real estate owned | — | — | — | — |

| | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| 2020 | | | | |
| Assets (liabilities) measured at fair value on a recurring basis: | | | | |
| Securities available for sale: | | | | |
| U.S. government and agencies | $ — | $ 4,753 | $ — | $ 4,753 |
| State and municipal | — | 272,607 | — | 272,607 |
| Mortgage-backed securities | — | 373,362 | — | 373,362 |
| Collateralized mortgage obligations | — | 106,715 | — | 106,715 |
| Asset-backed and other amortizing securities | — | 33,572 | — | 33,572 |
| Other securities | — | 12,078 | — | 12,078 |
| Loans held for sale (mandatory) | — | 80,174 | — | 80,174 |
| Mortgage servicing rights | — | — | 9,049 | 9,049 |
| Asset derivatives | — | 6,734 | — | 6,734 |
| Liability derivatives | — | (4,357) | — | (4,357) |
| | | | | |
| Assets measured at fair value on a non-recurring basis: | | | | |
| Impaired loans | — | — | 11,926 | 11,926 |
| Other real estate owned | — | — | 1,353 | 1,353 |

Securities – Fair value is calculated based on market prices of similar securities using matrix pricing. Matrix pricing is a mathematical technique commonly used to price debt securities that are not actively traded.

Loans held for sale (mandatory) – Loans held for sale originated for mandatory delivery are reported at fair value. Fair value is determined using quoted prices for similar assets, adjusted for specific attributes of that loan.

Mortgage servicing rights – Mortgage servicing rights are reported at fair value using Level 3 inputs. The mortgage servicing rights asset is valued by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair value of the mortgage servicing rights asset is impacted by a variety of factors, including prepayment and discount rates, which are significant unobservable inputs.

Derivatives – Fair value of derivatives is based on valuation models using observable market data as of the measurement date.

Impaired loans – Impaired loans are reported at the fair value of the underlying collateral, less estimated disposal costs, if repayment is expected solely from the sale of the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

Foreclosed assets – Foreclosed assets are transferred from loans at the lower of cost or fair value, less estimated costs to sell. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

Loans held for sale (best efforts) – Loans held for sale originated for best efforts delivery are reported at fair value if, on an aggregate basis, the fair value for the loans is less than cost. In determining whether the fair value of loans held for sale is less than cost when quoted market prices are not available, the Company may consider outstanding investor commitments or discounted cash flow analyses with market assumptions. Such fair values are classified within either Level 2 or Level 3 of the fair value hierarchy.

The following table presents quantitative information about recurring and non-recurring Level 3 fair value measurements at December 31:

| | Fair Value | Valuation Techniques | Unobservable Inputs | Range of Discounts |
|---|---|---|---|---|
| 2021 | | | | |
| Non-recurring: | | | | |
| Impaired loans | $ 6,427 | Third party appraisals or inspections | Collateral discounts and selling costs | 20%-100% |
| Other real estate owned | — | Third party appraisals or inspections | Collateral discounts and selling costs | 0% |
| Recurring: | | | | |
| Mortgage servicing rights | 19,700 | Discounted cash flows | Conditional prepayment rate | 12.35% |
| | | | Discount rate | 9.14% |
| 2020 | | | | |
| Non-recurring: | | | | |
| Impaired loans | $ 11,926 | Third party appraisals or inspections | Collateral discounts and selling costs | 0%-100% |
| Other real estate owned | 1,353 | Third party appraisals or inspections | Collateral discounts and selling costs | 15%-66% |
| Recurring: | | | | |
| Mortgage servicing rights | 9,049 | Discounted cash flows | Conditional prepayment rate | 18.16% |
| | | | Discount rate | 9.72% |

The following table summarizes carrying value measurements as of December 31:

| 2021 | Carrying Amount | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|---|
| Financial assets: | | | | | |
| Cash and cash equivalents | $ 486,821 | $ 486,821 | $ — | $ — | $ 486,821 |
| Loans, net | 2,395,479 | — | — | 2,397,079 | 2,397,079 |
| Accrued interest receivable | 13,900 | — | 13,900 | — | 13,900 |
| Bank-owned life insurance | 71,978 | — | 71,978 | — | 71,978 |
| Financial liabilities: | | | | | |
| Deposits | 3,341,222 | 3,004,091 | 339,797 | — | 3,343,888 |
| Accrued interest payable | 1,914 | — | 1,914 | — | 1,914 |
| Notes payable & other borrowings | — | — | — | — | — |
| Junior subordinated deferrable interest debentures | 46,393 | — | 45,690 | — | 45,690 |
| Subordinated debt securities | 75,775 | — | 77,939 | — | 77,939 |

| 2020 | Carrying Amount | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|---|
| Financial assets: | | | | | |
| Cash and cash equivalents | $ 300,307 | $ 300,307 | $ — | $ — | $ 300,307 |
| Loans, net | 2,176,030 | — | — | 2,179,573 | 2,179,573 |
| Accrued interest receivable | 15,233 | — | 15,233 | — | 15,233 |
| Bank-owned life insurance | 70,731 | — | 70,731 | — | 70,731 |
| Financial liabilities: | | | | | |
| Deposits | 2,974,351 | 2,649,830 | 329,609 | — | 2,979,439 |
| Accrued interest payable | 2,113 | — | 2,113 | — | 2,113 |
| Notes payable & other borrowings | 75,000 | — | 75,000 | — | 75,000 |
| Junior subordinated deferrable interest debentures | 46,393 | — | 45,690 | — | 45,690 |
| Subordinated debt securities | 75,589 | — | 76,889 | — | 76,889 |

### *22. BUSINESS COMBINATIONS*

In June 2020, Windmark acquired the operating assets of a crop insurance agency in Nebraska for $687 thousand. Fair value of the assets acquired in this transaction as of the closing date are as follows:

| | |
|---|---|
| Cash paid | $ 687 |
| | |
| Assets acquired: | |
| Premises and equipment, net | $ 24 |
| Customer list | 512 |
| Other intangible assets | 151 |
| Total assets acquired | $ 687 |
| Goodwill recorded in acquisition | $ — |

### *23. SUBSEQUENT EVENTS*

*Dividend Declaration*

On January 20, 2022, the Company declared a cash dividend of $0.11 per share of common stock to be paid on February 14, 2022 to all shareholders of record as of January 31, 2022.

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

## Item 9A. Controls and Procedures.

The Company's management has carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Exchange Act. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Report, the disclosure controls and procedures of the Company were effective.

There have been no significant changes in our internal control over financial reporting during the three months ended December 31, 2021 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

Report of Management on Internal Control over Financial Reporting. The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with GAAP.

Management conducted an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2021, utilizing the framework established in Internal Control – Integrated Framework 2013, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2021 was effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions and dispositions of assets and provide reasonable assurances that: (1) transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP; (2) receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the Company's financial statements are prevented or timely detected.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This Report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. As an emerging growth company, management's report was not subject to attestation by the Company's independent registered public accounting firm in accordance with the JOBS Act.

**Item 9B. Other Information.**

None.

**Item 9C. Disclosure Regarding Foreign Jurisdictions that Prevent Inspections.**

Not applicable.

# Part III

## Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this Item is incorporated herein by reference to our Definitive Proxy Statement for the 2022 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after our fiscal year end (the "Proxy Statement").

In accordance with Item 406 of Regulation S-K, we have adopted a Code of Business Conduct and Ethics that applies to Company executives, directors and employees. The Code of Business Conduct and Ethics is posted on our website at www.spfi.bank under "Governance." Within the time period required by the SEC, we will post on our website any amendment to the Code of Business Conduct and Ethics and any waiver applicable to our principal executive officer, principal financial officer, and principal accounting officer or controller.

## Item 11. Executive Compensation.

The information required by this Item is incorporated herein by reference to our Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after our fiscal year end.

## Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this Item is incorporated herein by reference to our Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after our fiscal year end.

## Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this Item is incorporated herein by reference to our Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after our fiscal year end.

## Item 14. Principal Accounting Fees and Services.

The information required by this Item is incorporated herein by reference to our Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after our fiscal year end.

## Part IV

### Item 15. Exhibits, Financial Statement Schedules.

(1) The consolidated financial statements, notes thereto and independent auditors' report thereon, filed as part hereof, are listed in Item 8.

(2) All financial statement schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

(3) Exhibits

| Exhibit No. | Description |
|---|---|
| 2.1 | Agreement and Plan of Merger by and between South Plains Financial, Inc., SPFI Merger Sub, Inc., City Bank, and West Texas State Bank, dated as of July 25, 2019, (incorporated herein by reference to Exhibit 2.1 to the Current Report on Form 8-K filed with the SEC on July 25, 2019 (File No. 38895)) (schedules to which have been omitted pursuant to Item 601(b)(2) of Regulation S-K and will be provided to the SEC upon request). |
| 3.1 | Amended and Restated Certificate of Formation of South Plains Financial, Inc. (incorporated herein by reference to Exhibit 3.1 to the Registration Statement on Form S-1 of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 3.2 | Second Amended and Restated Bylaws of South Plains Financial, Inc. (incorporated herein by reference to Exhibit 3.1 to the Current Report on Form 8-K filed with the SEC on November 1, 2021 (File No. 001-38895)). |
| 4.1 | Specimen common stock certificate of South Plains Financial, Inc. (incorporated herein by reference to Exhibit 4.1 to the Registration Statement on Form S-1 of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 4.2 | Indenture, dated September 29, 2020, by and between South Plains Financial, Inc. and UMB Bank, National Association, as trustee (incorporated herein by reference to Exhibit 4.1 to the Current Report on Form 8-K filed with the SEC on September 30, 2020 (File No. 001-38895)). |
| 4.3 | Form of Fixed to Floating Rate Subordinated Note due September 30, 2030 (included as Exhibit A-2 to the Indenture incorporated herein by reference as Exhibit 4.2 hereto). |
| 10.1 | Form of Voting Agreement, dated as of July 25, 2019, by and among South Plains Financial, Inc., West Texas State Bank and the shareholders of West Texas State Bank party thereto (incorporated herein by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on July 25, 2019 (File No. 38895)). |
| 10.2 | Form of Director Support Agreement, dated as of July 25, 2019, by and among South Plains Financial, Inc. and each non-employee director of West Texas State Bank (incorporated herein by reference to Exhibit 10.2 to the Current Report on Form 8-K filed with the SEC on July 25, 2019 (File No. 38895)). |
| 10.3† | Executive Employment Agreement, dated December 18, 2019, by and between South Plains Financial, Inc., City Bank, and Curtis C. Griffith (incorporated herein by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on December 19, 2019 (File No. 001-38895)). |
| 10.4† | Executive Employment Agreement, dated March 6, 2019, by and between South Plains Financial, Inc. and Cory T. Newsom (incorporated herein by reference to Exhibit 10.4 to the Registration Statement on Form S-1/A of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 10.5† | Amendment No. 1 to Executive Employment Agreement, dated December 15, 2021, by and among City Bank, Curtis C. Griffith and South Plains Financial, Inc. (incorporated herein by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on December 21, 2021 (File No. 001-38895)). |
| 10.6† | Amendment No. 1 to Executive Employment Agreement, dated December 15, 2021, by and among City Bank, Cory T. Newsom and South Plains Financial, Inc. (incorporated herein by reference to Exhibit 10.2 to the Current Report on Form 8-K filed with the SEC on December 21, 2021 (File No. 001-38895)). |
| 10.7† | South Plains Financial, Inc. 2019 Equity Incentive Plan (incorporated herein by reference to Exhibit 10.1 to the Registration Statement on Form S-1/A of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |

| | |
|---|---|
| 10.8† | Form of Stock Option Award Agreement under the South Plains Financial, Inc. 2019 Equity Incentive Plan (incorporated herein by reference to Exhibit 10.2 to the Registration Statement on Form S-1/A of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 10.9† | Form of Restricted Stock Unit Award Agreement under the South Plains Financial, Inc. 2019 Equity Incentive Plan (incorporated herein by reference to Exhibit 10.3 to the Registration Statement on Form S-1 of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 10.10† | Form of Indemnification Agreement (incorporated herein by reference to Exhibit 10.9 to the Registration Statement on Form S-1/A of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 10.11† | Deferred Compensation Plan Adoption Agreement of Cory T. Newsom (incorporated herein by reference to Exhibit 10.5 to the Registration Statement on Form S-1/A of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 10.12† | Joint Beneficiary Designation Agreement of Cory Newsom, effective January 1, 2008 (incorporated herein by reference to Exhibit 10.6 to the Registration Statement on Form S-1/A of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 10.13† | Joint Beneficiary Designation Agreement of Cory Newsom, effective April 1, 2014 (incorporated herein by reference to Exhibit 10.7 to the Registration Statement on Form S-1/A of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 10.14 | Board Representation Agreement between South Plains Financial, Inc. and James C. Henry (incorporated herein by reference to Exhibit 10.8 to the Registration Statement on Form S-1/A of South Plains Financial, Inc. (Registration No. 333-230851) filed April 29, 2019). |
| 10.15 | Form of Note Purchase Agreement, dated as of September 29, 2020, by and among South Plains Financial, Inc. and the Purchasers (incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the SEC on September 30, 2020 (File No. 001-38895)). |
| 10.16 | Form of Registration Rights Agreement, dated as of September 29, 2020, by and among South Plains Financial, Inc. and the Purchasers (incorporated herein by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the SEC on September 30, 2020 (File No. 001-38895)). |
| 16.1 | Letter from Weaver and Tidwell, L.L.P., dated October 26, 2021, to the U.S. Securities and Exchange Commission (incorporated herein by reference to Exhibit 16.1 of the Current Report on form 8-K filed with the SEC on October 26, 2021 (File No. 001-38895)). |
| 21.1* | Subsidiaries of South Plains Financial, Inc. |
| 23.1* | Consent of Weaver and Tidwell, LLP. |
| 31.1* | Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended. |
| 31.2* | Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended. |
| 32.1** | Section 1350 Certification of Chief Executive Officer. |
| 32.2** | Section 1350 Certification of Chief Financial Officer. |
| 101.INS* | Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document). |
| 101.SCH* | Inline XBRL Taxonomy Extension Schema Document. |
| 101.CAL* | Inline XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF* | Inline XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB* | Inline XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE* | Inline XBRL Taxonomy Extension Presentation Linkbase Document. |
| 104* | Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101). |

* Filed with this Annual Report on Form 10-K.

** Furnished with this Annual Report on Form 10-K.

† Indicates a management contract or compensatory plan.

**Item 16. Form 10-K Summary**

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized**.**

**South Plains Financial, Inc.**

Date: March 7, 2022

By: /s/ Curtis C. Griffith
Curtis C. Griffith
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

| Signature | Title | Date |
| --- | --- | --- |
| /s/ Curtis C. Griffith<br>Curtis C. Griffith | Director (Chairman); Chief Executive Officer (principal executive officer) | March 7, 2022 |
| /s/ Cory T. Newsom<br>Cory T. Newsom | Director and President | March 7, 2022 |
| /s/ Steven B. Crockett<br>Steven B. Crockett | Chief Financial Officer and Treasurer (principal financial and accounting officer) | March 7, 2022 |
| /s/ Richard D. Campbell<br>Richard D. Campbell | Director | March 7, 2022 |
| /s/ Cynthia B. Keith<br>Cynthia B. Keith | Director | March 7, 2022 |
| /s/ Noe G. Valles<br>Noe G. Valles | Director | March 7, 2022 |
| /s/ Kyle R. Wargo<br>Kyle R. Wargo | Director | March 7, 2022 |

**Exhibit 21.1**

## Subsidiaries of South Plains Financial, Inc.

| Entity Name | State of Incorporation |
|---|---|
| CB Provence, LLC | Texas |
| CBT Brushy Creek, LLC | Texas |
| CBT Properties, LLC | Texas |
| City Bank | Texas |
| Ruidoso Retail, Inc. | Texas |
| South Plains Financial Capital Trust III | Delaware |
| South Plains Financial Capital Trust IV | Delaware |
| South Plains Financial Capital Trust V | Delaware |
| Windmark Insurance Agency, Inc. | Texas |

**Exhibit 23.1**

## Consent of Independent Registered Public Accounting Firm

To the Shareholders, Board of Directors and Audit Committee
South Plains Financial, Inc.
Lubbock, Texas

We consent to the incorporation by reference in South Plains Financial, Inc.'s Registration Statement (No. 333-231667) on Form S-8 and the Registration Statement (No. 333-250021) on Form S-4/A of our report dated March 7, 2022 relating to the consolidated financial statements of South Plains Financial, Inc. appearing in this Annual Report on Form 10-K.

/s/ **Weaver and Tidwell, L.L.P.**

Fort Worth, Texas
March 7, 2022

**Exhibit 31.1**

**CERTIFICATION PURSUANT TO**
**RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,**
**AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Curtis C. Griffith, certify that:

1. I have reviewed this Annual Report on Form 10-K of South Plains Financial, Inc. (the "registrant") for the year ended December 31, 2021 (this "report");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant'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 registrant's internal control over financial reporting.

Date: March 7, 2022

By: /s/ Curtis C. Griffith
Curtis C. Griffith
Chairman and Chief Executive Officer

**Exhibit 31.2**

# CERTIFICATION PURSUANT TO
# RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
# AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Steven B. Crockett, certify that:

1. I have reviewed this Annual Report on Form 10-K of South Plains Financial, Inc. (the "registrant") for the year ended December 31, 2021 (this "report");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant'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 registrant's internal control over financial reporting.

Date: March 7, 2022

By: /s/ Steven B. Crockett

Steven B. Crockett
Chief Financial Officer

**Exhibit 32.1**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of South Plains Financial, Inc. (the “Company”) for the year ended December 31, 2021 (the “Report”), as filed with the Securities and Exchange Commission on the date hereof, I certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 7, 2022

By: /s/ Curtis C. Griffith
Curtis C. Griffith
Chairman and Chief Executive Officer

**Exhibit 32.2**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of South Plains Financial, Inc. (the “Company”) for the year ended December 31, 2021 (the “Report”), as filed with the Securities and Exchange Commission on the date hereof, I certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 7, 2022

By: /s/ Steven B. Crockett
Steven B. Crockett
Chief Financial Officer