

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

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2005

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 000-14517

**TEXAS REGIONAL BANCSHARES, INC.**

(Exact name of registrant as specified in its charter)

[www.trbsinc.com](http://www.trbsinc.com)

**Texas**

(State or other jurisdiction  
of incorporation or organization)

**74-2294235**

(I.R.S. Employer  
Identification No.)

**3900 North 10<sup>th</sup> Street, 11<sup>th</sup> Floor  
McAllen, Texas 78501**

(Address of principal executive offices) (Zip Code)

**(956) 631-5400**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

There were 49,643,618 shares of the registrant's Class A Voting Common Stock, \$1.00 par value, outstanding as of August 4, 2005.

## PART I - FINANCIAL INFORMATION

### ITEM 1. Financial Statements

Texas Regional Bancshares, Inc. and Subsidiaries  
Condensed Consolidated Balance Sheets  
(Dollars in Thousands, Except Share Data)

	June 30, 2005	December 31, 2004
	(Unaudited)	
<b>Assets</b>		
Cash and Due From Banks	\$ 141,182	\$ 145,528
Interest-Bearing Deposits at Other Banks	855	779
Total Cash and Cash Equivalents	142,037	146,307
Time Deposits	-	8
Securities Available for Sale, at Fair Value	1,741,617	1,530,503
Securities Held to Maturity, at Amortized Cost (Fair Value of \$211 in 2005 and \$215 in 2004)	210	210
Loans Held for Sale, Net of Unearned Discount of \$18 in 2005 and \$17 in 2004	23,451	28,982
Loans Held for Investment, Net of Unearned Discount of \$182 in 2005 and \$376 in 2004	3,903,850	3,750,519
Less: Allowance for Loan Losses	(48,022)	(45,024)
Net Loans Held for Investment	3,855,828	3,705,495
Premises and Equipment, Net	143,136	134,239
Accrued Interest Receivable	39,771	36,082
Other Real Estate	8,230	6,223
Goodwill	194,849	174,503
Identifiable Intangibles, Net	28,553	29,607
Other Assets	48,483	47,188
Total Assets	\$6,226,165	\$5,839,347
<b>Liabilities</b>		
<b>Deposits</b>		
Demand	\$ 916,727	\$ 866,773
Savings	214,010	211,825
Money Market Checking and Savings	1,611,010	1,440,207
Time Deposits	2,412,190	2,242,035
Total Deposits	5,153,937	4,760,840
Other Borrowed Money	405,888	461,751
Accounts Payable and Accrued Liabilities	44,716	22,698
Total Liabilities	5,604,541	5,245,289
<b>Commitments and Contingencies</b>		
<b>Shareholders' Equity</b>		
Preferred Stock; \$1.00 Par Value, 10,000,000 Shares Authorized; None Issued and Outstanding	-	-
Common Stock – Class A; \$1.00 Par Value, Authorized 100,000,000 in 2005 and 50,000,000 Shares in 2004; Issued 49,645,560 Shares in 2005 and 49,574,900 Shares in 2004	Shares 49,646	49,575
Paid-In Capital	402,786	401,414
Retained Earnings	180,820	146,020
Accumulated Other Comprehensive Loss, Net of Tax	(10,889)	(2,212)
Treasury Stock; 21,780 Shares in 2005 and 2004, at Cost	(739)	(739)
Total Shareholders' Equity	621,624	594,058
Total Liabilities and Shareholders' Equity	\$6,226,165	\$5,839,347

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

Texas Regional Bancshares, Inc. and Subsidiaries Condensed Consolidated Statements of Income and Comprehensive Income (Loss) (Dollars in Thousands, Except Per Share Data)	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2005	2004	2005	2004
	(Unaudited)			
Interest Income				
Loans Held for Sale	\$ 778	\$ 352	\$ 1,423	\$ 611
Loans Held for Investment, Including Fees	70,001	54,669	136,062	99,184
Securities				
Taxable	14,276	11,426	27,205	22,635
Tax-Exempt	1,183	1,147	2,393	2,068
Interest-Bearing and Time Deposits	3	26	34	43
Federal Funds Sold	75	11	175	28
<b>Total Interest Income</b>	<b>86,316</b>	<b>67,631</b>	<b>167,292</b>	<b>124,569</b>
Interest Expense				
Deposits	24,280	14,185	44,518	26,623
Federal Funds Purchased and Securities				
Sold Under Repurchase Agreements	580	473	1,148	1,048
Federal Home Loan Bank Advances	1,866	399	3,310	682
Other Borrowed Money	1,115	840	2,161	1,378
<b>Total Interest Expense</b>	<b>27,841</b>	<b>15,897</b>	<b>51,137</b>	<b>29,731</b>
Net Interest Income Before Provision for Loan Losses	58,475	51,734	116,155	94,838
Provision for Loan Losses	5,801	4,693	11,208	8,617
<b>Net Interest Income After Provision for Loan Losses</b>	<b>52,674</b>	<b>47,041</b>	<b>104,947</b>	<b>86,221</b>
Noninterest Income				
Service Charges on Deposit Accounts	9,641	10,264	18,781	17,562
Other Service Charges	2,704	2,182	5,654	4,210
Insurance Commissions, Fees and Premiums, Net	980	1,077	1,978	1,373
Trust Fees	1,904	1,444	3,744	2,171
Net Realized Gains on Sales of Securities				
Available for Sale	323	1,383	321	1,882
Data Processing Service Fees	2,148	2,128	4,772	4,250
Loan Servicing Income (Loss), Net	3	(279)	156	(461)
Other Noninterest Income	2,738	745	9,696	1,352
<b>Total Noninterest Income</b>	<b>20,441</b>	<b>18,944</b>	<b>45,102</b>	<b>32,339</b>
Noninterest Expense				
Salaries and Employee Benefits	19,609	19,428	42,326	33,205
Net Occupancy Expense	3,747	3,299	7,161	5,472
Equipment Expense	3,610	3,234	6,933	5,961
Other Real Estate Expense, Net	418	572	647	693
Amortization of Identifiable Intangibles	1,652	1,602	3,493	2,400
Other Noninterest Expense, Net	10,036	10,234	19,534	17,421
<b>Total Noninterest Expense</b>	<b>39,072</b>	<b>38,369</b>	<b>80,094</b>	<b>65,152</b>
Income Before Income Tax Expense	34,043	27,616	69,955	53,408
Income Tax Expense	12,129	8,784	24,242	17,419
<b>Net Income</b>	<b>21,914</b>	<b>18,832</b>	<b>45,713</b>	<b>35,989</b>
Other Comprehensive Income (Loss), Net of Tax				
Net Unrealized Gains (Losses) on Securities Available for Sale				
Net Unrealized Holding Gains (Losses) Arising During Period	4,288	(28,596)	(8,468)	(20,004)
Less: Reclassification Adjustment for Net Realized Gains				
Included in Net Income	210	899	209	1,223
<b>Total Other Comprehensive Income (Loss)</b>	<b>4,078</b>	<b>(29,495)</b>	<b>(8,677)</b>	<b>(21,227)</b>
<b>Comprehensive Income (Loss)</b>	<b>\$ 25,992</b>	<b>\$ (10,663)</b>	<b>\$ 37,036</b>	<b>\$ 14,762</b>
Earnings Per Common Share				
Basic	\$ 0.44	\$ 0.39	\$ 0.92	\$ 0.76
Diluted	0.44	0.38	0.92	0.76

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

Texas Regional Bancshares, Inc. and Subsidiaries Condensed Consolidated Statements of Changes in Shareholders' Equity (Dollars in Thousands)	Common		Retained Earnings	Accumulated Other	Treasury Stock	Total Shareholders' Equity
	Stock - Class A	Paid-In Capital		Comprehensive Income (Loss)		
(Unaudited)						
Six Months Ended June 30, 2005						
Balance, December 31, 2004	\$49,575	\$401,414	\$146,020	\$ (2,212)	\$(739)	\$594,058
Net Income	-	-	45,713	-	-	45,713
Net Change in Unrealized Gains and Losses on Securities Available for Sale, Net of Tax and Reclassification Adjustment	-	-	-	(8,677)	-	(8,677)
<b>Total Comprehensive Income</b>	<b>-</b>	<b>-</b>	<b>45,713</b>	<b>(8,677)</b>	<b>-</b>	<b>37,036</b>
Exercise of Stock Options, 70,660 Shares of Class A Common Stock	71	1,098	-	-	-	1,169
Tax Effect of Nonqualified Stock Options Exercised and Disqualifying Dispositions on Qualified Stock Options	-	274	-	-	-	274
Class A Common Stock Cash Dividends	-	-	(10,913)	-	-	(10,913)
<b>Balance, June 30, 2005</b>	<b>\$49,646</b>	<b>\$402,786</b>	<b>\$180,820</b>	<b>\$(10,889)</b>	<b>\$(739)</b>	<b>\$621,624</b>
Six Months Ended June 30, 2004						
Balance, December 31, 2003	\$29,471	\$278,131	\$103,773	\$ 10,356	\$ -	\$421,731
Net Income	-	-	35,989	-	-	35,989
Net Change in Unrealized Gains and Losses on Securities Available for Sale, Net of Tax and Reclassification Adjustment	-	-	-	(21,227)	-	(21,227)
<b>Total Comprehensive Income</b>	<b>-</b>	<b>-</b>	<b>35,989</b>	<b>(21,227)</b>	<b>-</b>	<b>14,762</b>
Exercise of Stock Options, 40,416 Shares of Class A Common Stock	40	921	-	-	-	961
Tax Effect of Nonqualified Stock Options Exercised and Disqualifying Dispositions on Qualified Stock Options	-	157	-	-	-	157
Issuance of Common Stock	3,073	107,001	-	-	-	110,074
Class A Common Stock Cash Dividends	-	-	(8,184)	-	-	(8,184)
<b>Balance, June 30, 2004</b>	<b>\$32,584</b>	<b>\$386,210</b>	<b>\$131,578</b>	<b>\$(10,871)</b>	<b>\$ -</b>	<b>\$539,501</b>

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

Texas Regional Bancshares, Inc. and Subsidiaries  
Condensed Consolidated Statements of Cash Flows  
(Dollars in Thousands)

Six Months  
Ended June 30,  
2005      2004  
(Unaudited)

Cash Flows from Operating Activities		
Net Income	\$ 45,713	\$ 35,989
Adjustments to Reconcile Net Income to		
Net Cash Provided by Operating Activities		
Depreciation, Amortization and Accretion	14,447	13,994
Provision for Loan Losses	11,208	8,617
Provision for Estimated Losses on Other Real Estate and Other Assets	119	712
Increase (Decrease) in Valuation Allowance for Mortgage Servicing Rights	(142)	90
Net Realized Gains on Sale of Securities Available for Sale	(321)	(1,882)
Gain on Sale of Other Assets	(5)	(72)
Loss on Sale of Other Real Estate	92	1
(Gain) Loss on Disposal of Premises and Equipment	(28)	9
Gain on Sale of Loans Held for Sale	(1,064)	(80)
Gain on Sale of Mortgage Servicing Rights	(899)	-
Net Decrease in Loans Held for Sale	6,595	9,585
Deferred Tax Benefit	(2,483)	(1,391)
Increase in Accrued Interest Receivable and Other Assets	(728)	(6,895)
Increase in Accounts Payable and Accrued Liabilities	4,735	1,695
<b>Net Cash Provided by Operating Activities</b>	<b>77,239</b>	<b>60,372</b>
Cash Flows from Investing Activities		
Net Decrease in Time Deposits at Other Banks	8	188
Proceeds from Sales of Securities Available for Sale	116,350	299,414
Proceeds from Maturing Securities Available for Sale	101,349	81,227
Purchases of Securities Available for Sale	(427,071)	(356,954)
Loan Originations and Advances, Net	(53,178)	(239,806)
Recoveries of Charged-Off Loans	1,465	1,346
Proceeds from Sale of Premises and Equipment	30	349
Purchases of Premises and Equipment	(10,510)	(11,732)
Proceeds from Sale of Other Real Estate	3,607	3,308
Proceeds from Sale of Other Assets	987	936
Net Cash Provided by Merger	20,407	71,875
<b>Net Cash Used in Investing Activities</b>	<b>(246,556)</b>	<b>(149,849)</b>
Cash Flows from Financing Activities		
Net Increase in Demand Deposits, Savings, Money		
Market Checking and Savings Accounts	84,174	54,188
Net Increase in Time Deposits	135,480	69,175
Net Increase (Decrease) in Other Borrowed Money	(45,863)	7,438
Cash Dividends Paid on Class A Common Stock	(9,913)	(7,648)
Proceeds from Sale of Common Stock	1,169	961
<b>Net Cash Provided by Financing Activities</b>	<b>165,047</b>	<b>124,114</b>
Increase (Decrease) in Cash and Cash Equivalents	(4,270)	34,637
Cash and Cash Equivalents at Beginning of Period	146,307	100,723
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$142,037</b>	<b>\$135,360</b>

(Continued)

Texas Regional Bancshares, Inc. and Subsidiaries  
Condensed Consolidated Statements of Cash Flows  
(Dollars in Thousands)

Six Months  
Ended June 30,  


---

2005      2004  


---

(Unaudited)

Supplemental Disclosures of Cash Flow Information:

Interest Paid	\$ 47,884	\$ 28,760
Income Taxes Paid	22,955	21,403

Supplemental Schedule of Noncash Investing and Financing Activities:

Foreclosure and Repossession in Partial Satisfaction of Loans Receivable	8,946	1,946
Financing Provided for Sales of Other Real Estate	2,169	1,264
Increase in Securities Purchased But Not Settled	17,736	-
Increase in Other Real Estate Sold But Not Settled	53	-
Net Increase in Dividends Payable	1,000	536

The Company acquired Mercantile Bank & Trust, FSB, on January 14, 2005.

Assets acquired and liabilities assumed are as follows:

Fair Value of Assets Acquired, Including Goodwill, Net of Cash and Cash Equivalents Received	144,464	-
Net Cash and Cash Equivalents Received	20,430	-
Fair Value of Liabilities Assumed	164,894	-

The Company acquired Southeast Texas Bancshares, Inc. and its subsidiary,  
Community Bank and Trust, SSB, on March 12, 2004. Assets acquired and  
liabilities assumed are as follows:

Fair Value of Assets Acquired Including Goodwill, Net of Cash and Cash Equivalents Received	-	1,020,963
Net Cash and Cash Equivalents Received	-	71,875
Fair Value of Liabilities Assumed	-	982,764
Fair Value of Stock Issued	-	110,074

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

**TEXAS REGIONAL BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1: BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all information and notes necessary for a complete presentation of financial position, results of operations, changes in shareholders' equity, and cash flows in conformity with U.S. generally accepted accounting principles. However, the condensed consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation. All such adjustments were of a normal and recurring nature. The results of operations and cash flows for the six months ended June 30, 2005 should not be considered indicative of the results to be expected for the full year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Texas Regional Bancshares, Inc. and Subsidiaries ("Texas Regional" or the "Company") Annual Report on Form 10-K for the year ended December 31, 2004.

The condensed consolidated financial statements include the accounts of Texas Regional Bancshares, Inc. (the "Parent") and its wholly-owned subsidiaries, Texas Regional Delaware, Inc., Texas State Bank (the "Bank"), Southeast Texas Insurance Services, L.P., operating under the name Community Insurance, Port Arthur Abstract and Title Company, Southeast Texas Title Company, TSB Securities, Inc., TSB Properties, Inc., Hydrox Holdings, Inc. and Valley Mortgage Company, Inc. ("Valley Mortgage"). The Company eliminates all significant intercompany transactions and balances in consolidation. The Company accounts for its investments in subsidiaries on the equity method in the Parent's financial statements.

**NEW ACCOUNTING PRONOUNCEMENTS**

In December 2003, the American Institute of Certified Public Accountants issued Statement of Position 03-3 ("SOP 03-3"), "Accounting for Certain Loans or Debt Securities Acquired in a Transfer". SOP 03-3 provides guidance on the accounting for differences between contractual and expected cash flows from the purchaser's initial investment in loans or debt securities acquired in a transfer, if those differences are attributable, at least in part, to credit quality. Among other things, SOP 03-3: (1) prohibits the recognition of the excess of contractual cash flows over expected cash flows as an adjustment of yield, loss accrual, or valuation allowance at the time of purchase; (2) requires that subsequent increases in expected cash flows be recognized prospectively through an adjustment of yield; and (3) requires the subsequent decreases in expected cash flows be recognized as an impairment. In addition, SOP 03-3 prohibits the creation or carrying over of a valuation allowance in the initial accounting of all loans within its scope that are acquired in a transfer. SOP 03-3 becomes effective for loans or debt securities acquired in fiscal years beginning after December 15, 2004. The Company does not expect the requirements of SOP 03-3 to have a material impact on its condensed consolidated financial statements.

In March 2004, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 105 ("SAB 105"), "Application of Accounting Principles to Loan Commitments". SAB 105 summarizes the view of the staff regarding the application of generally accepted accounting principles to loan commitments accounted for as derivative instruments including recognition of the loan commitment and financial statement disclosures. The requirements of SAB 105 did not have a material impact on the Company's condensed consolidated financial statements.

In December 2004, the Financial Accounting Standards Board issued Statement No. 123 (revised 2004) ("Statement 123R") "Share-Based Payment", a revision of Statement No. 123 ("Statement 123"), "Accounting for Stock-Based Compensation". This statement supersedes Accounting Principles Board Opinion No. 25 ("Opinion 25"), "Accounting for Stock Issued to Employees". Statement 123R eliminates an entity's ability to report employee stock options under the methods prescribed by Opinion 25. Statement 123R establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods or services or incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. This statement requires entities to recognize the cost of employee services received in exchange for an award of equity instruments, based on the grant-date fair value of the awards. In April 2005, the Securities and Exchange Commission amended the required effective date of Statement 123R. Statement 123R will be effective as of the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005.

Statement 123R provides alternative methods of adoption which include using either a "modified prospective application" or a "modified retrospective application". The "modified prospective application" requires the recognition of compensation cost, beginning with the effective date, for all awards granted after the adoption date based on the requirements of Statement 123R and for all unvested awards granted prior to the adoption date of Statement 123R, based on the requirements of Statement 123. The "modified retrospective application" includes the requirements of the "modified prospective application", but also permits the restatement of financial statements of previous periods based on amounts previously disclosed in accordance with Statement 123. The Company is currently evaluating the adoption alternatives. Based on stock options granted to employees through June 30, 2005, for which service is not expected to be fully rendered prior to January 1, 2006, the Company expects to recognize

additional pre-tax compensation costs of approximately \$1,677,000 during 2006 as a result of the adoption of Statement 123R effective January 1, 2006. Future levels of compensation cost related to stock-based compensation awards will be impacted by new stock option awards by the Company occurring before and after the adoption of Statement 123R.

In May 2005, the Financial Accounting Standards Board issued Statement No. 154 ("Statement 154"), "Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3". This statement replaces Accounting Principles Board Opinion No. 20 ("Opinion 20"), "Accounting Changes" and Financial Accounting Standards Board Statement No. 3 ("Statement 3"), "Reporting Accounting Changes in Interim Financial Statements – an amendment of APB Opinion No. 28", and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement that does not include specific transition provisions. Opinion 20 required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. Statement 154 will require companies to recognize a change in accounting principle by applying that change retrospectively to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. Statement 154 also makes a distinction between "retrospective application" of an accounting principle and the "restatement" of financial statements to reflect the correction of an error. Statement 154 also requires that a change in depreciation, amortization or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. Statement 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company will assess the impact of a retrospective application of a change in accounting principle in accordance with Statement 154 should such a change arise after the effective date.

#### STOCK BASED EMPLOYEE COMPENSATION

The Company has accounted for its stock-based compensation plans in accordance with the intrinsic value provisions of Accounting Principles Board Opinion No. 25 ("Opinion 25"), "Accounting for Stock Issued to Employees". As indicated above, the Company has adopted Statement 123R, which supersedes Opinion 25, beginning January 1, 2006. Under Opinion 25, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. All outstanding options have been granted at fair market value at date of grant; therefore, the Company did not record any compensation expense in the condensed consolidated financial statements for its stock-based compensation plans. In accordance with Statement 148, the following table illustrates the effect on net income and earnings per common share had compensation expense been recognized consistent with the fair value provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (dollars in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
	(Unaudited)			
Net Income, As Reported	\$21,914	\$18,832	\$45,713	\$35,989
Deduct: Total Stock-Based Employee Compensation Expense Determined Under Fair Value Based Method For All Awards, Net of Related Tax Effect	(1,092)	(971)	(1,516)	(1,171)
Pro Forma Net Income	\$20,822	\$17,861	\$44,197	\$34,818
Earnings Per Common Share:				
Basic – As Reported	\$ 0.44	\$ 0.39	\$ 0.92	\$ 0.76
Basic – Pro Forma	0.42	0.37	0.89	0.74
Diluted – As Reported	0.44	0.38	0.92	0.76
Diluted – Pro Forma	0.42	0.36	0.89	0.73

#### NOTE 2: IMPAIRED LOANS

Loans that the Company does not expect to collect the full principal and interest based on the terms of the original loan agreement are identified as impaired loans. These include loans that are on nonaccrual status or are considered troubled debt restructurings due to the granting of a below-market rate of interest or a partial forgiveness of indebtedness on an existing loan. The balance of impaired loans was \$47,484,000 at June 30, 2005 for which there was a related allowance for loan losses of \$9,984,000. At June 30, 2005, the balance of impaired loans included \$320,000 for which there was no related allowance for loan losses. The average recorded investment in impaired loans during the six months ended June 30, 2005 was \$33,674,000. Interest income on impaired loans of \$217,000 for cash payments received on nonaccrual loans was recognized during the six months ended June 30, 2005.

### NOTE 3: JUNIOR SUBORDINATED DEBENTURES

As of June 30, 2005, the Riverway Holdings Capital Trust I, Riverway Holdings Capital Trust II and the Texas Regional Statutory Trust I (the "Trusts"), all wholly-owned unconsolidated subsidiaries of Texas Regional Delaware, Inc., had the following trust preferred securities outstanding and the Company had the following issues of junior subordinated debentures, all held by the Trusts, outstanding (dollars in thousands):

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate	Junior Subordinated Debt Owed To Trust	Final Maturity Date
Riverway Holdings Capital Trust I	March 28, 2001	\$10,000	10.18% Fixed	\$10,310	June 8, 2031
Riverway Holdings Capital Trust II	July 16, 2001	5,000	6-month LIBOR plus 3.75%	5,155	July 25, 2031
Texas Regional Statutory Trust I	February 24, 2004	50,000	3-month LIBOR plus 2.85%	51,547	March 17, 2034

The Company owns all of the common stock of the three business trusts, which have issued trust preferred securities in conjunction with the Company and an acquired company issuing junior subordinated debentures to the Trusts. The terms of the junior subordinated debentures are substantially the same as the terms of the trust preferred securities. The Company's obligations under the debentures constitute a full and unconditional guarantee by the Company of the obligations of the Trusts. The junior subordinated debentures issued to the Trusts are included as other borrowed money in the condensed consolidated balance sheets.

On March 1, 2005, the Federal Reserve Board issued a final rule that allows the continued limited inclusion of trust preferred securities in the Tier 1 capital of bank holding companies. Under the rule, trust preferred securities and other restricted core capital elements will be subject to stricter quantitative limits. The final rule provides a five-year transition period ending March 31, 2009, for application of the quantitative limits. Because the Company's trust preferred securities are within the quantitative limits, the trust preferred securities are expected to be fully included in Tier 1 Capital under the Federal Reserve's final rule.

### NOTE 4: COMMON STOCK

On March 8, 2005, the Board of Directors approved a cash dividend of \$0.10 per share for shareholders of record on April 1, 2005 and payable on April 15, 2005. In addition, on June 14, 2005, the Board of Directors approved a cash dividend of \$0.12 per share for shareholders of record on July 1, 2005 and payable on July 15, 2005.

### NOTE 5: EARNINGS PER COMMON SHARE COMPUTATIONS

The table below presents a reconciliation of basic and diluted earnings per common share computations ("EPS") (dollars in thousands, except share data). The number of shares outstanding and the related earnings per common share amounts for 2004 have been restated to retroactively give effect to the three-for-two stock split effected as a 50 percent stock dividend declared and distributed during August 2004.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
	(Unaudited)			
Net Income	\$ 21,914	\$ 18,832	\$ 45,713	\$ 35,989
Weighted Average Number of Common Shares Outstanding				
Used in Basic EPS Calculation	49,606,250	48,859,639	49,588,453	47,048,190
Add Assumed Exercise of Dilutive Securities				
Outstanding Stock Options	248,533	317,946	235,547	280,027
Riverway Holdback Shares	-	247,500	-	247,500
Weighted Average Number of Common Shares Outstanding Used in Diluted EPS Calculation	49,854,783	49,425,085	49,824,000	47,575,717
Basic EPS	\$ 0.44	\$ 0.39	\$ 0.92	\$ 0.76
Diluted EPS	0.44	0.38	0.92	0.76

#### NOTE 6: RECENT ACQUISITION

On January 14, 2005, the Company completed the acquisition through merger of Mercantile Bank & Trust, FSB ("Mercantile"). Mercantile was a privately held Federal savings bank headquartered in Dallas, Texas, with two additional banking locations in the Dallas metropolitan area. The shareholders of Mercantile received \$35,640,000 in cash in exchange for all the outstanding shares of Mercantile. Mercantile had total assets of \$213.8 million, loans held for investment of \$118.1 million, deposits of \$197.5 million and equity of \$14.7 million. The transaction was accounted for under the purchase method of accounting; therefore, the results of operations are included in the condensed consolidated financial statements from the date of acquisition, January 14, 2005. The proforma effect and the financial results of Mercantile included in the results of operations subsequent to the date of acquisition were not material to the Company's financial condition or the operating results for the periods presented. Mercantile was merged with and into the Bank.

#### NOTE 7: RECLASSIFICATIONS

Certain amounts in the prior periods' presentation have been reclassified to conform to the current presentation. These reclassifications have no effect on previously reported net income.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*Forward-Looking Statements.* This Management's Discussion and Analysis and other information in this Quarterly Report on Form 10-Q include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the "safe harbor" created by these sections. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the following factors: significant increases in competitive pressure in the banking industry; changes in the interest rate environment reducing margins; general economic conditions, either nationally or regionally, becoming less favorable than expected, resulting in, among other things, a deterioration in credit quality and an increase in the provision for possible loan losses; changes in the regulatory environment; changes in business conditions; volatility of rate sensitive deposits; operational risks including data processing system failures or fraud; asset/liability matching risks and liquidity risks; and changes in the securities markets. Because of these uncertainties, actual future results may be materially different from the results indicated by these forward-looking statements. The Company assumes no obligation and does not intend to update these forward-looking statements. In addition, the Company's past results do not necessarily indicate its future results.

Management's discussion and analysis of the Company's condensed consolidated financial condition and results of operations at the dates and for the periods indicated follows. This discussion should be read in conjunction with the Company's condensed consolidated financial statements and the accompanying notes.

### GENERAL

Texas Regional Bancshares, Inc. is a Texas business corporation incorporated in 1983 and headquartered in McAllen, Texas. The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956 and as such is registered with the Board of Governors of the Federal Reserve System ("Federal Reserve Board"). Texas Regional Delaware, Inc. ("Texas Regional Delaware"), incorporated under the laws of Delaware as a wholly-owned second tier bank holding company subsidiary, owns Texas State Bank (the "Bank"), the Company's primary operating subsidiary. As a result of the acquisition of Southeast Texas Bancshares, Inc. ("Southeast Texas") in March 2004, Texas Regional Delaware is now the owner, directly or indirectly, of all of the ownership interests in (i) Southeast Texas Insurance Services, L.P., which operates under the name of Community Insurance and offers general lines of insurance and (ii) Port Arthur Abstract and Title Company and its wholly-owned subsidiary, Southeast Texas Title Company, which offer title insurance agency services. The Bank has four active wholly-owned subsidiaries: (i) TSB Securities, Inc., incorporated in 1997 to provide full service broker-dealer services, (ii) TSB Properties, Inc., incorporated in 1998 primarily to receive and liquidate foreclosed assets, (iii) Hydrox Holdings, Inc., a subsidiary formed by an acquired institution to own and operate certain real estate properties and (iv) Valley Mortgage Company, Inc., a corporation acquired in November 2004 which operates a mortgage banking business in Texas.

By authority of the Board of Directors of the Company, Texas Regional in May 2000 filed a Declaration Electing to be a Financial Holding Company with the Federal Reserve Bank of Dallas. The Declaration became effective in June 2000.

Texas State Bank operates seventy-one banking offices. Thirty-one banking locations are located in the Rio Grande Valley including four banking locations in McAllen (including its main office), four banking locations in Brownsville, four banking locations in Harlingen, three banking locations in Mission, three banking locations in Weslaco, two banking locations in Edinburg, two banking locations in San Juan, and one banking location each in Hidalgo, La Feria, Mercedes, Palm Valley, Peñitas, Progreso, Raymondville, Rio Grande City, and Roma. In addition, Texas State Bank operates one banking location each

in Bishop, Corpus Christi, Eagle Pass and Sugar Land, two banking locations in Houston and three banking locations in Dallas. Thirty-one banking locations are located in the East Texas area including seven banking locations in Beaumont, five banking locations in Port Arthur, two banking locations in Orange, two banking locations in Jasper, two banking locations in Lumberton, two banking locations in Silsbee, and one banking location each in Kountze, Port Neches, Sour Lake, Vidor, Tyler, Broadus, Buna, Colmesneil, Kirbyville, San Augustine and Woodville. At June 30, 2005, Texas Regional had consolidated total assets of \$6,226,165,000, loans held for investment (net of unearned discount) of \$3,903,850,000, deposits of \$5,153,937,000 and shareholders' equity of \$621,624,000.

The Bank provides data processing services to correspondent banks. The Bank's data processing center serves banks both in North Texas and the Rio Grande Valley, in addition to providing data processing services for all of the Bank's banking locations.

## **CRITICAL ACCOUNTING POLICIES**

*Allowance for Loan Losses.* The Company considers its Allowance for Loan Losses and related provision for loan losses policy as a policy critical to the sound operations of the Bank. The Company provides for loan losses each period by an amount resulting from both (a) an estimate by management of probable loan losses that occurred during the period and (b) the ongoing adjustment of prior estimates of probable losses occurring in prior periods. The provision for loan losses increases the allowance for loan losses, which is netted against loans held for investment on the condensed consolidated balance sheets. As losses are confirmed, the loan is written down, reducing the allowance for loan losses. See "Allowance for Loan Losses - Critical Accounting Policy" and "Provision for Loan Losses" for further information regarding the Company's provision and allowance for loan losses policy.

*Mortgage Servicing Rights.* The Company also considers the accounting estimates used in evaluating the carrying value of the mortgage servicing rights to be critical. The Company evaluates the carrying value of the mortgage servicing rights for impairment based upon the fair value of those rights. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates, terms and type (fixed or adjustable). Fair value of mortgage servicing rights is determined by discounting the present value of the estimated future net servicing revenues using a discount rate commensurate with the risks involved based on management's best estimate of remaining loan lives. This method of valuation incorporates assumptions that market participants would use in their estimate of future servicing income and expense, including assumptions about prepayments, defaults and interest rates. At June 30, 2005, the fair value was based on the present value of future cash flows using prepayment rates ranging from 85% to 400% of standard Public Securities Association prepayment rates, discount rates ranging from 8% to 20% and weighted average lives ranging from 2 to 10 years.

## **FINANCIAL CONDITION**

### **CASH AND CASH EQUIVALENTS**

The Company offers a broad range of commercial banking services to individuals and businesses in its service area. It also acts as a correspondent to a number of banks in its service area, providing check clearing, loan participations and other correspondent services. The amount of cash and cash equivalents held on any day is significantly influenced by temporary changes in cash items in process of collection. The Company had cash and cash equivalents totaling \$142,037,000 at June 30, 2005. By comparison, the Company had \$146,307,000 in cash and cash equivalents at December 31, 2004, a decrease of \$4,270,000 or 2.9%.

### **SECURITIES**

Securities consist of U.S. Treasury, U.S. Government Agency, mortgage-backed and state, county and municipal securities. The Bank classifies debt and equity securities into one of three categories: held to maturity, trading or available for sale. At each reporting date, management reassesses the appropriateness of the classification. Investments in debt securities are classified as held to maturity and measured at amortized cost in the condensed consolidated balance sheets only if management has the positive intent and ability to hold those securities to maturity. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and measured at fair value in the condensed consolidated balance sheets with unrealized holding gains and losses included in earnings. Securities not classified as either held to maturity or trading are classified as available for sale and measured at fair value in the condensed consolidated balance sheets with unrealized holding gains and losses reported in accumulated other comprehensive income (loss), net of applicable income taxes, until realized.

At June 30, 2005 and December 31, 2004, no securities were classified as trading. The Company does not currently engage in trading activities or use derivative instruments to control interest rate risk. Even though such activities may be permitted with the approval of the Board of Directors, the Company does not intend to engage in such activities in the immediate future.

The following table presents the amortized cost and estimated fair value of securities at June 30, 2005 and December 31, 2004 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Securities Available for Sale</b>				
June 30, 2005 (Unaudited)				
U.S. Treasury	\$ 6,067	\$ -	\$ (104)	\$ 5,963
U.S. Government Agency	833,278	1,318	(11,122)	823,474
Mortgage-Backed	706,837	188	(7,921)	699,104
States and Political Subdivisions	167,550	1,946	(1,141)	168,355
Other	44,819	23	(121)	44,721
<b>Total</b>	<b>\$1,758,551</b>	<b>\$3,475</b>	<b>\$(20,409)</b>	<b>\$1,741,617</b>
December 31, 2004				
U.S. Treasury	\$ 6,110	\$ -	\$ (65)	\$ 6,045
U.S. Government Agency	789,514	2,837	(6,508)	785,843
Mortgage-Backed	547,505	1,593	(3,788)	545,310
States and Political Subdivisions	149,073	2,967	(583)	151,457
Other	41,780	79	(11)	41,848
<b>Total</b>	<b>\$1,533,982</b>	<b>\$7,476</b>	<b>\$(10,955)</b>	<b>\$1,530,503</b>
<b>Securities Held to Maturity</b>				
June 30, 2005 (Unaudited)				
States and Political Subdivisions	\$ 210	\$ 1	\$ -	\$ 211
<b>Total</b>	<b>\$ 210</b>	<b>\$ 1</b>	<b>\$ -</b>	<b>\$ 211</b>
December 31, 2004				
States and Political Subdivisions	\$ 210	\$ 5	\$ -	\$ 215
<b>Total</b>	<b>\$ 210</b>	<b>\$ 5</b>	<b>\$ -</b>	<b>\$ 215</b>

Net unrealized holding losses on securities available for sale, net of related tax effect, of \$10,889,000 and \$2,212,000 at June 30, 2005 and December 31, 2004, respectively, were reported in a separate component of shareholders' equity as accumulated other comprehensive loss, net of tax.

A summary of securities available for sale, which were in an unrealized loss position at June 30, 2005, is provided below. The Company has both the ability and intent to hold these securities for the time period necessary to recover the costs. In addition, the Company believes the decrease in value is attributable to changes in market interest rates and not credit quality of the issuer.

(Dollars in Thousands)	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
	(Unaudited)					
U.S. Treasury	\$ 697	\$ (2)	\$ 5,266	\$ (102)	\$ 5,963	\$ (104)
U.S. Government Agency	462,237	(4,681)	288,738	(6,441)	750,975	(11,122)
Mortgage-Backed	350,531	(3,255)	196,300	(4,666)	546,831	(7,921)
States and Political Subdivisions	26,663	(273)	45,298	(868)	71,961	(1,141)
Other	1,067	(108)	319	(13)	1,386	(121)
<b>Total Temporarily Impaired Securities</b>	<b>\$841,195</b>	<b>\$(8,319)</b>	<b>\$535,921</b>	<b>\$(12,090)</b>	<b>\$1,377,116</b>	<b>\$(20,409)</b>

Securities available for sale and securities held to maturity with carrying values of \$1,359,891,000 and \$210,000, respectively, at June 30, 2005 and \$1,416,232,000 and \$210,000, respectively, at December 31, 2004 were pledged to secure public funds, trust assets on deposit and for other purposes required or permitted by law.

#### LOANS HELD FOR SALE

Loans held for sale of \$23,451,000 at June 30, 2005 decreased \$5,531,000 or 19.1% compared to the December 31, 2004 balance of \$28,982,000. The decrease in loans held for sale for the six months ended June 30, 2005 resulted primarily from a decrease in loan volume due to rising interest rates.

## LOANS HELD FOR INVESTMENT

The Company manages its credit risk by establishing and implementing strategies and guidelines appropriate to the characteristics of borrowers, industries, geographic locations and risk products. Diversification of risk within each of these areas is a primary objective. The objectives of the Company's policies and procedures is to ensure that loan commitments conform to current strategies and guidelines. Management continually refines the Company's credit policies and procedures to address the risks in the current and prospective environment and to reflect management's current strategic focus. The credit process is controlled with continuous credit review and analysis, and review by internal and external auditors and regulatory authorities. The Company's loans are widely diversified by borrower and industry group. The Company does not have any single loan relationship that it considers material to the overall portfolio.

The Company has collateral management policies in place so that collateral lending of all types is approached on a basis consistent with safe and sound standards. Valuation analysis is utilized to take into consideration the potentially adverse economic conditions under which liquidation could occur. Collateral accepted against the commercial loan portfolio includes accounts receivable and inventory, marketable securities, equipment, agricultural products and real estate. Autos, real estate, life insurance and marketable securities are accepted as collateral for the consumer loan portfolio.

Management of the Company believes that the Company has benefited from increased loan demand due to passage of the North American Free Trade Agreement ("NAFTA") and the strong population growth in the Rio Grande Valley. The effects of NAFTA have also increased cross-border trade and industrial development including activity at twin manufacturing plants located on each side of the border (referred to as maquiladoras), which benefit the Rio Grande Valley economy. Management believes that NAFTA will continue to have a positive impact on the Company's growth and earnings prospects.

The majority of the Company's loans are loans held for investment. Loans held for sale, which are generally mortgage loans originated and intended for sale in the secondary market, represent 0.6% of total loans at June 30, 2005.

International loans are loans to borrowers, primarily from borrowers in Mexico, that are domiciled in a country other than the United States of America. The Company's total international loans at June 30, 2005 of \$53,006,000 represented 1.4% of total loans held for investment.

Total loans held for investment of \$3,903,850,000 at June 30, 2005 increased \$153,331,000 or 4.1% compared to December 31, 2004 levels of \$3,750,519,000. The increase in loans held for investment resulted primarily from an increase in commercial and real estate loans combined with \$118,129,000 in loans held for investment acquired with the Mercantile acquisition during first quarter 2005.

The following table presents the composition of the loans held for investment portfolio (dollars in thousands):

	June 30, 2005	December 31, 2004
	(Unaudited)	
Commercial	\$1,112,276	\$1,098,028
Commercial Tax-Exempt	22,621	49,622
<b>Total Commercial</b>	<b>1,134,897</b>	<b>1,147,650</b>
Agricultural	72,501	78,761
Real Estate		
Construction	817,520	768,497
Commercial Mortgage	1,272,051	1,199,600
Agricultural Mortgage	114,729	100,628
1-4 Family Mortgage	331,747	286,809
<b>Total Real Estate</b>	<b>2,536,047</b>	<b>2,355,534</b>
Consumer	164,641	172,571
<b>Total Principal Amount of Loans Held for Investment</b>	<b>3,908,086</b>	<b>3,754,516</b>
Less: Unearned Income and Net Unamortized Deferred Fees and Costs	4,236	3,997
<b>Total Loans Held for Investment</b>	<b>\$3,903,850</b>	<b>\$3,750,519</b>

In the ordinary course of business, the Company's subsidiary bank makes loans to its officers and directors, including entities related to those individuals. These loans are made on substantially the same terms and conditions as those prevailing at the time for comparable transactions with other persons and do not involve more than the normal risk of collectibility or present other unfavorable features. As of June 30, 2005 and December 31, 2004, loans outstanding to directors, officers and their affiliates totaled approximately \$89,595,000 and \$65,181,000, respectively.

The Company's policy on maturity extensions and rollovers is based on management's assessment of individual loans. Approvals for the extension or renewal of loans without reduction of principal for more than one twelve-month period are generally avoided, unless the loans are fully secured and properly margined by cash or marketable securities, or are revolving lines subject to annual analysis and renewal.

#### NONPERFORMING ASSETS

The Company has several procedures in place to assist in maintaining the overall quality of its loan portfolio. The Bank has established underwriting guidelines to be followed by its officers and monitors its delinquency levels for any negative or adverse trends.

Nonperforming assets consist of nonperforming (impaired) loans and other assets, primarily real estate, acquired in partial or full satisfaction of loan obligations. The Company's policy generally is to place a loan on nonaccrual status when payment of principal or interest is contractually past due 90 days, or earlier when concern exists as to the ultimate collection of principal and interest. At the time a loan is placed on nonaccrual status, interest previously accrued but uncollected is reversed and charged against current income unless the collateral provides more than adequate margin to ensure collection of that interest. A restructured loan is generally a loan that is accruing interest, but on which concessions in terms have been made as a result of deterioration in the borrower's financial condition. The Company's classification of nonperforming loans includes those loans for which management believes collection is doubtful. Management is not aware of any specific borrower relationships that are not reported as nonperforming where management has serious doubts as to the ability of such borrowers to comply with the present loan repayment terms which would cause nonperforming assets to increase materially.

Nonperforming assets of \$56,807,000 at June 30, 2005 increased \$29,659,000 or 109.2% compared to December 31, 2004 levels of \$27,148,000. Nonaccrual loans of \$45,680,000 at June 30, 2005 increased \$25,930,000 or 131.3% compared to \$19,750,000 at December 31, 2004. The increase was primarily the result of the addition of one loan relationship totaling \$22,649,000 and the increase in another loan relationship of \$4,415,000. The increase was partially offset by a \$1,124,000 loan relationship, a portion of which was paid off and the remainder of which is now current, as well as \$885,000 from a loan relationship that was partially charged-off and partially transferred to foreclosed and other assets as of June 30, 2005. During second quarter 2005, the Company reduced the interest rate on a real estate loan and identified this loan as troubled debt restructuring. The Company reported \$1,804,000 as total restructured loans at June 30, 2005. Foreclosed and other assets of \$9,323,000 at June 30, 2005 increased \$1,925,000 or 26.0% compared to \$7,398,000 at December 31, 2004. The increase was primarily the result of the addition of a property totaling \$2,900,000, partially offset by the sale of two properties totaling \$763,000. Management actively seeks buyers for all Other Real Estate. See "Noninterest Expense" below.

Loans which are contractually past due 90 days or more, which are both well secured or guaranteed by financially responsible third parties and in the process of collection, generally are not placed on nonaccrual status. The amount of such loans at June 30, 2005 and December 31, 2004 totaled \$22,613,000 and \$19,684,000, respectively, reflecting an increase of \$2,929,000 or 14.9%. The increase at June 30, 2005 as compared to December 31, 2004 resulted primarily from the addition of four loan relationships totaling \$9,101,000. The increase was partially offset by the foreclosure of properties securing two loan relationships totaling \$4,593,000 and the transfer of one loan relationship to current status in the amount of \$1,007,000. The ratio of nonperforming assets plus accruing loans 90 days or more past due as a percent of total loans held for investment and foreclosed and other assets at June 30, 2005 increased to 2.03% from 1.25% at December 31, 2004.

Since June 30, 2005, a cash payment of \$4,000,000 was made on the Company's largest nonperforming credit. Also since June 30, 2005, the borrower on the Company's second largest nonperforming credit made a payment of approximately \$4,000,000. As of June 30, 2005, this credit was classified as 90 days past due and still accruing and had a principal balance of approximately \$6,805,000. The principal balance of the credit was reduced by \$2,626,000 without a change in the Company's collateral position. Furthermore, over \$2,600,000 of the Company's foreclosed assets as of June 30, 2005 have pending contracts for sale. Management anticipates closing on most of these transactions by the end of August 2005.

An analysis of the components of nonperforming assets follows (dollars in thousands):

	June 30, 2005	December 31, 2004
	(Unaudited)	
Nonaccrual Loans	\$45,680	\$19,750
Restructured Loans	1,804	-
Nonperforming Loans	47,484	19,750
Foreclosed and Other Assets	9,323	7,398
Total Nonperforming Assets	56,807	27,148
Accruing Loans 90 Days or More Past Due	22,613	19,684
Total Nonperforming Assets and Accruing Loans 90 Days or More Past Due	\$79,420	\$46,832
Nonperforming Loans as a Percentage of Loans Held for Investment	1.22%	0.53%
Nonperforming Assets as a Percentage of Loans Held for Investment and Foreclosed and Other Assets	1.45	0.72
Nonperforming Assets as a Percentage of Total Assets	0.91	0.46
Nonperforming Assets Plus Accruing Loans 90 Days or More Past Due as a Percentage of Loans Held for Investment and Foreclosed and Other Assets	2.03	1.25

Management regularly reviews and monitors the loan portfolio to identify borrowers experiencing financial difficulties. Management believes that, at June 30, 2005, all such loans had been identified and included in the nonaccrual, renegotiated or 90 days or more past due loan totals reflected in the table above. Management continues to emphasize maintaining a low level of nonperforming assets and returning nonperforming assets to an earning status.

#### ALLOWANCE FOR LOAN LOSSES - CRITICAL ACCOUNTING POLICY

Management analyzes the loan portfolio to determine the adequacy of the allowance for loan losses and the appropriate provision required to maintain an adequate allowance. Estimating the allowance is a critical accounting policy. It is subjective in nature and requires material estimates that may be subject to revision as facts and circumstances warrant. The Company's allowance for loan losses represents estimations based on guidance provided by Statement of Financial Accounting Standards No. 114, "Accounting by Creditors for Impairment of a Loan-an amendment of FASB Statements No. 5 and 15", as amended by Statement No. 118, "Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures-an amendment of FASB Statement No. 114" and Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies".

In assessing the adequacy of the allowance, management reviews the size, quality and risks of loans in the portfolio and considers factors such as specific known risks, past experience, the status and amount of nonperforming assets and economic conditions. A specific percentage is allocated to total loans not specifically reserved while additional amounts are added for individual loans considered to have specific loss potential. Loans identified as losses are charged off. In addition, the loan review committee of the Bank reviews the assessments of management in determining the adequacy of the Bank's allowance for loan losses on a quarterly basis. Based on total allocations, the provision is recorded to maintain the allowance at a level deemed appropriate by management based on probable losses in the loan portfolio. There can be no assurance that future additions or reductions to the allowance will not be necessary.

The allowance for loan losses at June 30, 2005 totaled \$48,022,000, representing a net increase of \$2,998,000 or 6.7% compared to \$45,024,000 at December 31, 2004. The acquisition of Mercantile during first quarter 2005 attributed to \$1,524,000 of the increase. Management believes that the allowance for loan losses at June 30, 2005 adequately reflects the probable losses in the loan portfolio. Various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgments of information available to them at the time of their examination.

The following table summarizes the activity in the allowance for loan losses (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
	(Unaudited)			
Balance at Beginning of Period	\$47,313	\$41,094	\$45,024	\$31,234
Balance from Acquisition	-	-	1,524	8,795
Provision for Loan Losses	5,801	4,693	11,208	8,617
Charge-Offs				
Commercial	4,466	3,835	8,573	6,343
Agricultural	56	-	56	189
Real Estate	526	58	1,135	154
Consumer	749	725	1,435	1,350
Total Charge-Offs	5,797	4,618	11,199	8,036
Recoveries				
Commercial	349	493	757	711
Agricultural	5	4	27	4
Real Estate	53	55	114	143
Consumer	298	235	567	488
Total Recoveries	705	787	1,465	1,346
Net Charge-Offs	5,092	3,831	9,734	6,690
Balance at End of Period	\$48,022	\$41,956	\$48,022	\$41,956
Allowance for Loan Losses as a Percentage of Loans Held for Investment	1.23%	1.22%	1.23%	1.22%
Allowance for Loan Losses as a Percentage of Nonperforming Loans	101.13	350.66	101.13	350.66
Net Charge-Offs as a Percentage of Average Loans Held for Investment	0.53	0.46	0.51	0.44

#### PREMISES AND EQUIPMENT, NET

Premises and equipment, net of \$143,136,000 at June 30, 2005 increased by \$8,897,000 or 6.6% compared to December 31, 2004 levels of \$134,239,000. The increase was partially attributable to \$4,689,000 of premises and equipment acquired in the Mercantile acquisition during first quarter 2005, as well as \$1,185,000 in real estate purchased during the six months ending June 30, 2005 in Houston and Rio Grande City, Texas for future banking locations. The Company is continuing to evaluate the premises with the Mercantile and Valley Mortgage acquisitions.

#### GOODWILL

Goodwill of \$194,849,000 at June 30, 2005 increased \$20,346,000 or 11.7% compared to \$174,503,000 at December 31, 2004. The increase is primarily attributable to \$19,719,000 in goodwill added with the Mercantile acquisition. In addition, goodwill adjustments totaling \$384,000 and \$243,000 relating to the Southeast Texas and Valley Mortgage acquisitions, respectively, were recorded during the six months ended June 30, 2005. The Company is continuing to evaluate the goodwill recorded with the Mercantile and Valley Mortgage acquisitions.

#### IDENTIFIABLE INTANGIBLES, NET

Identifiable intangibles, net of \$28,553,000 at June 30, 2005 decreased \$1,054,000 or 3.6% compared to \$29,607,000 at December 31, 2004. Identifiable intangibles, net increased as a result of a \$2,028,000 core deposit intangible added with the Mercantile acquisition. The increase was offset by net amortization of \$3,124,000 for the six months ended June 30, 2005, including amortization of \$362,000 on the unfavorable lease commitment obtained with the Southeast Texas acquisition included as a reduction of net occupancy expense. The Company is continuing to evaluate the value of the core deposit intangible obtained with the Mercantile acquisition.

#### DEPOSITS

Total deposits of \$5,153,937,000 at June 30, 2005 increased \$393,097,000 or 8.3% compared to December 31, 2004 levels of \$4,760,840,000. The increase in total deposits for the six months ended June 30, 2005 is primarily attributable to \$173,444,000 added with the Mercantile acquisition, as well as growth in the volume of business conducted by the Company.

The following table presents the composition of total deposits (dollars in thousands):

	June 30, 2005	December 31, 2004
(Unaudited)		
Demand Deposits		
Commercial and Individual	\$ 904,391	\$ 849,865
Public Funds	12,336	16,908
Total Demand Deposits	916,727	866,773
Interest-Bearing Deposits		
Savings		
Commercial and Individual	213,605	211,393
Public Funds	405	432
Money Market Checking and Savings		
Commercial and Individual	1,171,208	980,005
Public Funds	439,802	460,202
Time Deposits		
Commercial and Individual	1,867,023	1,655,042
Public Funds	545,167	586,993
Total Interest-Bearing Deposits	4,237,210	3,894,067
Total Deposits	\$5,153,937	\$4,760,840

#### OTHER BORROWED MONEY

Total other borrowed money of \$405,888,000 at June 30, 2005 decreased \$55,863,000 or 12.1% compared to December 31, 2004 levels of \$461,751,000.

The components of total other borrowed money are as follows (dollars in thousands):

	June 30, 2005	December 31, 2004
(Unaudited)		
Federal Funds Purchased and Securities		
Sold Under Repurchase Agreements	\$ 83,234	\$108,891
Federal Home Loan Bank Advances	255,642	285,848
Junior Subordinated Debentures	67,012	67,012
Total Other Borrowed Money	\$405,888	\$461,751

At June 30, 2005, the Company had available lines of credit totaling \$155,000,000 with correspondent banks for short-term liquidity needs. In addition, the Company had available credit of approximately \$1,125,952,000 with the Federal Home Loan Bank, of which \$255,642,000 was advanced at June 30, 2005.

#### SHAREHOLDERS' EQUITY

Shareholders' equity increased by \$27,566,000 or 4.6% during the six months ended June 30, 2005 primarily due to comprehensive income of \$37,036,000 less dividends of \$10,913,000. Comprehensive income for the period included net income of \$45,713,000 and net change in unrealized gains and losses on securities available for sale, net of tax and reclassification adjustment, of \$(8,677,000).

Bank holding companies are required to maintain capital ratios in accordance with guidelines adopted by the Federal Reserve Board ("FRB"). The guidelines are commonly known as Risk-Based Capital Guidelines.

The table below reflects various measures of regulatory capital (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	<b>Texas Regional Bancshares, Inc.</b>					
As of June 30, 2005 (Unaudited)						
Total Capital (to Risk-Weighted Assets)	\$521,499	11.74%	\$355,419	8.00%	\$444,274	10.00%
Tier I Capital (to Risk-Weighted Assets)	473,477	10.66	177,710	4.00	266,565	6.00
Tier I Capital (to Average Assets)	473,477	7.98	237,312	4.00	296,640	5.00
As of December 31, 2004						
Total Capital (to Risk-Weighted Assets)	\$501,326	11.91%	\$336,800	8.00%	\$421,001	10.00%
Tier I Capital (to Risk-Weighted Assets)	456,302	10.84	168,400	4.00	252,600	6.00
Tier I Capital (to Average Assets)	456,302	8.32	219,331	4.00	274,163	5.00
<b>Texas State Bank</b>						
As of June 30, 2005 (Unaudited)						
Total Capital (to Risk-Weighted Assets)	\$496,371	11.19%	\$354,919	8.00%	\$443,648	10.00%
Tier I Capital (to Risk-Weighted Assets)	448,349	10.11	177,459	4.00	266,189	6.00
Tier I Capital (to Average Assets)	448,349	7.57	236,999	4.00	296,249	5.00
As of December 31, 2004						
Total Capital (to Risk-Weighted Assets)	\$475,282	11.31%	\$336,320	8.00%	\$420,399	10.00%
Tier I Capital (to Risk-Weighted Assets)	430,258	10.23	168,160	4.00	252,240	6.00
Tier I Capital (to Average Assets)	430,258	7.86	218,899	4.00	273,624	5.00

At June 30, 2005, the Company and the Bank met the criteria for classification as a “well-capitalized” institution under the prompt corrective action rules promulgated under the Federal Deposit Insurance Act. Designation as a well-capitalized institution under these regulations does not constitute a recommendation or endorsement of the Company or the Bank by Federal bank regulators.

## RESULTS OF OPERATIONS

### NET INCOME

Net income was \$21,914,000 and \$18,832,000 and earnings per diluted common share was \$0.44 and \$0.38 for the three months ended June 30, 2005 and 2004, respectively. Net income increased primarily due to sustained loan growth combined with a full three months of operations from Valley Mortgage and Mercantile. The Company completed the acquisition of Valley Mortgage on November 23, 2004 and Mercantile on January 14, 2005. The results of operations for Valley Mortgage and Mercantile have been included in the condensed consolidated financial statements since their respective purchase dates. Return on assets averaged 1.43% and 1.39% while return on shareholders’ equity averaged 14.26% and 13.79% for the three months ended June 30, 2005 and 2004, respectively.

For the six months ended June 30, 2005, net income was \$45,713,000 compared to \$35,989,000 for the same period in 2004, representing an increase of \$9,724,000 or 27.0%. Net income increased primarily due to the recognition of a full six months of results from the Southeast Texas acquisition completed on March 12, 2004, as well as results from the Valley Mortgage and Mercantile acquisitions. Furthermore, the Company benefited from an aggregate \$6,160,000 in special distributions received during the first two quarters of 2005, as a result of the merger of PULSE EFT Association with Discover Financial Services, Inc., a business unit of Morgan Stanley. Earnings per diluted common share was \$0.92 and \$0.76 for the six months ended June 30, 2005 and 2004, respectively. Return on assets averaged 1.51% and return on shareholders' equity averaged 15.07% for the six months ended June 30, 2005 compared to 1.46% and 14.41%, respectively, for the same period in 2004.

### NET INTEREST INCOME

Net interest income, reported on a tax-equivalent basis, was \$59,396,000 for the three months ended June 30, 2005 compared with \$52,653,000 for the same period in 2004, an increase of \$6,743,000 or 12.8%. The net interest margin was 4.26% for the three months ended June 30, 2005 compared to 4.30% for the same period in 2004. Tax-equivalent interest income for the three months ended June 30, 2005 was \$87,237,000, an increase of \$18,687,000 or 27.3% from the three months ended June 30, 2004. This increase in tax-equivalent interest income was largely due to growth in average interest-earning assets, which rose to \$5,594,489,000 representing a \$668,153,000 or 13.6% increase compared to the same period in 2004. The increase was further affected by a 65 basis point increase in the yield on average interest-earning assets. Tax-equivalent interest income on loans held

for investment increased \$15,314,000 or 27.9% to \$70,285,000 for the three months ended June 30, 2005 compared to the same period in 2004. The increase was primarily due to a \$492,254,000 or 14.5% increase in average loans held for investment over the same period in 2004, resulting from a 10.2% internal loan growth rate for the twelve months ended June 30, 2005. The increase was further affected by a 74 basis point increase in the yield on average loans held for investment resulting primarily from an increase in the average prime rate from 4.00% during second quarter 2004 to 5.92% during second quarter 2005. Tax-equivalent interest income on securities increased to \$16,096,000, reflecting a \$2,906,000 or 22.0% increase from the prior comparable period. This increase was attributable to an \$183,975,000 increase in average securities, up 12.2% compared to the three months ended June 30, 2004. The increase was further affected by a 30 basis point increase in the yield on average securities during second quarter 2005 compared to the same period in 2004.

For the six months ended June 30, 2005, tax-equivalent interest income on loans held for investment increased \$36,840,000 or 36.9% to \$136,693,000 compared to the same period in 2004. The increase was primarily due to an \$818,591,000 or 26.9% increase in average loans held for investment over the same period in 2004, resulting from loans obtained with the Southeast Texas acquisition on March 12, 2004, as well as a 10.2% internal loan growth rate for the twelve months ended June 30, 2005. The increase was further affected by a 54 basis point increase in the yield on average loans held for investment resulting primarily from an increase in the average prime rate from 4.00% during the six months ended June 30, 2004 to 5.68% during the same period in 2005. Tax-equivalent interest income on securities increased to \$30,887,000, reflecting a \$5,071,000 or 19.6% increase from the prior comparable period. This increase was attributable to a \$174,478,000 increase in average securities, up 12.0% compared to the six months ended June 30, 2004. The increase was further affected by a 25 basis point increase in the yield on average securities during the six months ended June 30, 2005 compared to the same period in 2004.

Interest expense increased to \$27,841,000 for the three months ended June 30, 2005 compared to \$15,897,000 for the same period in 2004, representing an increase of \$11,944,000 or 75.1%. The increase was primarily due to an 84 basis point increase in the cost of funds during second quarter 2005 compared to the same period in 2004 resulting from increasing market rates. The increase was further affected by an increase in average interest-bearing liabilities of \$559,135,000 or 13.9% to \$4,589,480,000 compared to \$4,030,345,000 for second quarter 2004. Interest expense on deposits increased by \$10,095,000 or 71.2% to \$24,280,000 for second quarter 2005 compared to the comparable period in 2004. The increase reflects the effects of higher rates offered on deposits due to increases in market rates since June 30, 2004. Average interest-bearing deposits increased by \$437,479,000 or 11.7% to \$4,184,552,000 for second quarter 2005 compared with second quarter 2004. The increase in average interest-bearing deposits was primarily attributable to an internal growth rate of 10.3% for the twelve months ended June 30, 2005. Interest expense on other borrowed money increased \$1,849,000 or 108.0% to \$3,561,000 for the three months ended June 30, 2005 compared to the same period in 2004. The increase was primarily attributable to a \$121,656,000 or 42.9% increase in average other borrowed money to \$404,928,000 during the three months ended June 30, 2005 compared to \$283,272,000 during the three months ended June 30, 2004, as well as a 110 basis point increase in the cost of other borrowed money during the three months ended June 30, 2005 compared to the same period in 2004. The increase in the cost of other borrowed money during second quarter 2005 resulted from increases in interest rates since June 30, 2004. The cost of Federal Home Loan Bank advances and junior subordinated debentures for second quarter 2005 increased by 180 and 163 basis points, respectively, compared to the same period in 2004. In addition, the average balance of Federal Home Loan Bank advances increased by \$114,644,000 or 85.1% to \$249,380,000 for second quarter 2005 compared to the same 2004 period to partially fund growth in the securities portfolio.

For the six months ended June 30, 2005, interest expense was \$51,137,000 compared to \$29,731,000 for the same period in 2004. The increase was primarily due to a 67 basis point increase in the cost of funds during the six months ended June 30, 2005 from the comparable period in 2004 resulting from increasing market rates. Average interest-bearing liabilities increased \$817,831,000 or 21.9% to \$4,544,939,000 for the six months ended June 30, 2005 compared to \$3,727,108,000 for the six months ended June 30, 2004. Interest expense on deposits totaled \$44,518,000 for the six months ended June 30, 2005, reflecting an increase of \$17,895,000 or 67.2% compared to the same prior year period. The increase in interest expense on deposit resulted primarily from a \$682,358,000 or 19.7% increase in average interest-bearing deposits combined with a 62 basis points increase in the average rate paid on interest-bearing deposits. Interest expense on other borrowed money increased to \$6,619,000 for the six months ended June 30, 2005 compared to \$3,108,000 for the same prior year period. The increase was primarily attributable to a \$135,473,000 or 51.1% increase in average other borrowed money to \$400,523,000 during the six months ended June 30, 2005 compared to \$265,050,000 during the six months ended June 30, 2004 resulting primarily from an \$115,240,000 increase in the average balance of Federal Home Loan Bank advances. In addition, the cost of other borrowed money increased by 97 basis points primarily due to an increase of 168 and 114 basis points in the cost of Federal Home Loan Bank advances and junior subordinated debentures, respectively, resulting from increasing interest rates.

The Company's net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as a "volume change". It is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds, referred to as a "rate change". The following tables present for periods indicated the total dollar amount of interest income from average interest-earning assets and the resultant yields, reported on a tax equivalent basis, and the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. Average balances are derived from average daily balances and the yields and costs are established by dividing income or expense by the average balance of the asset or liability. Income and yield on interest-earning assets include amounts to convert tax-exempt income to a taxable-equivalent basis, assuming a 35% effective tax rate for 2005 and 2004 (dollars in thousands):

Tax-Equivalent Basis <sup>(1)</sup>	Three Months Ended					
	June 30, 2005			June 30, 2004		
	Average Balance	Interest	Yield/ Rate <sup>(3)</sup>	Average Balance	Interest	Yield/ Rate <sup>(3)</sup>
	(Unaudited)					
<b>Assets</b>						
Interest-Earning Assets						
Loans Held for Sale <sup>(2)</sup>	\$ 21,333	\$ 777	14.61%	\$ 24,927	\$ 352	5.68%
Loans Held for Investment <sup>(2)</sup>						
Commercial	1,192,806	20,404	6.86	1,109,424	16,196	5.87
Real Estate	2,516,580	46,613	7.43	2,085,325	34,983	6.75
Consumer	166,665	3,268	7.86	189,048	3,792	8.07
<b>Total Loans Held for Investment</b>	<b>3,876,051</b>	<b>70,285</b>	<b>7.27</b>	<b>3,383,797</b>	<b>54,971</b>	<b>6.53</b>
Securities						
Taxable	1,540,554	14,275	3.72	1,361,743	11,426	3.37
Tax-Exempt	145,339	1,821	5.03	140,175	1,764	5.06
<b>Total Securities</b>	<b>1,685,893</b>	<b>16,096</b>	<b>3.83</b>	<b>1,501,918</b>	<b>13,190</b>	<b>3.53</b>
Interest-Bearing and Time Deposits	992	3	1.21	11,190	26	0.93
Federal Funds Sold	10,220	76	2.98	4,504	11	0.98
<b>Total Interest-Earning Assets</b>	<b>5,594,489</b>	<b>\$87,237</b>	<b>6.25%</b>	<b>4,926,336</b>	<b>\$68,550</b>	<b>5.60%</b>
Cash and Due from Banks	130,212			141,624		
Premises and Equipment, Net	141,391			126,577		
Other Assets, Net	321,237			290,574		
Allowance for Loan Losses	(48,500)			(43,849)		
<b>Total Assets</b>	<b>\$6,138,829</b>			<b>\$5,441,262</b>		
<b>Liabilities</b>						
Interest-Bearing Liabilities						
Savings	\$ 217,515	\$ 238	0.44%	\$ 214,588	\$ 168	0.31%
Money Market Checking and Savings	1,587,841	6,447	1.63	1,325,257	2,362	0.72
Time Deposits	2,379,196	17,595	2.97	2,207,228	11,655	2.12
<b>Total Savings and Time Deposits</b>	<b>4,184,552</b>	<b>24,280</b>	<b>2.33</b>	<b>3,747,073</b>	<b>14,185</b>	<b>1.52</b>
Other Borrowed Money	404,928	3,561	3.53	283,272	1,712	2.43
<b>Total Interest-Bearing Liabilities</b>	<b>4,589,480</b>	<b>\$27,841</b>	<b>2.43%</b>	<b>4,030,345</b>	<b>\$15,897</b>	<b>1.59%</b>
Demand Deposits	902,549			834,725		
Other Liabilities	30,556			26,852		
<b>Total Liabilities</b>	<b>5,522,585</b>			<b>4,891,922</b>		
Shareholders' Equity	616,244			549,340		
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$6,138,829</b>			<b>\$5,441,262</b>		
Net Interest Income <sup>(1)</sup>		\$59,396			\$52,653	
Less: Tax-Equivalent Adjustment		921			919	
<b>Net Interest Income, As Reported</b>		<b>\$58,475</b>			<b>\$51,734</b>	
<b>Net Interest Margin</b>			<b>4.26%</b>			<b>4.30%</b>

<sup>(1)</sup> For analytical purposes, income from tax-exempt assets, primarily securities issued by state and local governments or authorities, is adjusted by an increment that equates tax-exempt income to income from taxable assets (assuming a 35% tax rate). Income on a tax-equivalent basis is not considered to be in accordance with generally accepted accounting principles ("GAAP").

<sup>(2)</sup> Average balances of loans include nonaccrual loans and are presented net of unearned income and unamortized deferred fees and costs.

<sup>(3)</sup> Annualized.

Tax-Equivalent Basis <sup>(1)</sup>	Six Months Ended					
	June 30, 2005			June 30, 2004		
	Average Balance	Interest	Yield/ Rate <sup>(3)</sup>	Average Balance	Interest	Yield/ Rate <sup>(3)</sup>
	(Unaudited)					
<b>Assets</b>						
Interest-Earning Assets						
Loans Held for Sale <sup>(2)</sup>	\$ 21,069	\$ 1,423	13.62%	\$ 21,825	\$ 611	5.63%
Loans Held for Investment <sup>(2)</sup>						
Commercial	1,204,558	39,834	6.67	1,073,687	30,195	5.66
Real Estate	2,493,459	90,236	7.30	1,822,736	63,192	6.97
Consumer	169,295	6,623	7.89	152,298	6,466	8.54
Total Loans Held for Investment	3,867,312	136,693	7.13	3,048,721	99,853	6.59
Securities						
Taxable	1,488,043	27,205	3.69	1,342,449	22,635	3.39
Tax-Exempt	145,849	3,682	5.09	116,965	3,181	5.47
Total Securities	1,633,892	30,887	3.81	1,459,414	25,816	3.56
Interest-Bearing and Time Deposits						
Federal Funds Sold	3,765	34	1.82	9,280	43	0.93
	13,180	175	2.68	5,216	28	1.08
Total Interest-Earning Assets	5,539,218	\$169,212	6.16%	4,544,456	\$126,351	5.59%
Cash and Due from Banks	136,712			122,766		
Premises and Equipment, Net	139,887			119,013		
Other Assets, Net	318,019			225,763		
Allowance for Loan Losses	(48,524)			(39,453)		
Total Assets	\$6,085,312			\$4,972,545		
<b>Liabilities</b>						
Interest-Bearing Liabilities						
Savings	\$ 217,438	\$ 491	0.46%	\$ 188,545	\$ 295	0.31%
Money Market Checking and Savings	1,591,694	11,696	1.48	1,188,492	4,310	0.73
Time Deposits	2,335,284	32,331	2.79	2,085,021	22,018	2.12
Total Savings and Time Deposits	4,144,416	44,518	2.17	3,462,058	26,623	1.55
Other Borrowed Money	400,523	6,619	3.33	265,050	3,108	2.36
Total Interest-Bearing Liabilities	4,544,939	\$ 51,137	2.27%	3,727,108	\$ 29,731	1.60%
Demand Deposits	899,607			717,224		
Other Liabilities	29,114			25,830		
Total Liabilities	5,473,660			4,470,162		
Shareholders' Equity	611,652			502,383		
Total Liabilities and Shareholders' Equity	\$6,085,312			\$4,972,545		
Net Interest Income <sup>(1)</sup>		\$118,075			\$ 96,620	
Less: Tax-Equivalent Adjustment		1,920			1,782	
Net Interest Income, As Reported		\$116,155			\$ 94,838	
Net Interest Margin			4.30%			4.28%

<sup>(1)</sup> For analytical purposes, income from tax-exempt assets, primarily securities issued by state and local governments or authorities, is adjusted by an increment that equates tax-exempt income to income from taxable assets (assuming a 35% tax rate). Income on a tax-equivalent basis is not considered to be in accordance with GAAP.

<sup>(2)</sup> Average balances of loans include nonaccrual loans and are presented net of unearned income and unamortized deferred fees and costs.

<sup>(3)</sup> Annualized.

The following table presents the effects of changes in volume, rate and rate/volume on interest income and interest expense for major categories of interest-earning assets and interest-bearing liabilities. Nonaccrual loans are included in assets, thereby reducing yields (see “Nonperforming Assets”). The allocation of the rate/volume variance has been made pro-rata on the percentage that volume and rate variances produce in each category. An analysis of changes in net interest income follows (dollars in thousands):

Tax-Equivalent Basis <sup>(1)</sup>	Three Months Ended June 30, 2005 Compared to 2004				Six Months Ended June 30, 2005 Compared to 2004			
	Net Change	Due to Change in Volume	Rate	Rate/ Volume	Net Change	Due to Change in Volume	Rate	Rate/ Volume
	(Unaudited)							
Interest Income								
Loans Held for Sale	\$ 425	\$ (50)	\$ 555	\$ (80)	\$ 812	\$ (23)	\$ 865	\$ (30)
Loans Held for Investment	15,314	8,170	6,237	907	36,840	26,460	8,183	2,197
Securities								
Taxable	2,849	1,536	1,161	152	4,570	2,385	1,971	214
Tax-Exempt	57	70	(13)	-	501	774	(219)	(54)
Interest-Bearing and Time								
Deposits	(23)	(24)	8	(7)	(9)	(26)	41	(24)
Federal Funds Sold	65	14	22	29	147	43	41	63
Total Interest Income	18,687	9,716	7,970	1,001	42,861	29,613	10,882	2,366
Interest Expense								
Deposits	10,095	1,699	7,518	878	17,895	5,159	10,639	2,097
Other Borrowed Money	1,849	742	774	333	3,511	1,575	1,281	655
Total Interest Expense	11,944	2,441	8,292	1,211	21,406	6,734	11,920	2,752
Net Interest Income Before								
Allocation of Rate/Volume	6,743	7,275	(322)	(210)	21,455	22,879	(1,038)	(386)
Allocation of Rate/Volume	-	274	(484)	210	-	737	(1,123)	386
Changes in Net Interest Income	\$ 6,743	\$ 7,549	\$ (806)	\$ -	\$ 21,455	\$ 23,616	\$ (2,161)	\$ -

<sup>(1)</sup> For analytical purposes, income from tax-exempt assets, primarily securities issued by state and local governments or authorities, is adjusted by an increment that equates tax-exempt income to income from taxable assets (assuming a 35% effective federal income tax rate). Income on a tax-equivalent basis is not considered to be in accordance with GAAP.

#### PROVISION FOR LOAN LOSSES

The Company recorded a provision for loan losses of \$5,801,000 for the three months ended June 30, 2005 compared to \$4,693,000 for the three months ended June 30, 2004. For the six months ended June 30, 2005, the Company recorded a provision for loan losses of \$11,208,000 compared to \$8,617,000 for the same period in 2004. The increases in the provision for loan losses for the three and six months ended June 30, 2005 compared to the same periods in 2004 were a result of loan growth, management’s assessment of current regional economic conditions and probable losses in the portfolio. Net charge-offs totaled \$5,092,000 and \$9,734,000 for the three and six months ended June 30, 2005, respectively, compared to \$3,831,000 and \$6,690,000 for the same comparable periods in 2004. Net charge-offs to average loans held for investment increased during the six months ended June 30, 2005 to 0.51% compared to 0.44% for the same period in 2004.

Management charges provisions for loan losses to earnings to bring the total allowance for loan losses to a level deemed appropriate. Management bases its decision on many factors which include historical loan loss experience, the volume and type of lending conducted by the Company, the amount of nonperforming assets, specific provisions for individual nonperforming loans, regulatory policies, generally accepted accounting principles, and general economic conditions, particularly as they relate to the Company’s lending area. For additional information on charge-offs and recoveries and the aggregate provision for loan losses, see the “Allowance for Loan Losses – Critical Accounting Policy” section of this report.

#### NONINTEREST INCOME

The Company’s primary sources of noninterest income are service charges on deposit accounts, other banking service related fees, data processing fees and trust fees. Noninterest income totaled \$20,441,000 for the three months ended June 30, 2005 compared to \$18,944,000 for the same period in 2004. Excluding net realized gains on sales of securities available for sale of \$323,000 and \$1,383,000 for second quarter 2005 and second quarter 2004, respectively, and the \$908,000 special distribution received during second quarter 2005 as a result of the merger of PULSE EFT Association with Discover Financial Services, noninterest income for second quarter 2005 increased \$1,649,000 or 9.4% compared to second quarter 2004. The increase was primarily attributable a \$1,112,000 increase in gains on sales of loans held for sale and mortgage servicing rights. For the six months ended June 30, 2005, noninterest income totaled \$45,102,000, up from \$32,339,000 for the same period in 2004. Excluding net realized gains on securities available for sale of \$321,000 and \$1,882,000 for the six months ended June 30, 2005 and 2004, respectively, and the aggregate \$6,160,000 in special distributions received as a result of the merger of PULSE EFT Association with Discover Financial Services during the six months ended June 30, 2005, noninterest income for the six months

ended June 30, 2005 increased \$8,164,000 or 26.8% over the same period in 2004. The majority of the increase is attributable to an increase in total service charges, trust fees and gains on sales of loans held for sale and mortgage servicing rights.

Total service charges of \$12,345,000 for the three months ended June 30, 2005 decreased \$101,000 or 0.8% compared to \$12,446,000 for the same period in 2004. Although average deposits excluding time deposits increased \$333,335,000 or 14.0%, service charges on deposit accounts decreased \$623,000 or 6.1%. The decrease resulted primarily from a \$792,000 reduction in non-sufficient and return item charges. This decrease was partially offset by a \$522,000 increase in other service charges resulting primarily from a \$260,000 increase in merchant credit and debit card income combined with \$141,000 in mortgage banking fees generated from Valley Mortgage. Total service charges were \$24,435,000 for the six months ended June 30, 2005 compared to \$21,772,000 for the same period in 2004, reflecting an increase of 12.2%. The increase in total service charges is reflective of the increase in average deposits excluding time deposits of \$614,478,000 or 29.3% for the six months ended June 30, 2005 compared with the same period in 2004. Non-sufficient and return item charges, which comprises 65.1% of service charges on deposits accounts for six months ended June 30, 2005, increased by \$303,000. In addition, there was an increase in merchant debit and credit card income of \$841,000 and a \$236,000 increase in mortgage banking fees for the six months ended June 30, 2005 compared with the comparable prior year period.

Insurance commissions, fees and premiums, net for the three months ended June 30, 2005 totaled \$980,000 decreasing by \$97,000 or 9.0% compared to \$1,077,000 for the same period in 2004. The decrease resulted primarily from \$100,000 decrease in title insurance income during second quarter 2005 compared to second quarter 2004. For the six months ended June 30, 2005, insurance commissions, fees and premiums, net of \$1,978,000 increased \$605,000 or 44.1% compared to \$1,373,000 for the comparable period in 2004. The increase in insurance commissions, fees and premiums, net for the six months ended June 30, 2005 resulted primarily from the inclusion of a full six months of income generated by the title insurance and general lines insurance agencies acquired with the Southeast Texas acquisition. The principal component of insurance commissions, fees and premiums, net prior to the Southeast Texas transaction was insurance commissions and fees received from the sale of credit life insurance, since prior to the merger with Southeast Texas the Company did not have other significant insurance business.

Trust fees of \$1,904,000 for the three months ended June 30, 2005 increased \$460,000 or 31.9% compared to \$1,444,000 for the comparable prior year period. Trust fees were \$3,744,000 for the six months ended June 30, 2005 compared to \$2,171,000 for the same period in 2004, increasing by \$1,573,000 or 72.5%. The increase in trust fees is reflective of the increase in the average fair value of trust accounts by 63.2% during the six months ended June 30, 2005 compared to the prior comparable period. The increase in the average fair value of trust accounts is primarily due to the addition of \$623,267,000 in trust assets with the Southeast Texas acquisition in March 2004 and additional trust business developed during the last twelve months. The fair market value of trust accounts at June 30, 2005 was \$1,681,922,000 compared to \$1,466,841,000 at December 31, 2004 and \$1,315,346,000 at June 30, 2004. Assets held by the trust department of the Bank in fiduciary or agency capacities are not assets of the Company and are not included in the condensed consolidated balance sheets.

Net realized gains on sales of securities available for sale for the three months ended June 30, 2005 totaled \$323,000 compared to \$1,383,000 for the same period in 2004. For the six months ended June 30, 2005, net realized gains on sales of securities available for sale totaled \$321,000 compared to \$1,882,000 for the comparable period in 2004. During the six months ended June 30, 2004, the Company sold various callable securities with unrealized gains before their anticipated call dates. During 2005, opportunities to recognize unrealized gains in the investment portfolio decreased as gross unrealized gains in the available for sale portfolio decreased from \$20,900,000 at December 31, 2003 to \$7,476,000 at December 31, 2004. Net unrealized holding loss on securities available for sale, net of tax, totaled \$10,889,000 at June 30, 2005. See "Shareholders' Equity".

Data processing service fees of \$2,148,000 for the three months ended June 30, 2005 remained comparable to \$2,128,000 for the three months ended June 30, 2004, increasing by only \$20,000 or 0.9%. During the six months ended June 30, 2005, data processing service fees increased \$522,000 or 12.3% to \$4,772,000 compared to \$4,250,000 during the same period in 2004. The increase in data processing fees for the six months ended June 30, 2005 compared to the same period last year was due to an increase in account volume for one data processing client. In addition, during first quarter 2005, the Company collected a \$332,000 termination fee. There were 25 data processing clients at June 30, 2005 and 26 at June 30, 2004.

Loan servicing income (loss), net of amortization of the mortgage servicing rights ("MSR") asset increased to \$3,000 net servicing income for second quarter 2005 compared to \$279,000 net servicing loss for second quarter 2004, reflecting an increase of \$282,000 from the prior year period. During the six months ended June 30, 2005, loan servicing income (loss), net increased \$617,000 to \$156,000 net servicing income compared to \$461,000 net servicing loss for the same period in 2004. The increases resulted primarily from \$170,000 and \$351,000 in servicing income generated from Valley Mortgage for the three and six months ended June 30, 2005, respectively, as well as a decrease in MSR amortization of \$219,000 and \$476,000 for the three and six months ended June 30, 2005, respectively, compared to the comparable prior year periods resulting from a slowdown in prepayments.

Other noninterest income of \$2,738,000 for the three months ended June 30, 2005 increased \$1,993,000 compared to \$745,000 for the comparable 2004 period. During the six months ended June 30, 2005, other noninterest income increased \$8,344,000 to \$9,696,000 compared to \$1,352,000 during the same period in 2004. The increase for the six months ended June 30, 2005 compared to the same period in 2004 resulted primarily from an aggregate \$6,160,000 in special distributions received during the first two quarters of 2005, as a result of the merger of PULSE EFT with Discover Financial Services. In addition,

gains on sale of loans held for sale and mortgage servicing rights increased \$1,112,000 and \$1,883,000 during the three and six months ending June 30, 2005, respectively, compared to the same 2004 periods.

#### NONINTEREST EXPENSE

Noninterest expense of \$39,072,000 for the three months ended June 30, 2005 increased \$703,000 or 1.8% compared to \$38,369,000 for the same period in 2004. For the six months ended June 30, 2005, noninterest expense totaled \$80,094,000 compared to \$65,152,000 for the same period in 2004, representing an increase of \$14,942,000 or 22.9%. The efficiency ratio was 49.51% for the three months ended June 30, 2005 compared to 54.29% for the same period in 2004. The improvement in the efficiency ratio resulted primarily from the minor increase in noninterest expense. Noninterest expense increased only 1.8% during second quarter 2005 compared to the same period in 2004 primarily due to the reversal of \$1,179,000 in pension plan and bonus expense accrued during first quarter 2005 compared to \$1,322,000 in pension plan and bonus expense during the second quarter of 2004. Bonus and pension plan payments are determined by management and are based upon the Company achieving certain goals for income and asset quality. The efficiency ratio was also affected by the \$908,000 special distribution received during second quarter 2005 as a result of the merger of PULSE EFT with Discover Financial Services. For the six months ended June 30, 2005, the efficiency ratio was 49.67% compared to 51.23% for the same period in 2004. The efficiency ratio is defined as noninterest expense divided by the total of net interest income and noninterest income.

Salaries and employee benefits, the largest category of noninterest expense, of \$19,609,000 for the three months ended June 30, 2005 increased by only \$181,000 or 0.9% compared to the same period last year of \$19,428,000. Although salaries increased \$2,607,000 during second quarter 2005 compared to the same period in 2004, the increase was offset by a \$2,501,000 decrease in bonus and pension plan expense. During second quarter 2005, \$1,179,000 in bonus and pension plan accruals recorded during first quarter 2005 were reversed. Bonus and pension plan expense totaled \$1,322,000 for the three months ended June 30, 2004. Salaries and employee benefits for the six months ended June 30, 2005 totaled \$42,326,000, reflecting an increase of \$9,121,000 or 27.5% from the comparable prior year period. The increase reflects increases in base salaries and higher levels of staff, including staff acquired with the Valley Mortgage and Mercantile acquisitions. The increase also reflects a full six months of expenses for staff acquired with the Southeast Texas acquisition. The number of full-time equivalent employees of 2,057 at June 30, 2005 represents an increase of 8.2% from 1,901 at June 30, 2004. Salaries and employee benefits averaged 1.28% of average assets for the three months ended June 30, 2005 compared to 1.44% for the three months ended June 30, 2004. For the six months ended June 30, 2005, salaries and employee benefits averaged 1.40% of average assets compared to 1.34% for the six months ended June 30, 2004.

Net occupancy expense totaled \$3,747,000 for the three months ended June 30, 2005 compared to \$3,299,000 reported for second quarter 2004, increasing by \$448,000 or 13.6%. For the six months ended June 30, 2005, net occupancy expense increased \$1,689,000 or 30.9% to \$7,161,000 compared to the same period a year ago. The increase corresponds generally with growth in business volumes during the twelve months ended June 30, 2005, including business volumes attributable to the acquisition of Mercantile and its three banking locations during January 2005 and increases from the Weslaco banking location opened during February 2005. In addition, net occupancy expense for the six months ended June 30, 2005 includes a full six months of expenses associated with the 29 banking locations acquired in the Southeast Texas acquisition during March 2004. Texas State Bank operated 71 banking locations as of June 30, 2005 compared to 67 as of June 30, 2004.

Equipment expense of \$3,610,000 for the three months ended June 30, 2005 increased \$376,000 or 11.6% from \$3,234,000 reported for the same period in 2004. For the six months ended June 30, 2005, equipment expense totaled \$6,933,000, reflecting an increase of \$972,000 or 16.3% compared to the same period in 2004. The increase is primarily the result of equipment expenses incurred in the acquired and new banking locations. The majority of the increase in equipment expense resulted from increases in depreciation expense on furniture, fixtures and equipment and personal property tax expense. Depreciation expense on furniture, fixtures and equipment increased \$117,000 and \$441,000 for the three and six months ending June 30, 2005, respectively, compared to the same periods last year. The increase in depreciation expense resulted primarily from a 13.5% and 22.0% increase in the average balance of the related asset accounts for the three and six months ended June 30, 2005, respectively, compared to the same 2004 periods. In addition, personal property tax expense increased \$93,000 and \$201,000 for the three and six months ending June 30, 2005, respectively, compared to the same periods in 2004.

Other real estate expense, net includes income from foreclosed properties, gain or loss on sale of other real estate properties and direct expenses of foreclosed real estate including property taxes, maintenance costs and write-downs. Write-downs of other real estate are required if the fair value less estimated selling costs of an asset acquired in a loan foreclosure subsequently declines below its carrying value. Other real estate expense, net of \$418,000 for the three months ended June 30, 2005 decreased \$154,000 or 26.9% from \$572,000 for the three months ended June 30, 2004. The decrease in other real estate expense, net during second quarter 2005 compared to second quarter 2004 resulted primarily from a decrease in net operating losses generated from foreclosed properties. During the six months ended June 30, 2005, other real estate expense, net of \$647,000 was comparable to \$693,000 reported for the six months ended June 30, 2004, decreasing by \$46,000 or 6.6%. Management is actively seeking buyers for all other real estate.

Amortization of identifiable intangibles of \$1,652,000 for the three months ended June 30, 2005 increased \$50,000 or 3.1% compared to \$1,602,000 for the same period in 2004. For the six months ended June 30, 2005, amortization of identifiable intangibles increased \$1,093,000 or 45.5% to \$3,493,000, compared to the same prior year period. The increase is primarily the

result of a \$951,000 increase in amortization on intangibles relating to the Southeast Texas acquisition combined with \$160,000 in amortization on intangibles added with the Mercantile acquisition.

A detailed summary of Noninterest Expense follows (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
	(Unaudited)			
Salaries and Wages	\$15,647	\$15,125	\$32,810	\$25,308
Employee Benefits	3,962	4,303	9,516	7,897
<b>Total Salaries and Employee Benefits</b>	<b>19,609</b>	<b>19,428</b>	<b>42,326</b>	<b>33,205</b>
Net Occupancy Expense	3,747	3,299	7,161	5,472
Equipment Expense	3,610	3,234	6,933	5,961
Other Real Estate Expense, Net				
Income	(18)	(254)	(35)	(512)
Loss on Sale	74	147	92	1
Expenses	243	679	471	1,061
Write-Downs	119	-	119	143
<b>Total Other Real Estate Expense, Net</b>	<b>418</b>	<b>572</b>	<b>647</b>	<b>693</b>
Amortization of Identifiable Intangibles	1,652	1,602	3,493	2,400
Other Noninterest Expense				
Advertising and Public Relations	1,482	1,404	2,920	2,567
Data Processing and Check Clearing	1,899	1,727	3,821	2,933
Director Fees	191	202	381	333
Franchise Tax	166	83	250	163
Insurance	123	133	301	258
FDIC Insurance	173	190	341	341
Legal	416	472	617	879
Professional Fees	1,247	741	2,181	1,349
Postage, Delivery and Freight	585	810	1,382	1,378
Printing, Stationery and Supplies	883	1,178	1,906	1,927
Telephone	513	469	957	774
Other Losses	229	649	442	917
Miscellaneous Expense	2,129	2,176	4,035	3,602
<b>Total Other Noninterest Expense</b>	<b>10,036</b>	<b>10,234</b>	<b>19,534</b>	<b>17,421</b>
<b>Total Noninterest Expense</b>	<b>\$39,072</b>	<b>\$38,369</b>	<b>\$80,094</b>	<b>\$65,152</b>

#### INCOME TAX EXPENSE

The Company recorded income tax expense of \$12,129,000 for the three months ended June 30, 2005 compared to \$8,784,000 for the three months ended June 30, 2004. For the six months ended June 30, 2005, income tax expense totaled \$24,242,000, representing an increase of \$6,823,000 or 39.2% compared to the same prior year period. The increase in income tax is primarily due to an increased level of pretax income for the three and six months ended June 30, 2005 compared to the same periods in 2004. The Company's effective tax rate was 34.7% for the six months ended June 30, 2005 and 32.6% for the six months ended June 30, 2004. The increase in the effective tax rate is primarily attributable to an increase in state income taxes, as well as a decrease in tax-exempt interest income as a percentage of income before income tax expense.

#### CAPITAL AND LIQUIDITY

Bank holding companies are required to maintain capital ratios in accordance with guidelines adopted by the Federal Reserve Board ("FRB"). The guidelines are commonly known as Risk-Based Capital Guidelines. On June 30, 2005, the Company exceeded all applicable capital requirements, having a total risk-based capital ratio of 11.74%, a Tier I risk-based capital ratio of 10.66% and a leverage ratio of 7.98%.

Shareholders' equity increased by \$27,566,000 or 4.6% during the six months ended June 30, 2005. The increase was primarily due to net income of \$45,713,000, offset by net unrealized holding losses, net of tax, of \$8,677,000 and dividends of \$10,913,000.

Liquidity management assures that adequate funds are available to meet deposit withdrawals, loan demand and maturing liabilities. Insufficient liquidity can result in higher costs of obtaining funds, while excessive liquidity can lead to a decline in earnings due to the cost of foregoing alternative investments. The ability to renew and acquire additional deposit liabilities is a major source of liquidity. The Company's principal sources of funds are primarily within the local markets of the Bank and consist of deposits, interest and principal payments on loans and securities, sales of loans and securities and borrowings.

Cash and assets which are readily marketable, or which can be pledged, or which will mature in the near future provide asset liquidity. These include cash, federal funds sold, time deposits and U.S. Treasury, U.S. Government Agency and mortgage-backed securities. At June 30, 2005, the Company's liquidity ratio, defined as cash, U.S. Treasury, U.S. Government Agency, mortgage-backed securities, interest-bearing deposits, time deposits and federal funds sold as a percentage of deposits, increased to 32.8% compared to 31.3% at December 31, 2004.

Liability liquidity is provided by access to core funding sources, principally various customers' interest-bearing and noninterest-bearing deposit accounts in the Company's trade area. The Company does not have nor does it solicit brokered deposits. Foreign deposits represent 8.0% of deposits at June 30, 2005 compared to 8.5% of deposits at June 30, 2004. Federal funds purchased and short-term borrowings are additional sources of liquidity. At June 30, 2005, the Company had lines of credit totaling \$155,000,000 with correspondent banks for short-term liquidity needs. In addition, the Company had available credit of approximately \$1,125,952,000 from the Federal Home Loan Bank, of which \$255,642,000 was advanced at June 30, 2005. These sources of liquidity are short-term in nature and are used, as necessary, to fund asset growth and meet short-term liquidity needs.

The Company enters into contractual commitments to extend credit, normally with a fixed expiration date, at specified rates and for specific purposes. All of the Company's commitments are contingent upon the customer maintaining specific credit standards at the time of the loan funding. At June 30, 2005, the Company had outstanding commitments to extend credit of approximately \$754,431,000, commercial letters of credit of \$62,000, standby letters of credit of \$82,064,000 and credit card guarantees of \$1,363,000. The Company guarantees the credit card debt of certain customers to the merchant bank that issues the cards, up to the customers' credit limit. In addition, the Company had construction and real estate commitments of \$5,813,000.

During the six months ended June 30, 2005, funds for \$427,071,000 of securities purchased, \$53,178,000 of net loan growth and \$45,863,000 for principal reductions of other borrowed money came from various sources, including \$217,699,000 of proceeds from security sales and maturities, a net increase in deposits of \$219,654,000 and \$77,239,000 from operating activities.

The Company is dependent on dividend and interest income from the Bank and the sale of stock for its liquidity. Applicable Federal Reserve Board regulations provide that bank holding companies are permitted by regulatory authorities to pay cash dividends on their common or preferred stock if consolidated earnings and consolidated capital are within regulatory guidelines. At June 30, 2005, an aggregate of \$52,723,000 was available for payment of dividends by the Bank to the Company under the applicable limitations and without regulatory approval.

#### **EFFECTS OF INFLATION**

Financial institutions are impacted differently by inflation than are industrial companies. While industrial and manufacturing companies generally have significant investments in inventories and fixed assets, financial institutions ordinarily do not have such investments. As a result, financial institutions are generally in a better position than industrial companies to respond to inflationary trends by monitoring the spread between interest costs and interest income yields through adjustments of maturities and interest rates of assets and liabilities. In addition, inflation tends to increase demand for loans from financial institutions as industrial companies attempt to maintain a constant level of goods in inventory and assets. As consumers of goods and services, financial institutions are affected by inflation as prices increase, causing an increase in costs of salaries, employee benefits, occupancy expense and similar items.

#### **POSSIBLE NEGATIVE IMPACT OF LITIGATION**

The Company is a defendant in various legal proceedings arising in connection with its ordinary course of business. In the opinion of management, the consolidated financial position and results of operations of the Company will not be materially affected by the final outcome of these legal proceedings.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risk to which the Company is exposed is interest rate risk. Interest rate risk occurs when assets and liabilities reprice at different times as interest rates change. For example, if fixed-rate loans are funded with floating-rate deposits, the spread between loan and deposit rates will decline or turn negative if rates increase. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Company's business activities. The Company's interest rate risk arises from transactions entered into for purposes other than trading. The Company does not currently engage in trading activities or use derivative instruments to control interest rate risk. Even though such activities may be permitted with the approval of the Board of Directors, the Company does not intend to engage in such activities in the immediate future.

Interest rate risk is managed within the funds management policy of the Company. The principal objectives of the funds management policy are to avoid fluctuating net interest margins and to maintain consistent growth of net interest income through periods of changing interest rates. The Board of Directors oversees implementation of strategies to control interest rate risk. The Company may take steps to alter its net sensitivity position by offering deposit and/or loan structures that tend to counter the natural rate risk profile of the Company. Funding positions are kept within predetermined limits designed to ensure that risk-

taking is not excessive and that liquidity is properly managed. Because of the volatility of market rates and uncertainties, there can be no assurance of the effectiveness of management programs to achieve a targeted moderation of risk.

In order to measure earnings and fair value sensitivity to changing rates, the Company utilizes three different measurement tools including static gap analysis, simulation earnings, and market value sensitivity (fair value at risk). The primary analytical tool used by the Company to quantify interest rate risk is a simulation model to project changes in net interest income that result from forecast changes in interest rates. This analysis estimates a percentage of change in net interest income from the stable rate scenario under scenarios of rising and falling market interest rates over a twelve month time horizon. The prime rate serves as a “driver” and is made to rise (or fall) evenly in 100 basis point increments over the twelve month forecast interval. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet.

The following table summarizes the simulated change in net interest income over a twelve month period as of June 30, 2005 and December 31, 2004 (dollars in thousands):

Changes in Interest Rates (Basis Points)	Estimated Net Interest Income	Increase (Decrease) in Net Interest Income	
		Amount	Percent
June 30, 2005 (Unaudited)			
+100	\$241,888	\$ 4,420	1.9%
-	237,468	-	-
-100	230,298	(7,170)	(3.0)
December 31, 2004			
+100	234,971	10,599	4.7
-	224,372	-	-
-100	207,191	(17,181)	(7.7)

All the measurements of risk described above are made based upon the Company’s business mix and interest rate exposures at the particular point in time. An immediate 100 basis point decline in interest rates is a hypothetical rate scenario, used to calibrate risk, and does not necessarily represent management’s current view of future market developments. Because of uncertainties as to the extent of customer behavior, refinance activity, absolute and relative loan and deposit pricing levels, competitor pricing and market behavior, product volumes and mix, and other unexpected changes in economic events impacting movements and volatility in market rates, there can be no assurance that simulation results are reliable indicators of net interest income under such conditions.

#### **ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s Chief Executive Officer along with the Company’s Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures pursuant to Rule 13a-15(b), as adopted by the Securities and Exchange Commission (“SEC”) under the Securities Exchange Act of 1934 (“Exchange Act”). Based upon that evaluation, the Company’s Chief Executive Officer along with the Company’s Chief Financial Officer concluded that the Company’s disclosure controls and procedures are effective to timely alert them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company’s periodic SEC filings.

Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in the Company’s internal controls or in other factors which could significantly affect these controls over financial reporting that have materially affected, or are or are reasonably likely to materially affect, the Company’s internal controls over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The Company has been notified of the filing, on April 28, 2005, of a lawsuit in the District Court of Orange County, Texas, 163<sup>rd</sup> Judicial District, styled Andrew W. Dunn and Kenneth D. Rogers, Plaintiffs, vs. Texas State Bank, Texas Regional Bancshares, Inc., Texas Regional Delaware, Inc., Community Bank & Trust, S.S.B. (“Community”), Quality Mat Company, Joe

Penland, Sr., Robert L. McDorman, C. Meshell McDorman, Mac-Pro GP, L.L.C., Mac-Pro, Ltd., McDorman Motors GP, L.L.C., McDorman Motors, Ltd., and additional unidentified defendants. Mr. Penland is a director of the Company and Texas State Bank. The plaintiffs in the lawsuit purport to act as the assignees of the former Mauriceville National Bank (“Mauriceville”) and as co-agents on behalf of Mauriceville’s former shareholders.

The lawsuit seeks recovery, among other things, of funds lost by Mauriceville arising out of an alleged check kiting scheme involving cashier’s checks issued by Mauriceville and customer checks drawn on Community and another bank. Plaintiffs seek recovery of \$3,374,256, plus an unspecified amount of consequential damages, interest, attorneys’ fees and expense. Community was acquired by the Company as part of its acquisition of Southeast Texas Bancshares, Inc. in March 2004. Texas Regional’s management has notified its insurance carriers and intends to vigorously defend the lawsuit.

The Company and its subsidiaries are also routinely involved in other legal proceedings concerning matters arising from the conduct of the Company’s and its subsidiaries’ business activities, including the prior business activities of acquired companies. In the opinion of management, pending legal proceedings will not have a material adverse effect on the Company’s condensed consolidated financial position or results of operations.

#### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Annual Meeting of Shareholders of the Corporation was held on April 25, 2005. The following matters were submitted to a vote of the Corporation’s shareholders.

Election of all thirteen director nominees was approved:

Nominee	Total Votes For	Total Votes Withheld
Morris Atlas	43,797,756	1,382,418
Robert F. Boggus	44,661,377	518,797
Robert G. Farris	44,662,446	517,728
Hill A. Feinberg	43,353,755	1,826,419
C. Kenneth Landrum, M.D.	43,290,371	1,889,803
David L. Lane	44,795,938	384,236
Jack H. Mayfield, Jr.	44,258,834	921,340
Joe Penland, Sr.	44,261,422	918,751
Joseph E. Reid	44,782,728	397,446
G. E. Roney	44,092,733	1,087,441
Tudor G. Uhlhorn	44,643,585	536,589
Walter Umphrey	43,811,223	1,368,950
Mario Max Yzaguirre	44,253,736	926,438

The amendment to the Articles of Incorporation to increase authorized shares of Class A voting common stock from 50,000,000 to 100,000,000 was approved:

Total Votes For	Total Votes Withheld	Total Votes Against
42,838,090	34,767	2,307,317

The 2005 Incentive Stock Option Plan was approved:

Total Votes For	Total Votes Withheld	Total Votes Against
37,548,117	174,177	1,713,392

The 2005 Nonstatutory Stock Option Plan was approved:

Total Votes For	Total Votes Withheld	Total Votes Against
37,388,372	224,721	1,822,593

The appointment of KPMG LLP as the Company's independent auditors for the year 2005 was ratified:

Total Votes For	Total Votes Withheld	Total Votes Against
44,463,813	31,242	685,119

## ITEM 6. EXHIBITS

(a) The following documents are filed as part of this Quarterly Report on Form 10-Q:

(1) Exhibits — The following exhibits are filed as a part of this Quarterly Report on Form 10-Q:

- 10.1 Amendment Number 18 to Texas Regional Bancshares, Inc. Amended and Restated Employee Stock Ownership Plan (with 401(k) provisions) (filed herewith).
- 31.1 Certification required by Rule 13a-14(a) as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (of Chief Executive Officer) (filed herewith).
- 31.2 Certification required by Rule 13a-14(a) as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (of Chief Financial Officer) (filed herewith).
- 32.1 Certification required by Rule 13a-14(b) and 18 U.S.C. §1350 as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

## SIGNATURES

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

TEXAS REGIONAL BANCSHARES, INC.  
(Registrant)

..... August 9, 2005

..... /s/ G. E. Roney

Glen E. Roney  
Chairman of the Board, President  
& Chief Executive Officer

..... August 9, 2005

..... /s/ John A. Martin

John A. Martin  
Executive Vice President  
& Chief Financial Officer

**CERTIFICATION REQUIRED BY RULE 13a-14(a)  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Glen E. Roney, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Texas Regional Bancshares, Inc.;
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 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 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: August 9, 2005

.....  
/s/ G.E. Roney  
Glen E. Roney  
Chairman of the Board, President  
& Chief Executive Officer

**CERTIFICATION REQUIRED BY RULE 13a-14(a)  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John A. Martin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Texas Regional Bancshares, Inc.;
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 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 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: August 9, 2005.....

-----/s/ John A. Martin  
John A. Martin  
Executive Vice President  
& Chief Financial Officer

**CERTIFICATION REQUIRED BY RULE 13a-14(b)  
AND 18 U.S.C. §1350, AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Texas Regional Bancshares, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, the undersigned, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that to our knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the consolidated financial condition and results of operations of the Company.

.....  
Date: August 9, 2005

.....  
/s/ G.E. Roney  
Glen E. Roney  
Chairman of the Board, President  
& Chief Executive Officer

.....  
Date: August 9, 2005

.....  
/s/ John A. Martin  
John A. Martin  
Executive Vice President  
& Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Texas Regional and will be retained by Texas Regional and furnished to the Securities and Exchange Commission or its staff upon request.

**AMENDMENT NUMBER EIGHTEEN  
TO  
TEXAS REGIONAL BANCSHARES, INC.  
AMENDED AND RESTATED EMPLOYEE STOCK OWNERSHIP PLAN  
(WITH 401(K) PROVISIONS)**

Texas Regional Bancshares, Inc., a corporation organized and operating under the laws of the State of Texas, and registered as a bank holding company under the Bank Holding Company Act of 1956, as amended (the "Company"), together with Texas State Bank, a Texas state banking association; TSB Securities, Inc., Port Arthur Abstract and Title Company, Southeast Texas Title Company, and Valley Mortgage Company, Inc., all Texas corporations; and Southeast Texas Insurance Services, L.P., a Texas limited partnership of which Southeast Texas Insurance Services Holdings, LLC is the general partner (collectively, the "Participating Employers"); and the Trustees and the Administrative Committee members of the Texas Regional Bancshares, Inc. Amended and Restated Employee Stock Ownership Plan (with 401(k) Provisions) adopt the following amendments to the Plan generally effective as of May 1, 2005.

WHEREAS, the Company has established and maintains the Texas Regional Bancshares, Inc. Amended and Restated Employee Stock Ownership Plan (with 401(k) Provisions) (the "Plan"); and

WHEREAS, the Company and the Participating Employers desire to amend the Plan to add in-kind distributions of Participants' account balances in circumstances where such distributions are feasible and to simplify certain other Plan provisions; and

WHEREAS, under Section 2.2 of the Plan, the Plan Administrator is the Company unless another person or entity has been appointed pursuant to Section 3.2 of the Plan as Plan Administrator; and

WHEREAS, the Company and the Participating Employers desire to appoint the Plan's existing Administrative Committee as the Plan Administrator under ERISA; and

WHEREAS, the Participating Employers have joined in the Plan for the purpose of providing benefits under the Plan to their eligible employees; and

WHEREAS, pursuant to Section 10.1 of the Plan, the Company has the right to amend the Plan, provided that the Trustees join in such Amendment if the provisions of the Plan affecting the Trustees are amended; and

WHEREAS, pursuant to Section 13.6 of the Plan, the Company has the right to amend the Plan, provided that the Participating Employers join in such Amendment; and

WHEREAS, the Company and the Participating Employers desire to amend the Plan to document the effective date of each Participating Employer's adoption of the Plan and to authorize the Company to adopt future amendments, to appoint fiduciaries, and to take other actions with respect to the Plan, all without the joinder of the Participating Employers.

NOW, THEREFORE, IT IS HEREBY RESOLVED THAT the Plan is amended effective May 1, 2005, except as specifically provided below, as follows:

**1. Plan Section 2.20 is amended and restated in its entirety to read as follows:**

2.20 "Employer" means Texas Regional Bancshares, Inc. and any successor which shall maintain this Plan; and any predecessor which has maintained this Plan. In addition, where appropriate, the term Employer shall include any Participating Employer (as defined in Section 13.1) which shall adopt this Plan. For purposes of Article IX, TRUSTEE, and Sections 10.1 and 10.2, relating to the Employer's authority to amend or terminate the Plan, however, the term "Employer" shall mean only Texas Regional Bancshares, Inc., which shall act under those provisions without the need to consult any Participating Employer.

**2. Plan Section 2.30 is amended and restated in its entirety, effective January 1, 2004, to read as follows:**

2.30 "Forfeiture" means that portion of a Participant's Account that is not Vested. A Forfeiture occurs on the earlier of:

(a) the distribution of the entire Vested portion of the Participant's Account of a Former Participant who has severed employment with the Employer. For purposes of this provision, if the Former Participant has a Vested benefit of zero, then such

Former Participant shall be deemed to have received a distribution of such Vested benefit as of the year in which the severance of employment occurs, or

(b) the last day of the Plan Year in which a Former Participant who has severed employment with the Employer incurs five (5) consecutive 1-Year Breaks in Service.

**3. Plan Section 2.55 is amended and restated in its entirety to read as follows:**

2.55 "Participant's Transfer/Rollover Account" means the account established and maintained by the Administrator for each Participant with respect to the Participant's total interest in the Plan resulting from amounts transferred to this Plan from a direct plan-to-plan transfer and/or with respect to such Participant's interest in the Plan resulting from amounts transferred from another qualified plan or "conduit" Individual Retirement Account in accordance with Section 5.11.

A separate accounting shall be maintained with respect to that portion of the Participant's Transfer/Rollover Account attributable to transfers (within the meaning of Code Section 414(1)) and "rollovers."

A Participant's Transfer/Rollover Account shall include Bank of Texas Transfer/Rollover Accounts, Harlingen National Bank Transfer/Rollover Accounts, Riverway Bank Transfer/Rollover Accounts, Texas Country Bank Transfer/Rollover Accounts, First State Bank, Bishop Transfer/Rollover Accounts, all of which are fully vested, and any other such accounts resulting from mergers of other plans into this Plan.

**4. Plan Section 4.7 is amended and restated in its entirety effective January 1, 2005, to read as follows:**

**4.7 REHIRED EMPLOYEES AND BREAKS IN SERVICE**

(a) Participation.

(1) A Former Participant shall participate in the Plan as of the date of reemployment.

(2) A rehired Eligible Employee who had fulfilled the requirements of Section 4.1 for participation in salary reduction elections and Employer Discretionary Matching Contributions prior to severance from employment may participate in such contributions immediately upon reemployment unless the Employee has incurred a 1-Year Break in Service. If a 1-Year Break in Service was incurred, the Employee's prior service will be disregarded for eligibility purposes, and the Eligible Employee shall be treated as a new employee.

(3) A rehired Eligible Employee who had fulfilled the requirements of Section 4.1 for participation in Employer Discretionary Optional Contributions prior to severance from employment, but who had not reached his or her effective date of participation under Section 4.2 shall participate in such those contributions as described in Section 4.2 unless the Employee has incurred a 1-Year Break in Service. If a 1-Year Break in Service was incurred, the Employee's prior service will be disregarded for eligibility purposes, and the Eligible Employee shall be treated as a new employee.

(4) A rehired Eligible Employee who had not fulfilled the requirements of Section 4.1 for participation in salary reduction elections and Employer Discretionary Matching Contributions prior to severance from employment shall continue to earn Years of Service for eligibility purposes upon reemployment unless the Employee has incurred a 1-Year Break in Service. If a 1-Year Break in Service was incurred, the Employee's prior service will be disregarded for eligibility purposes, and the Eligible Employee shall be treated as a new employee for purposes of such contributions.

(5) A rehired Eligible Employee who had not fulfilled the requirements of Section 4.1 for participation in Employer Discretionary Optional Contributions prior to severance from employment shall continue to earn Years of Service for eligibility purposes upon reemployment unless the Employee has incurred a 1-Year Break in Service. If a 1-Year Break in Service was incurred, the Employee's prior service will be disregarded for eligibility purposes, and the Eligible Employee shall be treated as a new employee for purposes of such contributions.

(b) Vesting. All Years of Service, as defined for vesting purposes under Section 2.76, shall be credited for all Accounts under the Plan except as specifically provided below for a Former Participant who is partially vested in any pre-break Account that is subject to vesting under the Plan.

(1) After a partially Vested Former Participant incurs five consecutive 1-Year Breaks in Service, the Vested portion of said Former Participant's Account attributable to pre-break service shall not be increased as a result of post-break service, nor shall the Participant's Account attributable to post-break service be increased as a result of pre-break service. In such case, separate accounts will be maintained as follows:

- (i) one account for nonforfeitable benefits attributable to pre-break service; and
- (ii) one account representing the Participant's Employer- derived account balance in the Plan attributable to post-break service.

(2) If a partially Vested Participant becomes a Former Participant due to severance of employment with the Employer and is reemployed by the Employer before five consecutive 1-Year Breaks in Service, and such Former Participant had received a distribution of his or her entire Vested interest prior to reemployment, then the forfeited account shall be reinstated only if the Former Participant repays the full amount which had been distributed. Such repayment must be made before the earlier of five years after the first date on which the Participant is subsequently reemployed by the Employer or the close of the first period of five consecutive 1-Year Breaks in Service commencing after the distribution. If a distribution occurs for any reason other than a severance of employment, the time for repayment may not end earlier than five years after the date of distribution. If the Former Participant does repay the full amount distributed, the forfeited portion of the Participant's Account must be restored in full, unadjusted by any gains or losses occurring subsequent to the Valuation Date preceding the distribution. The source for such reinstatement may be Forfeitures occurring during the Plan Year. If such source is insufficient, then the Employer will contribute an amount which is sufficient to restore any such forfeited Accounts, provided, however, that if a discretionary contribution is made for such year, such contribution shall first be applied to restore any such Accounts and the remainder shall be allocated in accordance with Section 4.4.

**5. Plan Subsection 5.11(a), relating to rollovers and transfers from other plans, is amended and restated in its entirety to read as follows:**

(a) With the consent of the Administrator, amounts may be transferred (within the meaning of Code Section 414(l)) to this Plan from other tax qualified plans under Code Section 401(a) by Eligible Employees, provided that the trust from which such funds are transferred permits the transfer to be made and the transfer will not jeopardize the tax exempt status of the Plan or Trust or create adverse tax consequences for the Employer. Prior to accepting any transfers to which this Section applies, the Administrator may require an opinion of counsel that the amounts to be transferred meet the requirements of this Section. The amounts transferred shall be set up in a separate account herein referred to as a Participant's Transfer/Rollover Account. Furthermore, unless a Participant is fully vested in the amounts transferred, for vesting purposes, the Participant's portion of the Participant's Transfer/Rollover Account attributable to any transfer shall be subject to Section 8.4(b).

Except as permitted by Regulations (including Regulation 1.411(d)-4), amounts attributable to elective contributions (as defined in Regulation 1.401(k)-1(g)(3)), including amounts treated as elective contributions, which are transferred from another qualified plan in a plan-to-plan transfer (other than a direct rollover) shall be subject to the distribution limitations provided for in Regulation 1.401(k)-1(d).

**6. Plan Subsection 5.12(a), relating to participant-directed investments, is amended and restated in its entirety to read as follows:**

(a) Effective as of December 1, 2001, Participants may, subject to Section 5.12(d) and a procedure established by the Administrator (the Participant Direction Procedures) and applied in a uniform nondiscriminatory manner, direct the Trustee, in writing (or in such other form which is acceptable to the Trustee), to invest all or a portion of their individual account balances attributable to their Deferred Compensation in specific assets, specific funds or other investments permitted under the Plan and the Participant Direction Procedures.

Effective as of January 1, 2002, Participants may, subject to the Participant Direction Procedures, direct the Trustee, in writing (or in such other form which is acceptable to the Trustee), to invest all or a portion of their individual account balances attributable to their Participant's Transfer/Rollover Accounts in specific assets, specific funds or other investments permitted under the Plan and the Participant Direction Procedures.

That portion of the interest of any Participant so directing will thereupon be considered a Participant's Directed Account.

**7. Plan Subsection 5.12(d), relating to the Plan's means of distribution, is amended and restated in its entirety to read as follows:**

(d) Each "Qualified Participant" may elect within ninety (90) days after the close of each Plan Year during the "Qualified Election Period" to direct the Trustee in writing to invest twenty-five percent (25%) of the total number of shares of Company Stock acquired by or contributed to the Plan that have ever been allocated to such "Qualified Participant's" Company Stock Account, excluding any portion of said Company Stock Account attributable to Elective Contributions or to the Participant's Transfer/Rollover Account (reduced by the number of shares of Company Stock previously diversified or distributed, pursuant to a prior election, in cash, in mutual fund interests as permitted by Section 8.6(a), and/or in Company

Stock) in the specific assets, specific funds or other investments permitted under the Plan, which investment options shall consist of at least three (3) investment options not inconsistent with any Regulations promulgated by the Secretary of the Treasury. The Trustee shall invest the portion of the "Qualified Participant's" Company Stock that is subject to the diversification election within ninety (90) days after the period during which the Participant's election may be made. In the case of the election year in which the last election can be made by the Participant, the preceding sentence shall be applied by substituting "50 percent" for "25 percent." If the "Qualified Participant" elects to direct the Trustee as to the distribution of the Participant's Company Stock Account, such direction shall be effective no later than 180 days after the close of the Plan Year to which such direction applies.

Notwithstanding the above, if the fair market value (determined pursuant to Section 6.1 at the Plan Valuation Date immediately preceding the first day on which a "Qualified Participant" is eligible to make an election) of Company Stock acquired by or contributed to the Plan and allocated to a "Qualified Participant's" Company Stock Account is \$500 or less, then such Company Stock shall not be subject to this paragraph. For purposes of determining whether the fair market value exceeds \$500, Company Stock held in accounts of all employee stock ownership plans (as defined in Code Section 4975(e)(7)) and tax credit employee stock ownership plans (as defined in Code Section 409(a)) maintained by the Employer or any Affiliated Employer shall be considered as held by the Plan.

**8. Plan Subsection 8.5(a), relating to lump-sum distributions, is amended and restated in its entirety effective January 1, 2004, to read as follows:**

(a) The Administrator, pursuant to the election of the Participant, shall direct the Trustee to distribute to a Participant or such Participant's Beneficiary any amount to which the Participant is entitled under the Plan in one lump-sum payment or in partial lump-sum payments, each less than the entire remaining Participant's Combined Account.

**9. Plan Subsection 8.5(j), relating to Bank of Texas Transfer/Rollover Accounts, is deleted.**

**10. Plan Subsection 8.6(a), relating to the Plan's means of distribution, is amended and restated in its entirety to read as follows:**

(a) Distribution of a Participant's benefit may be made in cash or Company Stock, or both, provided, however, that if a Participant or Beneficiary so demands, such benefit shall be distributed only in the form of Company Stock. Prior to making a distribution of benefits, the Administrator shall advise the Participant or the Participant's Beneficiary, in writing (or such other form as permitted by the Internal Revenue Service), of the right to demand that benefits be distributed solely in Company Stock. In addition, a Participant may elect distribution of interests in mutual funds to the extent that such mutual fund interests are allocated to the Participant's Combined Account at the time of distribution, provided that the distributee of such interests in mutual funds is capable of holding such interests.

**11. Plan Subsection 8.6(d), relating to the Plan's means of distribution, is amended and restated in its entirety to read as follows:**

(d) Notwithstanding anything contained herein to the contrary, if the Employer charter or by-laws restrict ownership of substantially all shares of Company Stock to Employees and the Trust Fund, as described in Code Section 409(h)(2)(B)(ii)(I), the Administrator shall distribute a Participant's Combined Account entirely in cash and/or mutual fund interests as described in Section 8.6(a) without granting the Participant the right to demand distribution in shares of Company Stock.

**12. Plan Subsection 8.6(f)(first paragraph only), relating to accounts that are subject to the annuity distribution rules, is amended and restated in its entirety effective January 1, 2003, to read as follows:**

(f) Notwithstanding anything contained herein to the contrary, this Section 8.6(f) shall apply with respect to any Participant's Target Benefit Capital Accumulation.

**13. Plan Subparagraph 8.6(f)(1)(i), relating to the Qualified Joint and Survivor Annuity, is amended and restated in its entirety to read as follows:**

(i) General. Unless otherwise elected as provided below, the Participant's Target Benefit Capital Accumulation (less amounts attributable to Employee contributions within the meaning of Code Section 72(o)) of a Participant who is married on the Annuity Starting Date and who does not die before the Annuity Starting Date shall be paid in the form of a Qualified Joint and Survivor Annuity. If said Participant has elected a life annuity option under this Plan, the vested portion of the Participant's Combined Account shall be paid in the form of a Qualified Joint and Survivor Annuity, unless otherwise elected as provided below.

An unmarried Participant shall receive the value of his benefit in the form of a life annuity. Such unmarried Participant, however, may elect in writing to waive the life annuity. The election must comply with the provisions of Section 8.6(f)(1)(ii) of this Plan as if it were an election to waive the Qualified Joint and Survivor Annuity by a married Participant, but without the spousal consent requirement.

The Participant may elect to have any annuity provided for in this Section distributed upon the attainment of the "earliest retirement age" under the Plan. The "earliest retirement age" is the earliest date on which, under the Plan, the Participant could elect to receive retirement benefits.

**14. Plan Subparagraph 8.6(f)(2)(i), relating to the Qualified Preretirement Survivor Annuity, is amended and restated in its entirety to read as follows:**

(i) General. Unless otherwise elected as provided below, in the case of a Vested Participant (or former Vested Participant) who dies before the Annuity Starting Date and who has a surviving spouse, the Participant's Target Benefit Capital Accumulation shall be paid to his or her surviving spouse in the form of a Qualified Preretirement Survivor Annuity. Further, if said Vested Participant (or former Vested Participant) has elected a life annuity option prior to December 31, 2001 under this Plan, the vested portion of the Participant's Combined Account shall be paid to the surviving spouse in the form of a Qualified Preretirement Survivor Annuity.

The Participant's spouse may direct that payment of the Qualified Preretirement Survivor Annuity commence within a reasonable period after the Participant's death. If the spouse does not so direct, payment of such benefit will commence at the time the Participant would have attained the later of his Normal Retirement Age or age 62. However, the spouse may elect a later commencement date. Any distribution to the Participant's spouse shall be subject to the rules specified in Section 8.5(e).

**15. Plan Subparagraph 8.6(f)(2)(v), relating to the Plan's means of distributing certain death benefits, is amended and restated in its entirety to read as follows:**

(v) To the extent the death benefit is not paid in the form of a Qualified Preretirement Survivor Annuity, it shall be paid to the Participant's Beneficiary by one lump-sum payment in cash and/or Company Stock.

**16. Plan Subsection 8.6(g), relating to certain previously eliminated distribution options, is deleted effective January 1, 2003.**

**17. Plan Subsection 8.6(h), relating to certain previously eliminated distribution options, is deleted effective January 1, 2003.**

**18. Plan Subsection 8.6(i), relating to certain previously eliminated distribution options, is deleted effective January 1, 2003.**

**19. Plan Section 8.11 is amended and restated in its entirety to read as follows:**

**8.11 IN-SERVICE DISTRIBUTION**

(a) At such time as an Employee has attained the age of 59 ½ years or at any time thereafter, the Employee may elect to commence distribution of all or a portion of any of the following amounts:

(1) The portion of the Employee's Elective Account that is attributable to Salary Reduction Contributions and any Employer Qualified Non-Elective Contributions.

(2) The portion of the Employee's Transfer/Rollover Account that is attributable to Matching Contributions made to a plan that was subsequently merged into this Plan.

(3) The portion of the Employee's Transfer/Rollover Account that is attributable to after-tax employee contributions made to a plan that was subsequently merged into this Plan.

(4) The portion of an Employee's Transfer/Rollover Account that is attributable to "rollovers" (as defined in Section 5.11(b)).

(5) The Employee's Bank of Texas Transfer/Rollover Account (if any), as defined in Section 2.55.

(b) At such time as an Employee has attained the age of 70 ½ years or at any time thereafter, the Employee may elect to commence distribution of all or a portion of any of the Participant's Accounts.

(c) In the event that a distribution is made to a Participant under this Section, the Participant shall continue to be eligible to participate in the Plan on the same basis as any other Eligible Employee. Any distribution made pursuant to this

Section shall be made in a manner consistent with Article VIII, including, but not limited to, all applicable notice and consent requirements.

**20. Article XIII of the Plan is amended and restated in its entirety to read as follows:**

ARTICLE XIII  
PARTICIPATING EMPLOYERS

13.1 ADOPTION BY OTHER EMPLOYERS

Notwithstanding anything herein to the contrary, with the consent of Texas Regional Bancshares, Inc. and Trustee, any other corporation or entity, whether an affiliate or subsidiary or not, may adopt this Plan and all of the provisions hereof, and participate herein and be known as a Participating Employer, by a properly executed document evidencing said intent and will of such Participating Employer.

13.2 REQUIREMENTS OF PARTICIPATING EMPLOYERS

(a) Each such Participating Employer shall be required to use the same Trustee as provided in this Plan.

(b) The Trustee may, but shall not be required to, commingle, hold and invest as one Trust Fund all contributions made by Participating Employers, as well as all increments thereof.

(c) At the option of Texas Regional Bancshares, Inc. and with the approval of the Administrator, any expenses of the Plan which are to be paid by the Employer or borne by the Trust Fund shall be paid by Texas Regional Bancshares, Inc. or by each Participating Employer in the same proportion that the total amount standing to the credit of all Participants employed by such Employer bears to the total standing to the credit of all Participants.

13.3 DESIGNATION OF AGENT

Each Participating Employer shall be deemed to be a party to this Plan; provided, however, that with respect to all of its relations with the Trustee and Administrator for the purpose of this Plan, each Participating Employer shall be deemed to have designated irrevocably Texas Regional Bancshares, Inc. as its agent.

13.4 EMPLOYEE TRANSFERS

In the event an Employee is transferred between Participating Employers, accumulated service and eligibility shall be carried with the Employee involved. No such transfer shall effect a termination of employment hereunder if the transfer involves an Affiliated Employer, and the Participating Employer to which the Employee is transferred shall thereupon become obligated hereunder with respect to such Employee in the same manner as was the Participating Employer from whom the Employee was transferred.

13.5 PARTICIPATING EMPLOYER CONTRIBUTION AND FORFEITURES

With respect to Participating Employers that are not Affiliated Employers, any contribution or Forfeiture subject to allocation during each Plan Year shall be allocated only among those Participants of the Participating Employer making the contribution or by which the forfeiting Participant was employed. However, if the contribution is made, or the forfeiting Participant was employed, by an Affiliated Employer, such contribution or Forfeiture shall be allocated among all Participants of all Participating Employers who are Affiliated Employers in accordance with the provisions of this Plan. On the basis of the information furnished by the Administrator, the Trustee may keep separate books and records concerning the affairs of each non-Affiliated Participating Employer hereunder and as to the accounts and credits of the Employees of each non-Affiliated Participating Employer. The Trustee may, but need not, register Contracts so as to evidence that a particular Participating Employer is the interested Employer hereunder, but in the event of an Employee transfer to or from a non-Affiliated Participating Employer to another Employer, the employing Participating Employer shall immediately notify the Trustee thereof.

13.6 AMENDMENT

Amendment of this Plan shall only be by the written action of Texas Regional Bancshares, Inc. and with the consent of the Trustee where such consent is necessary in accordance with the terms of this Plan.

### 13.7 DISCONTINUANCE OF PARTICIPATION

No Participating Employer shall be permitted to discontinue or revoke its participation in the Plan without the consent of Texas Regional Bancshares, Inc. Texas Regional Bancshares, Inc., may, however, discontinue the participation of any Participating Employer at any time without the consent of any person. At the time of any such discontinuance or revocation, satisfactory evidence thereof shall be delivered to the Trustee by Texas Regional Bancshares, Inc. The Trustee shall thereafter transfer, deliver and assign Contracts and other Trust Fund assets allocable to the Participants of such Participating Employer to such new trustee as shall have been designated by such Participating Employer, in the event that it has established a separate qualified retirement plan for its Employees, provided, however, that no such transfer shall be made if the result is the elimination or reduction of any "Section 411(d)(6) protected benefits" as described in Section 9.1(c). If no successor is designated, the Trustee shall retain such assets for the Employees of said Participating Employer pursuant to the provisions of Article VII hereof. In no such event shall any part of the corpus or income of the Trust as it relates to a non-Affiliated Employer be used for or diverted for purposes other than for the exclusive benefit of the Employees of such non-Affiliated Employer.

### 13.8 ADMINISTRATOR'S AUTHORITY

The Administrator shall have authority to make any and all necessary rules or regulations, binding upon all Participating Employers and all Participants, to effectuate the purpose of this Article.

**21. Schedule B to the Plan, Effective Date of Participating Employer Adoption, is adopted in the form attached to this Amendment as Exhibit "A."**

**22. Pursuant to Section 3.2 of the Plan, the Administrative Committee is hereby appointed to serve as the Plan Administrator of the Plan, effective May 1, 2005.**

IN WITNESS WHEREOF, this Eighteenth Amendment to the Texas Regional Bancshares, Inc. Amended and Restated Employee Stock Ownership Plan (with 401(k) Provisions) has been executed this 10th day of May, 2005 to be effective as of the dates provided above.

#### TEXAS REGIONAL BANCSHARES, INC.

By: /s/ G. E. Roney  
Glen E. Roney,  
Chairman of the Board and  
Chief Executive Officer

#### TEXAS STATE BANK

By: /s/ G. E. Roney  
Glen E. Roney,  
Chairman of the Board, Chief Executive  
Officer and Trust Officer

#### TSB SECURITIES, INC.

By: /s/ John R. Booth, Jr.  
John R. Booth, Jr.,  
President

#### PORT ARTHUR ABSTRACT AND TITLE COMPANY

By: /s/ Ken N. Whitlow  
Ken N. Whitlow,  
President

#### SOUTHEAST TEXAS TITLE COMPANY

By: /s/ Ken N. Whitlow  
Ken N. Whitlow,  
President

#### SOUTHEAST TEXAS INSURANCE SERVICES, L.P.

By: /s/ Susan Byrom  
Susan Byrom  
President, Southeast Texas Insurance Services Holdings,  
LLC

**VALLEY MORTGAGE COMPANY, INC.**

By: /s/ Paul Schwab  
Paul Schwab,  
President

**AGREED TO AND ACCEPTED BY:**

/s/ G. E. Roney  
Glen E. Roney, Trustee

/s/ Morris Atlas  
Morris Atlas, Trustee

/s/ Robert F. Boggus  
Robert F. Boggus, Trustee

**AGREED TO AND ACCEPTED BY:**

/s/ G. E. Roney  
Glen E. Roney, Committee Chairman

/s/ Doug G. Bready  
Douglas G. Bready, Committee Member

          
Danny L. Buttery, Committee Member

/s/ Tony J. Gorman  
Tony J. Gorman, Committee Member

/s/ Stanley Grisham  
Stan Grisham, Committee Member

/s/ John A. Martin  
John A. Martin, Committee Member

/s/ Paul Moxley  
Paul S. Moxley, Committee Member

/s/ J. Pat Parsons  
J. Pat Parsons, Committee Member

/s/ Lois Ann Stanton  
Lois Ann Stanton, Committee Member

/s/ Carroll W. Sturgis  
Carroll W. Sturgis, Jr., Committee Member

**Schedule B**

**Effective Date of Participating Employer Adoption**

The following Participating Employers have adopted the Texas Regional Bancshares, Inc. Amended and Restated Employee Stock Ownership Plan (with 401(k) Provisions) for the benefit of their eligible employees effective as of the dates indicated below.

<u>Name of Company</u>	<u>Effective Date of Adoption</u>
TEXAS REGIONAL BANCSHARES, INC.	January 1, 1984
TEXAS STATE BANK	January 1, 1984
TSB SECURITIES, INC.	January 1, 1997
PORT ARTHUR ABSTRACT AND TITLE COMPANY	March 12, 2004
SOUTHEAST TEXAS TITLE COMPANY	March 12, 2004
SOUTHEAST TEXAS INSURANCES SERVICES, L.P.	March 12, 2004
VALLEY MORTGAGE COMPANY, INC.	November 23, 2004

**EXHIBIT "A"**