

CULLEN FROST BANKERS INC

Form DEF 14A

April 18, 2005

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OMB APPROVAL

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

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. )

Filed by the Registrant    
Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

Cullen/Frost Bankers, Inc.

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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**100 West Houston Street  
San Antonio, Texas 78205**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
To Be Held on May 18, 2005**

To the Shareholders of  
CULLEN/ FROST BANKERS, INC.:

The Annual Meeting of Shareholders of Cullen/ Frost Bankers, Inc. ( Cullen/ Frost ) will be held in the Commanders Room at The Frost National Bank, 100 West Houston Street, San Antonio, Texas, on Wednesday, May 18, 2005, at 10:00 a.m., San Antonio time, for the following purposes:

1. To elect five nominees to serve as a Class III director for a three-year term that will expire at the 2008 Annual Meeting of Shareholders; and
2. To approve the Cullen/Frost Bankers, Inc. 2005 Omnibus Incentive Plan; and
3. To ratify the selection of Ernst & Young LLP to act as independent auditors of Cullen/Frost for the fiscal year that began January 1, 2005; and
4. To transact any other business that may properly come before the meeting.

You must be a shareholder of record at the close of business on April 8, 2005 to vote at the Annual Meeting. In order to hold the meeting, holders of a majority of the outstanding shares must be present either in person or by proxy.

Your vote is important, so please promptly complete and return the enclosed proxy card in the postage prepaid envelope provided.

All shareholders are cordially invited to attend the Annual Meeting.

By Order of the Board of Directors,

STAN McCORMICK  
Corporate Secretary

Dated: April 18, 2005

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**100 West Houston Street  
San Antonio, Texas 78205**

**PROXY STATEMENT FOR THE ANNUAL MEETING OF SHAREHOLDERS  
To Be Held on May 18, 2005**

**INTRODUCTION**

The Board of Directors of Cullen/Frost Bankers, Inc. ( Cullen/Frost or the Company ) is soliciting proxies to be used at the Annual Meeting of Shareholders. The meeting will be held in the Commanders Room at The Frost National Bank, 100 West Houston Street, San Antonio, Texas, on Wednesday, May 18, 2005 at 10:00 a.m., San Antonio time. This Proxy Statement and the accompanying proxy card will be mailed to shareholders beginning on or about April 18, 2005.

**Record Date and Voting Rights**

The close of business on April 8, 2005 has been fixed as the record date for the determination of shareholders entitled to vote at the Annual Meeting. The only class of securities of Cullen/Frost outstanding and entitled to vote at the Annual Meeting is Common Stock, par value \$0.01 per share. On April 8, 2005, there were outstanding 51,841,353 shares of Common Stock, with each share entitled to one vote.

**Proxies**

All shares of Cullen/Frost Common Stock represented by properly executed proxies, if timely returned and not subsequently revoked, will be voted at the Annual Meeting in the manner directed in the proxy. If a properly executed proxy does not provide directions, it will be voted for all proposals listed on the proxy and in the discretion of the persons named as proxies with respect to any other business that may properly come before the meeting.

A shareholder may revoke a proxy at any time before it is voted by delivering a written revocation notice to the Corporate Secretary of Cullen/Frost Bankers, Inc., 100 West Houston Street, San Antonio, Texas 78205. A shareholder who attends the Annual Meeting may, if desired, vote by ballot at the meeting, and such vote will revoke any proxy previously given.

**Quorum and Voting Requirements**

A quorum of shareholders is required to hold a valid meeting. If the holders of at least a majority of the issued and outstanding shares of Company Common Stock are present at the Annual Meeting in person or represented by proxy, a quorum will exist. Shares for which votes are withheld, as well as abstentions and broker non-votes, are counted as present for establishing a quorum.

Directors are elected by a plurality of the votes cast at the Annual Meeting. Accordingly, the nominees receiving the highest number of votes will be elected. In the election of Directors, votes may be cast for or withhold authority with respect to any or all nominees. Votes that are withheld will be excluded entirely from the vote and will have no effect on the outcome of the vote.

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With respect to other matters, including approval of the Cullen/Frost Bankers, Inc. 2005 Omnibus Incentive Plan (the Plan ) and ratification of the selection of Ernst & Young LLP to act as independent auditors of Cullen/Frost for the fiscal year that began January 1, 2005, the affirmative vote of the holders of a majority of the outstanding shares having voting power present in person or represented by proxy will be the act of the shareholders. In the voting for these other matters, shares may be voted for or against or abstain . An abstention will have the effect of a vote against these other matters.

Under the rules of the National Association of Securities Dealers, Inc., member brokers generally may not vote shares held by them in street name for customers unless they are permitted to do so under the rules of any national securities exchange of which they are a member. Under the rules of the New York Stock Exchange, Inc. ( NYSE ), a member broker that holds shares in street name for customers has the authority to vote on certain items if it has transmitted proxy soliciting materials to the beneficial owner but has not received instructions from that owner. NYSE rules permit member brokers that do not receive instructions to vote on the election of Directors and the proposal to ratify the selection of Ernst & Young LLP to act as Cullen/Frost s independent auditors, but do not permit such brokers to vote on the proposal to approve the Plan. Under NYSE rules, the proposal to approve the Plan is a non-discretionary item, which means that NYSE member brokers that have not received instructions from beneficial owners of Company Common Stock do not have discretion to vote the shares of Company Common Stock held by those beneficial owners on the Plan. Because the affirmative vote of the holders of a majority of the outstanding shares having voting power present in person or represented by proxy is necessary to approve the Plan, any such broker non-votes will have no effect on the outcome of the vote.

**Expenses of Solicitation**

Cullen/Frost will pay the expenses of the solicitation of proxies for the Annual Meeting. In addition to the solicitation of proxies by mail, Directors, officers, and employees of Cullen/Frost may solicit proxies by telephone, facsimile, in person or by other means of communication. Cullen/Frost also has retained Georgeson Shareholder Communications Inc. ( Georgeson ) to assist with the solicitation of proxies. Directors, officers, and employees of Cullen/Frost will receive no additional compensation for the solicitation of proxies, and Georgeson will receive a fee not to exceed \$6,500.00, plus reimbursement for out-of-pocket expenses. Cullen/Frost has requested that brokers, nominees, fiduciaries, and other custodians forward proxy-soliciting material to the beneficial owners of Cullen/Frost Common Stock. Cullen/Frost will reimburse these persons for out-of-pocket expenses they incur in connection with its request.

**Table of Contents****ELECTION OF DIRECTORS  
(Item 1 on Proxy Card)**

The Company's Bylaws provide for a classified Board of Directors. Directors are assigned to one of three classes, and all classes are as equal in number as possible. The term of office of Class III will expire at the 2005 Annual Meeting. The term of office of Class I will expire at the 2006 Annual Meeting, and the term of office of Class II will expire at the 2007 Annual Meeting.

The following four Directors currently assigned to Class III have been nominated to serve for a new three-year term: Mr. R. Denny Alexander, Mr. Carlos Alvarez, Mr. Ruben M. Escobedo and Ms. Ida Clement Steen. The following two Directors currently assigned to Class III are not standing for re-election and will be retiring from the Board of Directors after the Annual Meeting pursuant to the Board of Directors' retirement age policy: Mr. Eugene H. Dawson, Sr. and Mr. Joe R. Fulton. If any Director is unable to stand for re-election the Board may fill a directorship. The Board has nominated Mr. Royce S. Caldwell, who currently serves as a Class II Director, for election as a Class III Director to assist in equalizing the number of Directors in Class III. If any nominee is unable to serve, the individuals named as proxies on the enclosed proxy card will vote the shares to elect the remaining nominees and any substitute nominee or nominees designated by the Board.

The tables below provide information on each nominee, as well as each Director whose term continues after the meeting.

**Nominees for Three-Year Term Expiring in 2008 (Class III):**

Name	Age	Principal Occupation During Past Five Years	Director Since	Shares Owned <sup>(1,2)</sup>	
				Amount and Nature of Beneficial Ownership	Percent
R. Denny Alexander	59	Investments; former Chairman, Overton Bank & Trust and former Director, Overton Bancshares, Inc. (merged with Cullen/Frost)	1998	132,550 <sup>(3)</sup>	0.25%
Carlos Alvarez	54	Chairman, President and Chief Executive Officer of The Gambrinus Company	2001	26,000	0.05%
Royce S. Caldwell	66	Former Vice Chairman, SBC Corporation, SBC Communications Inc.	1994	12,800	0.02%
Ruben M. Escobedo	67	Certified Public Accountant	1996	29,000	0.05%
Ida Clement Steen	52	Investments	1996	26,300 <sup>(4)</sup>	0.05%



**Table of Contents****Directors Continuing in Office Term Expiring in 2007 (Class II):**

Name	Age	Principal Occupation During Past Five Years	Director Since	Shares Owned <sup>(1,2)</sup>	
				Amount and Nature of Beneficial Ownership	Percent
Richard W. Evans, Jr.	58	Chairman of the Board, Chief Executive Officer, and President of Cullen/Frost; Chairman of the Board and Chief Executive Officer of The Frost National Bank, a Cullen/Frost subsidiary	1993	803,491 <sup>(5, 6)</sup>	1.51%
T. C. Frost	77	Senior Chairman of the Board of Cullen/Frost	1966	1,249,922 <sup>(5,7)</sup>	2.35%
Preston M. Geren III	53	Special Assistant to the Secretary of Defense; Attorney; former Management Consultant, Public Strategies, Inc; former U.S. Congressman, 12th District of Texas	2001	253,840 <sup>(8)</sup>	0.48%
Karen E. Jennings	54	Senior Executive Vice President Human Resources and Communications, SBC Communications Inc.	2001	2,100	0.00%
Richard M. Kleberg, III	62	Investments	1992	34,425 <sup>(9)</sup>	0.06%
Horace Wilkins, Jr.	54	Former President, Special Markets, SBC Communications Inc.; former Regional President, Southwestern Bell Telephone Co.	1997	2,400	0.00%

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Name	Age	Principal Occupation During Past Five Years	Director Since	Shares Owned <sup>(1,2)</sup>	
				Amount and Nature of Beneficial Ownership	Percent
Isaac Arnold, Jr.	69	Oil, real estate, investments	1977	43,968	0.08%
Harry H. Cullen	69	Oil, real estate, investments	1993	265,542 <sup>(10)</sup>	0.50%
Patrick B. Frost	45	President, The Frost National Bank, a Cullen/Frost subsidiary	1997	361,881 <sup>(5, 11)</sup>	0.68%
James L. Hayne	71	Chairman, Catto & Catto Insurance	1977	152,416 <sup>(12)</sup>	0.29%
Robert S. McClane	66	President, McClane Partners, LLC; former Director of Prodigy Communications Corp.; former President of Cullen/Frost	1985	31,972	0.06%
Mary Beth Williamson	71	Education (Consultant)	1996	22,880	0.04%

(1) Beneficial ownership is stated as of December 31, 2004, except for Mr. T.C. Frost and Mr. Horace Wilkins, Jr., which is stated as of February 10, 2005 and Ms. Karen E. Jennings, which is stated as of February 14, 2005. The owners have sole voting and sole investment power for the shares of Company Common Stock reported unless otherwise indicated. Beneficial ownership includes the following shares that the individual had a right to acquire pursuant to stock options exercisable within sixty (60) days from December 31, 2004 (or February 10, 2005, in the case of Mr. T.C. Frost and Mr. Horace Wilkins, Jr. or February 14, 2005 in the case of Ms. Karen E. Jennings): Mr. T. C. Frost 148,000; Mr. Richard W. Evans, Jr. 507,000; Mr. Patrick B. Frost 202,000; Mr. Harry H. Cullen, Jr, Mr. James L. Hayne and Mr. Richard M. Kleberg, III 26,000; Ms. Ida Clement Steen 24,000; Mr. Ruben M. Escobedo 23,000; Ms. Mary Beth Williamson 22,000; Mr. R. Denny Alexander 20,000; Mr. Robert S. McClane and Mr. Isaac Arnold, Jr. 16,000; Mr. Carlos Alvarez, Mr. Royce S. Caldwell and Mr. Preston M. Geren III 12,000; Ms. Karen E. Jennings and Mr. Horace Wilkins, Jr. 2,000;. The number of shares of Cullen/Frost Common Stock beneficially owned by all Directors, nominees and named executive officers as a group is disclosed on page 18.

(2) Reflects 2-for-1 stock split of the Company's Common Stock in each of 1996 and 1999.

(3) Includes 21,000 shares held by a charitable foundation for which Mr. R. Denny Alexander disclaims beneficial ownership.

(4) Includes 1,100 shares for which Ms. Ida Clement Steen shares voting and investment power with her husband.

(5) Includes the following shares allocated under the 401(k) Stock Purchase Plan for Employees of Cullen/ Frost Bankers, Inc. for which each beneficial owner has both sole voting and sole investment power: Mr. T. C. Frost

48,284; Mr. Richard W. Evans, Jr. 38,931; and Mr. Patrick B. Frost 17,580.

- (6) Includes 120,003 shares held by a family limited partnership of which the general partner is a limited liability company of which Mr. Richard W. Evans, Jr. is the sole manager.
- (7) Includes (a) 664,911 shares held by a limited partnership of which the general partner is a limited liability company of which Mr. T.C. Frost is the sole manager, (b) 336,992 shares held by various trusts of which Mr. T.C. Frost is the trustee, and (c) 33,684 shares held by the Pat and Tom Frost Foundation Trust for which Mr. T.C. Frost disclaims beneficial ownership.

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- (8) Includes (a) 58,390 shares held by a family limited partnership of which Mr. Preston M. Geren III is a general partner and of which Mr. Preston M. Geren III and his wife are limited partners and for which Mr. Preston M. Geren III shares voting and investment power, (b) 4,310 shares for which Mr. Preston M. Geren III shares voting and investment power with his wife, and (c) 26,520 shares held by family trusts for which Mr. Preston M. Geren III disclaims beneficial ownership.
- (9) Includes 8,400 shares held by a family partnership for which Mr. Richard M. Kleberg, III has sole voting and sole investment power.
- (10) Includes 57,656 shares held by trusts for which Mr. Harry H. Cullen shares voting power and investment power.
- (11) Includes (a) 43,582 shares held by a trust of which Mr. Patrick B. Frost is the trustee, (b) 12,270 shares held by Mr. Patrick B. Frost's children for which Mr. Patrick B. Frost is the custodian, and (c) 630 shares held by Mr. Patrick B. Frost's wife for which Mr. Patrick B. Frost disclaims beneficial ownership.
- (12) Includes 106,820 shares held by a limited partnership in which Mr. James L. Hayne's wife owns an interest. Mr. James L. Hayne disclaims beneficial ownership of such shares.

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The Board of Directors had four meetings in 2004. Each of the Company's current Directors attended at least 75 percent of the meetings of the Board and the Committees of the Board on which he or she served during 2004.

At the meeting of the Board of Directors held on October 28, 2004, the Board adopted a policy that encourages Directors to attend Annual Meetings of Shareholders. In furtherance of this policy, the Board will hold one of its meetings on the same day as the 2005 Annual Meeting. In 2004, four Directors attended the Annual Meeting.

**Committees of the Board**

The Board of Directors has five Committees, each of which is described in the chart below.

<b>Committee</b>	<b>Members</b>	<b>Primary Responsibilities</b>	<b>Meetings in 2004</b>
Audit	Eugene H. Dawson, Sr. (Chair) Isaac Arnold, Jr. Royce S. Caldwell Ruben M. Escobedo Richard M. Kleberg, III	Assists Board oversight of the integrity of Cullen/Frost's financial statements, Cullen/Frost's compliance with legal and regulatory requirements, the independent auditors' qualifications and independence and the performance of the independent auditors and Cullen/Frost's internal audit function.  Appoints, compensates, retains and oversees the independent auditors, and pre-approves all audit and non-audit services.	6
Compensation and Benefits	Mary Beth Williamson (Chair) Ruben M. Escobedo Karen E. Jennings	Oversees the development and implementation of Cullen/Frost's compensation and benefit programs. Reviews and approves the corporate goals and objectives relevant to the compensation of the CEO, evaluates the CEO's performance based on these goals and objectives and sets the CEO's compensation based on the evaluation.	2
Corporate Governance and Nominating	Mary Beth Williamson (Chair) Ruben M. Escobedo Karen E. Jennings	Administers Cullen/Frost's compensation and benefit plans. Maintains and reviews Cullen/Frost's corporate governance principles.  Oversees and establishes procedures for the evaluation of the Board.	2
Executive	Richard W. Evans, Jr. (Chair) Patrick B. Frost T.C. Frost	Identifies and recommends candidates for election to the Board. Acts for the Board of Directors between meetings, except as limited by resolutions of the Board, Cullen/Frost's Articles of Incorporation or By-Laws and applicable law.	3



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<b>Committee</b>	<b>Members</b>	<b>Primary Responsibilities</b>	<b>Meetings in 2004</b>
Strategic Planning	Richard W. Evans, Jr. (Chair) R. Denny Alexander Isaac Arnold, Jr. Royce S. Caldwell Eugene H. Dawson, Sr. T.C. Frost James L. Hayne	Analyzes the strategic direction for Cullen/Frost, including reviewing short-term and long-term goals.  Monitors Cullen/Frost's corporate mission statement and capital planning.	4

The Board has adopted written charters for the Audit Committee, the Compensation and Benefits Committee and the Corporate Governance and Nominating Committee. The charter for the Audit Committee is attached as Annex A to this Proxy Statement. It is also available, together with the charter for the Compensation and Benefits Committee and the charter for the Corporate Governance and Nominating Committee, at [www.frostbank.com](http://www.frostbank.com).

As described in more detail below under "Certain Corporate Governance Matters" Director Independence, the Board has determined that each member of the Audit Committee, the Compensation and Benefits Committee and the Corporate Governance and Nominating Committee is independent within the meaning of the rules of the NYSE. The Board has also determined that each member of the Audit Committee is independent within the meaning of the rules of the Securities and Exchange Commission (the "SEC"). In addition, the Board has determined that each member of the Audit Committee is financially literate and that at least one member of the Audit Committee has accounting or related financial management expertise, in each case within the meaning of the NYSE's rules. The Board has also determined that Mr. Ruben M. Escobedo is an audit committee financial expert within the meaning of the SEC's rules.

**Director Nomination Process**

The Corporate Governance and Nominating Committee is responsible for identifying individuals qualified to become members of the Board of Directors and for recommending to the Board the nominees to stand for election as Directors.

In identifying Director candidates, the Corporate Governance and Nominating Committee may seek input from Cullen/Frost's management and from current members of the Board. In addition, it may use the services of an outside consultant, although it has not done so in the past. The Corporate Governance and Nominating Committee will consider candidates recommended by shareholders. Shareholders that wish to recommend candidates may do so by writing to the Corporate Governance and Nominating Committee of Cullen/Frost Bankers, Inc., c/o Corporate Secretary, 100 West Houston Street, San Antonio, Texas 78205. Recommendations may be submitted at any time, but recommendations for consideration as nominees at the Annual Meeting of Shareholders must be received not less than 120 days before the first anniversary of the date of the proxy statement released to shareholders in connection with the previous year's Annual Meeting. Therefore, to recommend a candidate for consideration as a nominee for Director at the 2006 Annual Meeting, a shareholder must submit the recommendation by December 19, 2005. The written recommendation must include the name of the candidate, the number of shares of Cullen/Frost Common Stock owned by the candidate and the information regarding the candidate that would be included in a proxy statement for the election of Directors pursuant to paragraphs (a), (e) and (f) of Item 401 of Regulation S-K adopted by the SEC.

In evaluating Director candidates, the Corporate Governance and Nominating Committee initially considers the Board's need for additional or replacement Directors. It also considers the criteria approved by the Board and set forth in Cullen/Frost's Corporate Governance Guidelines, which include, among other things, the candidate's personal qualities (in light of the Company's core values and mission statement), accomplishments and reputation in the business community, the fit of the candidate's skills and personality





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with those of other Directors and candidates and the ability of the candidate to commit adequate time to Board and committee matters. The objective is to build a Board that is effective, collegial and responsive to the needs of Cullen/ Frost. In addition, considerable emphasis is given to Cullen/ Frost's mission statement and core values, statutory and regulatory requirements, the Board's goal of having a substantial majority of independent directors and the Board's retirement policy.

The Corporate Governance and Nominating Committee evaluates all Director candidates in the same manner, including candidates recommended by shareholders. In considering whether candidates satisfy the criteria described above, it will initially utilize the information it receives with the recommendation or otherwise possesses. If it determines, in consultation with other Board members, including the Chairman, that more information is needed, it may, among other things, conduct interviews.

**Director Compensation**

Cullen/ Frost employees receive no fees for their services as members of the Board of Directors or any of its committees. Non-employee Directors receive an annual retainer fee of \$8,000 and \$2,000 for each Board meeting attended. In addition, non-employee Directors receive \$1,000 for attending each meeting of a committee of the Board to which they have been appointed, except that the Chairman of the Audit Committee receives \$1,500 for each meeting of the Audit Committee attended. Non-employee Directors are also eligible to receive stock options each year under Cullen/ Frost's 1997 Director Stock Plan. In July 2004, each non-employee Director received options to purchase 2,000 shares of the Company's Common Stock. A total of 32,000 stock options were granted to non-employee Directors in 2004. The options have a term of six years from the date of the grant, are exercisable immediately from the date of the grant and have an exercise price of \$43.08, which is equal to the closing price of the Company's Common Stock on the date of the grant.

In addition, the Board of Directors also serves as the Board of Directors for The Frost National Bank, a subsidiary of Cullen/ Frost, and non-employee Directors receive fees for serving in this capacity. In particular, non-employee Directors receive \$2,000 for each meeting of such Board attended and \$1,000 for attending each meeting of a committee of such Board to which they have been appointed.

**Other Directorships**

The following are directorships held by nominees and Directors in public companies other than Cullen/ Frost, or in registered investment companies:

Mr. Arnold	Plains Exploration & Production Company
Mr. Caldwell	SABRE Corporation
Mr. Escobedo	Valero Energy Corporation
Mr. Geren	Anadarko Petroleum Corporation

**Miscellaneous Information**

There are no arrangements or understandings between any nominee or Director of Cullen/ Frost and any other person regarding such nominee's or Director's selection as such, except that Mr. Robert S. McClane's retirement agreement with Cullen/ Frost provides that, until he reaches age 70, subject to the sole discretion of the Board of Directors, he will be considered as a candidate for reelection to the Board. In addition, pursuant to such retirement agreement, Mr. McClane is entitled to office space and secretarial services and support until he reaches age 70. The only family relationships among the Directors or executive officers of Cullen/ Frost that are first cousin or closer are those of Messrs. T.C. Frost and Patrick B. Frost, who are father and son, and Messrs. Harry H. Cullen and Isaac Arnold, Jr., who are first cousins.

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**CERTAIN CORPORATE GOVERNANCE MATTERS**

Cullen/ Frost believes that it has operated over the years with sound corporate governance practices that exemplify its commitment to integrity and protect both the interests of its shareholders and the other constituencies that it serves. These practices include a substantially independent Board of Directors, periodic meetings of non-management Directors and a sound and comprehensive code of conduct, which obligates Directors and all employees to adhere to the highest legal and ethical business practices. A review of some of Cullen/ Frost's corporate governance measures is set forth below.

**Director Independence**

The Board of Directors believes that a substantial majority of its members should be independent within the meaning of the NYSE's rules. To this end, the Board reviews annually the relevant facts and circumstances regarding relationships between Directors and Cullen/ Frost. The purpose of the Board's review is to determine whether any Director has a material relationship with Cullen/ Frost (either directly or as a partner, shareholder or officer of an organization that has a relationship with Cullen/ Frost).

In connection with the Board's latest review, the Board determined that the following Directors, which compose 84% of the Board, are independent within the meaning of the NYSE's rules: Mr. R. Denny Alexander, Mr. Carlos Alvarez, Mr. Isaac Arnold, Jr., Mr. Royce S. Caldwell, Mr. Harry H. Cullen, Mr. Eugene H. Dawson, Sr., Mr. Ruben M. Escobedo, Mr. Joe R. Fulton, Mr. Preston M. Geren III, Mr. James L. Hayne, Ms. Karen E. Jennings, Mr. Richard M. Kleberg, III, Mr. Robert S. McClane, Ms. Ida Clement Steen, Mr. Horace Wilkins, Jr. and Ms. Mary Beth Williamson. Mr. T.C. Frost, Mr. Richard W. Evans and Mr. Patrick B. Frost are not independent because they are executive officers of Cullen/ Frost.

In making its independence determinations, the Board considers the NYSE's rules, as well as the standards set forth below. The Board adopted these standards pursuant to the NYSE's rules to assist it in making independence determinations. For purposes of the standards, the term "Cullen/ Frost entity" means, collectively, Cullen/ Frost and each of its subsidiaries.

*Credit Relationships.* A proposed or outstanding relationship that consists of an extension of credit by a Cullen/ Frost entity to a Director or a person or entity that is affiliated, associated or related to a Director should not be deemed to be a material relationship if it satisfies each of the following criteria:

It is not categorized as "classified" by the Cullen/ Frost entity or any regulatory authority that supervises the Cullen/ Frost Entity.

It is made on terms and under circumstances, including credit standards, that are substantially similar to those prevailing at the time for comparable relationships with other unrelated persons or entities and, if subject to the Federal Reserve Board's Regulation O (12 C.F.R. Part 215), is made in accordance with Regulation O.

In the event that it was not made, in the case of a proposed extension of credit, or it was terminated in the normal course of the Cullen/ Frost entity's business, in the case of an outstanding extension of credit, the action would not reasonably be expected to have a material adverse effect on the Director or the business, results of operations or financial condition of any person or entity related to such Director.

*Non-Credit Banking or Financial Products or Services Relationships.* A proposed or outstanding relationship in which a Director or a person or entity that is affiliated, associated or related to a Director procures non-credit banking or financial products or services from a Cullen/ Frost entity should not be deemed to be a material relationship if it (i) has been or will be offered in the ordinary course of the Cullen/ Frost entity's business and (ii) has been or will be offered on terms and under circumstances that were or are substantially similar to those prevailing at the time for comparable non-credit banking or financial products or services provided by the Cullen/ Frost entity to other unrelated persons or entities.



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*Property or Services Relationships.* A proposed or outstanding relationship in which a Director or a person or entity that is affiliated, associated or related to a Director provides property or services to a Cullen/ Frost entity should not be deemed to be a material relationship if the property or services (i) have been or will be procured in the ordinary course of the Cullen/ Frost entity's business and (ii) have been or will be procured on terms and under circumstances that were or are substantially similar to those that the Cullen/ Frost entity would expect in procuring comparable property or services from other unrelated persons or entities.

**Meetings of Non-Management Directors**

Cullen/ Frost's non-management Directors meet in executive sessions without members of management present at each regularly scheduled meeting of the Board. The Chair of the Board's Corporate Governance and Nominating Committee, who is currently Ms. Mary Beth Williamson, presides at the executive sessions.

**Communications with Directors**

The Board of Directors has established a mechanism for shareholders or other interested parties to communicate with the non-management Directors as a group and the presiding non-management Director. All such communications should be addressed to the Board of Directors of Cullen/ Frost Bankers, Inc., c/o Corporate Counsel, 100 West Houston Street, San Antonio, Texas 78205.

In addition, the Board of Directors has established a mechanism for shareholders or other interested parties that have concerns or complaints regarding accounting, internal accounting controls or auditing matters to communicate them to the Audit Committee. Such concerns or complaints should be addressed to the Audit Committee of Cullen/ Frost Bankers, Inc., c/o Corporate Counsel, 100 West Houston Street, San Antonio, Texas 78205.

For shareholders or other interested parties desiring to communicate with the non-management Directors, the presiding non-management Director or the Audit Committee by e-mail or telephone, please see the information set forth on Cullen/ Frost's website at [www.frostbank.com](http://www.frostbank.com).

**Corporate Governance Guidelines**

The Board of Directors has adopted Corporate Governance Guidelines, which reaffirm Cullen/ Frost's commitment to having strong corporate governance practices. The Guidelines set forth, among other things, the policies of the Board with respect to Board composition, selection of Directors, retirement of Directors, Director orientation and continuing training, executive sessions of non-management Directors, Director compensation and Director responsibilities. The Guidelines are available on Cullen/ Frost's website at [www.frostbank.com](http://www.frostbank.com).

**Code of Business Conduct and Ethics**

The Board of Directors has adopted a Code of Business Conduct and Ethics to promote the highest legal and ethical business practices by Cullen/ Frost. The Code applies to Directors and Cullen/ Frost employees, including Cullen/ Frost's Chief Executive Officer, Chief Financial Officer and principal accounting officer. The Code addresses, among other things, honest and ethical conduct, accurate and timely financial reporting, compliance with applicable laws, accountability for adherence to the Code and prompt internal reporting of violations of the Code. The Code is available on Cullen/ Frost's website at [www.frostbank.com](http://www.frostbank.com). Cullen/ Frost intends to disclose any amendments to or waivers from the Code that apply to its Chief Executive Officer, Chief Financial Officer and principal accounting officer by posting such information on its website at [www.frostbank.com](http://www.frostbank.com).

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**EXECUTIVE COMPENSATION AND RELATED INFORMATION**

**Compensation and Benefits Committee Report on Executive Compensation**

The Compensation and Benefits Committee of the Board of Directors is composed of three Directors that the Board has determined to be independent within the meaning of the NYSE's rules. The duties and responsibilities of the Compensation and Benefits Committee, as well as certain components of Cullen/Frost's compensation philosophy, are set forth below.

*Compensation and Benefits Committee Duties and Responsibilities*

The duties and responsibilities of the Compensation and Benefits Committee include, among other things, the following:

In consultation with management, to establish Cullen/Frost's general compensation philosophy and oversee the development of Cullen/Frost's compensation and benefit programs;

To review and approve corporate goals and objectives relevant to the compensation of Cullen/Frost's Chief Executive Officer, evaluate his performance in light of those goals and objectives, and set his compensation level based on this evaluation.

*Certain Components of Cullen/Frost's Compensation Philosophy*

Compensation levels should be competitive with the median of comparable financial organizations to attract and maintain a stable, successful management team;

Executives' total compensation packages should depend upon the level of success in meeting specified Company and individual performance goals;

Executive ownership of the Company's Common Stock should be encouraged to align executives' interests with shareholders' interests; and

Sustained superior performance by individual executives should be rewarded.

Each year an independent consultant engaged by the Compensation and Benefits Committee provides a comprehensive analysis of competitive market data for senior executives, which compares Cullen/Frost's compensation practices and programs to a group of comparator companies that have similar business operations, total assets, market capitalizations, and lines of business. These companies include, but are not limited to, the companies in the Standard & Poor's (S&P) Bank Index. The Compensation and Benefits Committee has chosen not to use the S&P's Bank Index as its sole comparator group for compensation purposes since detailed data for all senior executives at the banks comprising the index is not available.

The S&P's Bank Index was used for comparison of total shareholder return shown in the Performance Graph on page 20.

The elements of Cullen/Frost's executive compensation are base salary, annual incentives, and long-term compensation, which are discussed below. The Compensation and Benefits Committee considers all elements of an executive's total compensation package, including severance plans, insurance, and other benefits, as set forth below.

*Base Salary*

Reviewed annually for each of the Company's four named executive officers.

Based on subjective evaluation of individual performance, achievement, and contribution to growth.

May be adjusted to reflect competitive market levels following performance evaluations.

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May be adjusted to attract and retain appropriate officers.

Company base salary levels for the senior executive group were overall slightly above market levels of comparator companies in 2004.

*Annual Incentives*

Designed to promote and reward teamwork as measured by overall corporate performance and also recognize individual contributions.

Generally, bonus pools are established when the Company achieves a predetermined level of financial performance, as established by the Compensation and Benefits Committee.

Compensation and Benefits Committee has authority to adjust the total bonus pool up or down based on Company's overall performance.

Compensation and Benefits Committee authorized payouts at target for 2004 based on Company's superior performance.

Actual award sizes recognized individual contributions and teamwork.

*Long-Term Incentives*

Size of award depends on levels of responsibility, prior experience, individual performance, and compensation practices at comparator companies.

Current stock holdings and the magnitude of outstanding long-term incentives are not considered in making current awards.

*Stock Options*

Primary long-term incentive award.