BANCFIRST CORP /OK/
Form 10-K
March 07, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2016   Commission File Number 0-14384

BANCFIRST CORPORATION

(Exact name of registrant as specified in its charter)

OKLAHOMA	73-1221379
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 North Broadway, Oklahoma City, Oklahoma 73102

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (405) 270-1086

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

Title of each class	Name of each exchange on which registered
Common Stock, $1.00 Par Value Per Share	NASDAQ Global Select Market System

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the Common Stock held by nonaffiliates of the registrant computed using the last sale price on June 30, 2016 was approximately $476,810,720.

As of January 31, 2017, there were 15,862,644 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Proxy Statement for the 2017 Annual Meeting of Stockholders of the registrant (the "2017 Proxy Statement") to be filed pursuant to Regulation 14A are incorporated by reference into Part III of this report.

BANCFIRST CORPORATION

ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

PART I

Item 1. Business.

General

BancFirst Corporation (the "Company") is an Oklahoma business corporation and a financial holding company under federal law. It conducts virtually all of its operating activities through its principal wholly-owned subsidiary, BancFirst (the "Bank" or "BancFirst"), a state-chartered bank headquartered in Oklahoma City, Oklahoma. The Company also owns 100% of the common securities of BFC Capital Trust II (a Delaware business trust), 100% of the common securities of CSB Bancshares Statutory Trust I (a Delaware business trust), 100% of Council Oak Partners LLC, an Oklahoma limited liability company engaging in investing activities and 100% of BancFirst Insurance Services, Inc., an Oklahoma business corporation operating as an independent insurance agency.

The Company was incorporated as United Community Corporation in July 1984 for the purpose of becoming a bank holding company. In June 1985, it merged with seven Oklahoma bank holding companies that had operated under common ownership and the Company has conducted business as a bank holding company since that time. Over the next several years the Company acquired additional banks and bank holding companies, and in November 1988 the Company changed its name to BancFirst Corporation. Effective April 1, 1989, the Company consolidated its 12 subsidiary banks and formed BancFirst. Over the intervening decades, the Company has continued to expand through acquisitions and de-novo branches. The Company currently has 100 banking locations serving 53 communities throughout Oklahoma.

The Company's strategy focuses on providing a full range of commercial banking services to retail customers and small to medium-sized businesses in both the non-metropolitan trade centers and cities in the metropolitan statistical areas of Oklahoma. The Company operates as a "super community bank", managing its community banking offices on a decentralized basis, which permits them to be responsive to local customer needs. Underwriting, funding, customer service and pricing decisions are made by presidents in each market within the Company's strategic parameters. At the same time, the Company generally has a larger lending capacity, broader product line and greater operational scale than its principal competitors in the non-metropolitan market areas (which typically are independently-owned community banks). In the metropolitan markets served by the Company, the Company's strategy is to focus on the needs of local businesses that seek more responsive services than are available at larger institutions.

The Bank maintains a strong community orientation by, among other things, selecting members of the communities in which the Bank's branches operate to local consulting boards that assist in marketing and providing feedback on the Bank's products and services to meet customer needs. As a result of the development of broad banking relationships with its customers and community branch network, the Bank's lending and investing activities are funded almost entirely by core deposits.

The Bank centralizes virtually all of its processing, support and investment functions in order to achieve consistency and operational efficiencies. The Bank maintains centralized control functions such as operations support, bookkeeping, accounting, loan review, compliance and internal auditing to ensure effective risk management. The Bank also provides centrally certain specialized financial services that require unique expertise.

The Bank provides a wide range of retail and commercial banking services, including: commercial, real estate, energy, agricultural and consumer lending; depository and funds transfer services; collections; safe deposit boxes; cash management services; trust services; retail brokerage services; and other services tailored for both individual and corporate customers. Through its Technology and Operations Center, the Bank provides item processing, research and other correspondent banking services to financial institutions and governmental units.

The Bank’s primary lending activity is the financing of business and industry in its market areas. Its commercial loan customers are generally small to medium-sized businesses engaged in light manufacturing, local wholesale and retail trade, commercial and residential real estate development and construction, services, agriculture and the energy industry. Most forms of commercial lending are offered, including commercial mortgages, other forms of asset-based financing and working capital lines of credit. In addition, the Bank offers Small Business Administration (“SBA”) guaranteed loans through BancFirst Commercial Capital, a division established in 1991.

Consumer lending activities of the Bank consist of traditional forms of financing for automobiles, home equity loans and other personal loans. Residential loans consist primarily of home loans in non-metropolitan areas which are generally shorter in duration than typical mortgages and reprice within five years.

The Bank’s range of deposit services include checking accounts, Negotiable Order of Withdrawal (“NOW”) accounts, savings accounts, money market accounts, sweep accounts, club accounts, individual retirement accounts and certificates of deposit. Overdraft protection and auto draft services are also offered. Deposits of the Bank are insured by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (“FDIC”).

Trust services offered through the Bank’s Trust and Investment Management Division (the “Trust Division”) consist primarily of investment management and administration of trusts for individuals, corporations and employee benefit plans. In addition, the Trust Division serves as bond trustee and paying agent for various Oklahoma municipalities and governmental entities.

Insurance services offered through BancFirst Insurance Services, Inc., and dba Wilcox & McGrath Insurance, consists of business and personal insurance, employee benefits, surety bonds and claims and risk management.

BancFirst has the following principal subsidiaries: Council Oak Investment Corporation, a small business investment corporation, Council Oak Real Estate, Inc., a real estate investment company, and BancFirst Agency, Inc., a credit life insurance agency. All of these companies are Oklahoma corporations.

The Company had approximately 1,773 full-time equivalent employees at December 31, 2016, compared to approximately 1,744 full-time equivalent employees at December 31, 2015. Its principal executive offices are located at 101 North Broadway, Oklahoma City, Oklahoma 73102, telephone number (405) 270-1086.

Market Areas and Competition

The banking environment in Oklahoma is very competitive. The geographic dispersion of the Company’s banking locations presents several different levels and types of competition. In general, however, each location competes with other banking institutions, savings and loan associations, brokerage firms, personal loan finance companies and credit unions within their respective market areas. The communities in which the Bank maintains offices are generally local trade centers throughout Oklahoma. The major areas of competition include interest rates charged on loans, underwriting terms and conditions, interest rates paid on deposits, fees on non-credit services, levels of service charges on deposits, completeness of product lines and quality of service.

Management believes the Company is in an advantageous competitive position operating as a “super community bank.” Under this strategy, the Company provides a broad line of financial products and services for small to medium-sized businesses and consumers through full service community banking offices with decentralized management, while achieving operating efficiency and product scale through product standardization and centralization of processing and other functions. Each full-service banking office has senior management with significant lending experience who exercise substantial autonomy over credit and pricing decisions. This decentralized management approach, coupled with continuity of service by the same staff members, enables the Bank to develop long-term customer relationships, maintain high-quality service and respond quickly to customer needs. The majority of its competitors in the non-metropolitan areas are much smaller, and neither offer the range of products and services nor have the lending capacity of BancFirst. In the metropolitan communities, the Company’s strategy is to be more responsive to, and more focused on, the needs of local businesses that are not served effectively by larger institutions. As reported by the FDIC, the Company’s market share of deposits for Oklahoma was 7.17% as of June 30, 2016 and 7.26% as of June 30, 2015 (including Bank of Commerce acquired October 2015).

Marketing to existing and potential customers is performed through a variety of media advertising, direct mail and direct personal contacts. The Company monitors the needs of its customer base through its Product Development Group, which develops and enhances products and services in response to such needs. Sales, customer service, compliance and product training are coordinated with incentive programs to sell the Bank’s products and services.

Operating Segments

The Company has four principal business units: metropolitan banks, community banks, other financial services and executive operations and support. For more information on the Company's Operating Segments see Note (22), "Segment Information" to the Company's Consolidated Financial Statements.

Control of Company

Affiliates of the Company beneficially own approximately 47% of the outstanding shares of the Company's common stock as of January 31, 2017. Under the Company's Bylaws, holders of a majority of the outstanding shares of common stock are able to elect all of the directors and approve significant corporate actions, including business combinations. Accordingly, the Company's affiliates have the ability to control the business and affairs of the Company.

Supervision and Regulation

Banking is a complex, highly regulated industry. The Company's growth and earnings performance and those of the Bank can be affected not only by management decisions and general and local economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. These authorities include, but are not limited to, the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), the FDIC and the Oklahoma State Banking Department.

The primary goals of the bank regulatory framework are to maintain a safe and sound banking system and to facilitate the conduct of monetary policy. This regulatory framework is intended primarily for the protection of a financial institution's depositors, rather than the institution's stockholders and creditors. The following discussion describes certain of the material elements of the regulatory framework applicable to bank holding companies and financial holding companies and their subsidiaries and provides certain specific information relevant to the Company, which is both a bank holding company and a financial holding company. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed. Further, such statutes, regulations and policies are continually under review by Congress and state legislatures, and federal and state regulatory agencies. A change in statutes, regulations or regulatory policies applicable to the Company, including changes in interpretation or implementation thereof, could have a material effect on the Company's business.

Regulatory Agencies

In the U.S., banking is regulated at both the federal and state level. Since 1863, commercial banks in the United States have been able to choose to organize as national banks with a charter issued by the Office of the Comptroller of the Currency ("OCC") or as state banks with a charter issued by a state government. The choice of charter determines which agency will supervise the bank: the primary supervisor of nationally chartered banks is the OCC, whereas state-chartered banks are supervised jointly by their state chartering authority and either the FDIC or the Federal Reserve Board, depending upon whether the state-chartered bank is a member of the Federal Reserve System. The Company's banking subsidiary, BancFirst, is chartered by the State of Oklahoma and at the state level is supervised and regulated by the Oklahoma State Banking Department under the Oklahoma Banking Code. BancFirst has elected not to be a member of the Federal Reserve System and, consequently, is supervised and regulated by the FDIC at the federal level. The Bank's deposits are insured by the Deposit Insurance Fund ("DIF") of the FDIC to the extent provided by law.

As a financial holding company and a bank holding company, the Company is subject to comprehensive regulation by the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended by the Gramm-Leach-Bliley Act of 1999 (the "GLB Act"), the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), and other legislation (as so amended, the "BHC Act"), as well as other federal and state laws governing the banking business. The BHC Act provides generally for regulation of financial holding companies and bank holding companies such as the Company by the Federal Reserve Board, and for functional regulation of banking activities by bank regulators, securities activities by securities regulators, and insurance activities by insurance regulators. Additionally, the Company is under the jurisdiction of the Securities and Exchange Commission ("SEC") and is subject to the periodic reporting, information, proxy solicitation, insider trading, corporate governance and other restrictions and requirements of the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Company's common stock is listed on the NASDAQ Global Select Market System under the trading symbol "BANF," and is subject to the listing and marketplace rules of the NASDAQ Stock Market, Inc. (the "NASDAQ").

The Federal Reserve Board supervises non-banking activities conducted by companies directly and indirectly owned by the Company. In addition, the Company's non-banking subsidiaries are subject to various other laws, regulations, supervision and examination by other regulatory agencies, all of which directly or indirectly affect the operations and management of the Company and its ability to make distributions to stockholders.

Bank Holding Company and Financial Holding Company Activities

The BHC Act generally limits the activities in which the Company and its non-banking subsidiaries may engage, to managing or controlling banks and to a range of activities that are considered to be closely related to banking. The list of activities permitted by the Federal Reserve Board includes, among other things: lending; operating a savings institution, mortgage company, finance company, credit card company or factoring company; performing certain data processing operations; providing certain investment and financial advice; underwriting and acting as an insurance agent for certain types of credit-related insurance; leasing property on a full-payout, non-operating basis; selling money orders; real estate and personal property appraising; providing tax planning and preparation services; and, subject to certain limitations, providing securities brokerage services for customers. These activities may also be affected by other federal legislation.

Bank holding companies that have elected to be treated as financial holding companies, such as the Company, may engage in a broader range of activities considered to be "financial in nature."

“Financial in nature” activities include securities underwriting, dealing and market making, sponsoring mutual funds and investment companies, insurance underwriting and agency, merchant banking and other activities that the Federal Reserve Board, in consultation with the Secretary of the U.S. Treasury, determines from time to time to be financial in nature or incidental to such financial activity or is complementary to a financial activity and does not pose a safety and soundness risk.

To maintain financial holding company status, a financial holding company and all of its depository institution subsidiaries must be “well capitalized” and “well managed.” A depository institution subsidiary is considered to be “well capitalized” if it satisfies the requirements for this status discussed in the section captioned “Capital Requirements,” included elsewhere in this item. A depository institution subsidiary is considered “well managed” if it received a composite rating and management rating of at least “satisfactory” in its most recent examination. A financial holding company’s status will also depend upon it maintaining its status as “well capitalized” and “well managed” under applicable Federal Reserve Board regulations. If a financial holding company ceases to meet these capital and management requirements, the Federal Reserve Board’s regulations provide that the financial holding company must enter into an agreement with the Federal Reserve Board to comply with all applicable capital and management requirements. Until the financial holding company returns to compliance, the Federal Reserve Board may impose limitations or conditions on the conduct of its activities, and the company may not commence any of the broader financial activities permissible for financial holding companies or acquire a company engaged in such financial activities without prior approval of the Federal Reserve Board. If the company does not return to compliance within 180 days, the Federal Reserve Board may require divestiture of the holding company’s depository institutions. Bank holding companies and banks must also be both well capitalized and well managed in order to acquire banks located outside their home state.

In order for a financial holding company to commence any new activity permitted by the BHC Act or to acquire a company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least “satisfactory” in its most recent examination under the Community Reinvestment Act. See the section captioned “Community Reinvestment Act” included elsewhere in this item.

The Federal Reserve Board has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the Federal Reserve Board has reasonable grounds to believe that continuation of such activity or such ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

Federal and state laws impose notice and approval requirements for mergers and acquisitions of other depository institutions or bank holding companies. The BHC Act requires the prior approval of the Federal Reserve Board for the direct or indirect acquisition by a bank holding company of more than 5% of the voting shares or substantially all of the assets of a commercial bank or its parent holding company (including a financial holding company). Additionally, under the Bank Merger Act, the prior approval of the Federal Reserve Board or other appropriate bank regulatory authority is required for a bank to merge with another bank or purchase the assets or assume the deposits of another bank. In determining whether to approve a proposed bank acquisition or merger, bank regulatory authorities will consider, among other factors, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant’s performance record under the Community Reinvestment Act (see the section captioned “Community Reinvestment Act” included elsewhere in this item) and its compliance with fair housing and other consumer protection laws and the effectiveness of the subject organizations in combating money laundering activities.

Dividend Restrictions

The principal source of the Company's liquidity is dividends from the Bank. Various federal and state statutory provisions and regulations limit the amount of dividends the Company's subsidiary bank and certain other subsidiaries may pay without regulatory approval. The payment of dividends by its subsidiary bank may also be affected by other regulatory requirements and policies, such as the maintenance of adequate capital. If, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice (which, depending on the financial condition of the bank, could include the payment of dividends), such authority may require, after notice and hearing, that such bank cease and desist from such practice. The appropriate federal regulatory authorities have stated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings. In addition, in the current financial and economic environment, the Federal Reserve Board has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong.

In October 2012, as required by the Dodd-Frank Act, the Federal Reserve Board published final rules regarding company-run stress testing. The rules require financial institutions to conduct an annual company-run stress test of capital, consolidated earnings and losses under at least three different sets of conditions, including baseline, adverse and severely adverse conditions. It is anticipated that the capital ratios reflected in the stress test calculations will be an important factor to be considered by the Federal Reserve Board in evaluating whether proposed payments of dividends or stock repurchases may be an unsafe or unsound practice. The rules apply to institutions with average total consolidated assets greater than $10 billion and, accordingly, do not currently apply to the Company, which had total consolidated assets at December 31, 2016 of approximately $7.0 billion. However, while the Federal Reserve Board has stated that smaller banking organizations such as the Company are not required or expected to conduct the types of stress-testing specifically mandated by the rules, they continue to emphasize that all banking institutions, regardless of size, should have the capacity to analyze the potential impact of adverse outcomes on their financial condition.

Transactions with Affiliates

The Company and the Bank are deemed affiliates of each other within the meaning of the Federal Reserve Act, and covered transactions between affiliates are subject to certain restrictions, including compliance with Sections 23A and 23B of the Federal Reserve Act and their implementing regulations. These regulations limit the types and amounts of covered transactions engaged in by a financial institution and its affiliates, and generally require those transactions to be on an arm's-length basis. "Covered transactions" are defined by statute to include a loan or extension of credit, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the Federal Reserve Board) from the affiliate, certain derivative transactions that create a credit exposure to an affiliate, the acceptance of securities issued by the affiliate as collateral for a loan and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. In general, these regulations require that any such transaction by a financial institution with an affiliate must be secured by designated amounts of specified collateral and must be limited to certain thresholds on an individual and aggregate basis.

Federal law also limits a bank's authority to extend credit to its directors, executive officers and 10% stockholders, as well as to entities controlled by such persons. Among other things, extensions of credit to insiders are required to be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons. Also, the terms of such extensions of credit may not involve more than the normal risk of non-repayment or present other unfavorable features and may not exceed certain limitations on the amount of credit extended to such persons individually and in the aggregate.

Source of Strength

Federal Reserve Board policy requires bank holding companies to act as a source of financial and managerial strength to their subsidiary banks and, under appropriate circumstances, to commit resources to support each such subsidiary bank. This support may be required at times when the bank holding company may not have the resources to provide the support. If a bank holding company was unable to pay mandated assessments in support of its subsidiary bank, the FDIC could order the sale of the bank holding company's stock in the subsidiary bank to cover the deficiency.

Capital loans by a bank holding company to its subsidiary bank are subordinate in right of payment to deposits and certain other indebtedness of the subsidiary bank. In addition, in the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of its subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Capital Requirements

The Company and the Bank are each required to comply with applicable capital adequacy standards established by the Federal Reserve Board and the FDIC. The current risk-based capital standards applicable to the Company and the Bank, parts of which are currently in the process of being phased-in, are based on the December 2010 final capital framework for strengthening international capital standards, known as Basel III, of the Basel Committee on Banking Supervision (the "Basel Committee"). The Basel Committee is a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines for use by each country's supervisors in determining the supervisory policies they apply. The requirements are intended to ensure that banking organizations have adequate capital given the risk levels of assets and off-balance sheet financial instruments. Prior to January 1, 2015, the risk-based capital standards applicable to the Company and the Bank were based on the 1988 Capital Accord, known as Basel I, of the Basel Committee. In July 2013, the federal bank regulators approved final rules (the "Basel III Capital Rules") implementing the Basel III framework as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and their depositary institution subsidiaries, including the Company and the Bank, as compared to the general risk-based capital rules under Basel I. The

Basel III Capital Rules became effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period for certain provisions).

As an additional means to identify problems in the financial management of depository institutions, the Federal Deposit Insurance Act (the “FDI Act”) requires federal bank regulatory agencies to establish certain non-capital safety and soundness standards for institutions for which they are the primary federal regulator. The standards relate generally to operations and management, asset quality, interest rate exposure and executive compensation. The agencies are authorized to take action against institutions that fail to meet such standards.

Basel III Capital Rules Effective January 1, 2015.

The Basel III Capital Rules, among other things, (i) introduce a new capital measure called “Common Equity Tier 1” (“CET1”), (ii) specify that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CETI and not to the other components of capital, and (iv) expand the scope of the deductions/adjustments to capital as compared to previous regulations.

Under the Basel III Capital Rules, the initial minimum capital ratios that became effective on January 1, 2015 are as follows:

• 4.5% CET1 to risk-weighted assets.

• 6.0% Tier 1 capital to risk-weighted assets.

• 8.0% Total capital to risk-weighted assets.

• 4.0% Tier 1 capital to average quarterly assets

The Basel III Capital Rules also require a “capital conservation buffer”, composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019. The Basel III Capital Rules also provide for a “countercyclical capital buffer” that is only applicable to certain covered institutions and does not have any current applicability to the Company or the Bank. The capital conservation buffer is designed to absorb losses during periods of economic stress and effectively increases the minimum required risk-weighted capital ratios. Banking institutions with a ratio of CET1 to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The enactment of the Basel III Capital Rules will increase the Company’s required capital levels and those of the Bank from levels previously required. Management believes that as of December 31, 2016, the Company and the Bank would have met all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements had been in effect at such date.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and the Bank to maintain an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, (iii) a minimum ratio of Total capital to risk-weighted assets of at least 10.5%; and (iv) a minimum leverage ratio of 4%. As of December 31, 2016, the Company had a CET1 ratio of 13.65%, a Tier 1 ratio of 14.30%, a total capital ratio of 15.33% and a leverage ratio of 9.94%. As of December 31, 2016, the Bank had a CET1 ratio of 12.36%, a Tier 1 ratio of 12.78%, a total capital ratio of 13.80% and a leverage ratio of 8.89%.

Liquidity Coverage Ratio

Historically, the regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. Liquidity risk management has become increasingly important since the financial crisis. The Basel III liquidity framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio (“LCR”), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity’s expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio (“NSFR”), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements are designed to incentivize banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source.

In September 2014, the federal bank regulators approved final rules implementing the LCR for advanced approaches banking organizations (i.e., banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure) and a modified version of the LCR for bank holding companies with at least $50 billion in total consolidated assets that are not advanced approach banking organizations, neither of which would apply to the Company or the Bank. In the second quarter of 2016, the federal banking regulators issued a proposed rule that would implement the NSFR for certain U.S. banking organizations. The proposed rule would require certain U.S. banking organizations to ensure they have access to stable funding over a one-year time horizon and has an effective date of January 1, 2018. The proposed rule would not apply to U.S. banking organizations with less than $50 billion in total consolidated assets such as the Company and the Bank.

Prompt Corrective Action

The FDI Act requires federal bank regulatory agencies to take “prompt corrective action” with respect to FDIC-insured depository institutions that do not meet minimum capital requirements. A depository institution’s treatment for purposes of the prompt corrective action provisions will depend upon how its capital levels compare to various capital measures and certain other factors, as established by regulation.

Under this system, the federal banking regulators have established five capital categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, in which all depository institutions are placed. The federal banking regulators have specified by regulation the relevant capital levels for each of the categories. Under certain circumstances, a well-capitalized, adequately capitalized or undercapitalized institution may be treated as if the institution were in the next lower capital category. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. A depository institution that is undercapitalized is required to submit a capital restoration plan. Failure to meet capital guidelines could subject a bank to a variety of enforcement remedies by federal bank regulatory agencies, including termination of deposit insurance by the FDIC, restrictions on certain business activities, and appointment of the FDIC as conservator or receiver. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized.

A bank will be (i) “well capitalized” if the institution has a total risk-based capital ratio of 10.0% or greater, a CET1 capital ratio of 6.5% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) “adequately capitalized” if the institution has a total risk-based capital ratio of 8.0% or greater, a CET1 capital ratio of 4.5% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 4.0% or greater and is not “well capitalized”; (iii) “undercapitalized” if the institution has a total risk-based capital ratio that is less than 8.0%, a CET1 capital ratio less than 4.5%, a Tier 1 risk-based capital ratio of less than 6.0% or a leverage ratio of less than 4.0%; (iv) “significantly undercapitalized” if the institution has a total risk-based capital ratio of less than 6.0%, a CET1 capital ratio less than 3.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 3.0%; and (v) “critically undercapitalized” if the institution’s tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank’s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

The FDI Act generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be "undercapitalized." "Undercapitalized" institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with such capital restoration plan. The bank holding company must also provide appropriate assurances of performance. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution's total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized."

"Significantly undercapitalized" depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

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

The Company believes that, as of December 31, 2016, the Bank was "well capitalized" based on the aforementioned ratios.

Deposit Insurance Assessments

The deposits of the Bank are insured by the FDIC in the standard insurance amount of $250,000 per depositor for each account ownership category. This insurance is funded through assessments on the Bank and other insured depository institutions. The FDIC's risk-based assessment system requires members to pay varying assessment rates depending upon the level of the institution's capital and the degree of supervisory concern over the institution. In connection with implementing the Dodd-Frank Act, the FDIC in 2011 changed each institution's assessment base from its total insured deposits to its average consolidated total assets less average tangible equity and created a scorecard method for calculating assessments that combines certain supervisory ratings and specified forward-looking financial measures to determine each institution's risk to the DIF. The Dodd-Frank Act also required the FDIC, in setting assessments, to offset the effect of increasing its reserve for the DIF on institutions with consolidated assets of less than $10 billion. The result of this revised approach to deposit-insurance assessments is generally an increase in costs, on an absolute or relative basis, for institutions with consolidated assets of $10 billion or more. The DIF assessment base rate currently ranges from 2.5 to 45 basis points for institutions that do not trigger factors for brokered deposits and unsecured debt, and higher rates for those that do trigger those risk factors.

At least semi-annually, the FDIC will update its loss and income projections for the DIF and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking if required. The FDIC may increase or decrease its rates by 2.0 basis points without further rulemaking. In an emergency, the FDIC may also impose a special assessment.

The Company's FDIC insurance expense totaled $2.9 million, $3.4 million and $3.3 million in 2016, 2015 and 2014, respectively. FDIC insurance expense includes deposit insurance assessments as well as Financing Corporation ("FICO") assessments. All FDIC-insured depository institutions must pay an annual FICO assessment to provide funds for the payment of interest on bonds issued by FICO during the 1980s to resolve the thrift bailout. FDIC-insured depository institutions paid an average FICO assessment of 57 cents for each $100 of assessable deposits in 2016.

As insurer, the FDIC is authorized to conduct examinations of and to require reporting by DIF-insured institutions. It also may prohibit any DIF-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the DIF. The FDIC also has the authority to take enforcement actions against insured institutions.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged or is engaging in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or written agreement entered into with the FDIC. The Company does not know of any practice, condition or violation that might lead to termination of deposit insurance for its banking subsidiary.

Safety and Soundness Standards

The FDI Act requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits and such other operational and managerial standards as the agencies deem appropriate. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal stockholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the "prompt corrective action" provisions of the FDI Act. See "--Prompt Corrective Action" above. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

Incentive Compensation

The Federal Reserve Board reviews, as part of its regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." These reviews are tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of this supervisory initiative will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In June 2010, the Federal Reserve Board, OCC and FDIC issued a comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk-management and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

During the second quarter of 2016, the U.S. financial regulators, including the Federal Reserve Board and the SEC, proposed revised rules on incentive-based payment arrangements at specified regulated entities having at least $1 billion in total assets (which would include the Company and the Bank). The proposed revised rules would establish general qualitative requirements applicable to all covered entities, which would include (i) prohibiting incentive arrangements that encourage inappropriate risks by providing excessive compensation; (ii) prohibiting incentive arrangements that encourage inappropriate risks that could lead to a material financial loss; (iii) establishing requirements for performance measures to appropriately balance risk and reward; (iv) requiring board of director oversight of incentive arrangements; and (v) mandating appropriate record-keeping. Under the proposed rule, larger financial institutions with total consolidated assets of at least $50 billion would also be subject to additional requirements applicable to such institutions' "senior executive officers" and "significant risk-takers." These additional requirements would not be applicable to the Company or the Bank.

Cybersecurity

In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet based services of the financial institution. The other statement indicates that a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If we fail to observe the regulatory guidance, we could be subject to various regulatory sanctions, including financial penalties.

In October 2016, the Federal Reserve, FDIC and OCC issued an advance notice of proposed rulemaking regarding enhanced cyber risk management standards, which would apply to a wide range of large financial institutions (ie., those with total consolidated assets of $50 billion or more) and their third-party service providers. The proposed standards would expand existing cybersecurity regulations and guidance to focus on cyber risk governance and management; management of internal and external dependencies; and incident response, cyber resilience and situational awareness. In addition, the proposal contemplates more stringent standards for institutions with systems that are critical to the financial sector. See Item 1A. Risk Factors for a further discussion of risks related to cybersecurity.

Fiscal and Monetary Policies

The Company's business and earnings are affected significantly by the fiscal and monetary policies of the federal government and its agencies. The Company is particularly affected by the policies of the Federal Reserve Board, which regulates the supply of money and credit in the United States. Among the instruments of monetary policy available to the Federal Reserve Board are (a) conducting open market operations in United States government securities, (b) changing the discount rates of borrowings of depository institutions, (c) imposing or changing reserve requirements against depository institutions' deposits and (d) imposing or changing reserve requirements against certain borrowings by banks and their affiliates. These methods are used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. The policies of the Federal Reserve Board may have a material effect on the Company's business, results of operations and financial condition.

Privacy Provisions of the GLB Act

Federal banking regulators, as required under the GLB Act, have adopted rules limiting the ability of banks and other financial institutions to disclose nonpublic information about consumers to nonaffiliated third parties. The rules require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to nonaffiliated third parties. The privacy provisions of the GLB Act affect how consumer information is transmitted through diversified financial services companies and conveyed to outside vendors.

Anti-Money Laundering and the Patriot Act

The USA Patriot Act of 2001 (the "Patriot Act") is intended to strengthen the ability of U.S. law enforcement agencies and intelligence communities to work together to combat terrorism on a variety of fronts. The Patriot Act substantially broadened the scope of the U.S. anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The U.S. Treasury Department has issued a number of implementing regulations which apply various requirements of the Patriot Act to financial institutions such as the Bank. Those regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing, and have significant implications for depository institutions, brokers, dealers and other businesses involved in the transfer of money. The Patriot Act also requires federal bank regulators to evaluate the effectiveness of an applicant in combating money laundering in determining whether to approve a proposed bank acquisition. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required. Regulatory authorities have imposed cease and desist orders and civil money penalties against institutions found to be violating these obligations.

Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Community Reinvestment Act

The Community Reinvestment Act of 1977 (the "CRA"), requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practices. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. In order for a financial holding company to commence any new activity permitted by the BHC Act, or to acquire any company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least “satisfactory” in its most recent examination under the CRA. Furthermore, banking regulations take into account CRA rating when considering approval of a proposed transaction. During its last examination in 2016, a rating of “satisfactory” was received by the Bank.

Consumer Laws and Regulations

Banks and other financial institutions are subject to numerous laws and regulations intended to protect consumers in their transactions with banks. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act and these laws’ respective state-law counterparts, as well as state usury laws and laws regarding unfair and deceptive acts and practices. These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit unfair, deceptive and abusive practices, restrict the Company’s ability to raise interest rates and subject the Company to substantial regulatory oversight. Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys’ fees. Federal bank regulators, state attorneys general and state and local consumer protection agencies may also seek to enforce consumer protection requirements and obtain these and other remedies, including regulatory sanctions, customer rescission rights, action by the state and local attorneys general in each jurisdiction in which we operate and civil money penalties. Failure to comply with consumer protection requirements may also result in the Company’s failure to obtain any required bank regulatory approval for merger or acquisition transactions the Company may wish to pursue or its prohibition from engaging in such transactions even if approval is not required.

The Consumer Financial Protection Bureau (“CFPB”) is a federal agency responsible for implementing, examining and enforcing compliance with federal consumer protection laws. The CFPB focuses on:

- Risks to consumers and compliance with the federal consumer financial laws, when it evaluates the policies and practices of a financial institution.
- The markets in which firms operate and risks to consumers posed by activities in those markets.
- Depository institutions that offer a wide variety of consumer financial products and services.
- Depository institutions with a more specialized focus.
- Non-depository companies that offer one or more consumer financial products or services.

The CFPB has broad rulemaking authority for a wide range of consumer financial laws that apply to all banks, including, among other things, the authority to prohibit “unfair, deceptive or abusive” acts and practices. Abusive acts or practices are defined as those that materially interfere with a consumer’s ability to understand a term or condition of a consumer financial product or service or take unreasonable advantage of a consumer’s (i) lack of financial savvy, (ii) inability to protect himself in the selection or use of consumer financial products or services, or (iii) reasonable reliance on a covered entity to act in the consumer’s interests. The CFPB can issue cease-and-desist orders against banks and other entities that violate consumer financial laws. The CFPB may also institute a civil action against an entity in violation of federal consumer financial law in order to impose a civil penalty or injunction. The CFPB has examination and enforcement authority over all banks with more than $10 billion in assets, as well as their affiliates. Banking regulators take into account compliance with consumer protection laws when considering approval of a proposed transaction.

Interstate Banking and Branching

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act, as amended by the Dodd-Frank Act (the "Riegle-Neal Act"), a bank holding company may acquire banks in states other than its home state, subject to any state requirement that the bank has been organized and operating for a minimum period of time, not to exceed five years, and the requirement that the bank holding company, prior to or following the proposed acquisition, control no more than 10% of the total amount of deposits of insured depository institutions nationwide and no more than 30% of such deposits in that state (or such amount as set by the state if such amount is lower than 30%).

The Riegle-Neal Act also authorizes banks to merge across state lines, thereby creating interstate branches. Banks are also permitted to either acquire existing banks or to establish new branches in other states where authorized under the laws of those states. Effective July 21, 2011, the Dodd-Frank Act also required that a bank holding company or bank be well-capitalized and well-managed (rather than simply adequately capitalized and adequately managed) in order to take advantage of these interstate banking and branching provisions.

Depositor Preference

The FDI Act provides that, in the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution (including the claims of the FDIC as subrogee of insured depositors) and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors with respect to any extensions of credit they have made to such insured depository institution.

Changes in Laws, Regulations or Policies

Banking is a heavily regulated industry. Additional initiatives may be proposed or introduced before Congress and other government bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions and may subject the Company to increased supervision and disclosure and reporting requirements. In addition, the various bank regulatory agencies often adopt new rules and regulations and policies to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulatory changes in policy may be enacted or the extent to which the business of the Company would be affected thereby.

State Regulation

BancFirst is an Oklahoma-chartered state bank. Accordingly, BancFirst's operations are subject to various requirements and restrictions of Oklahoma state law relating to loans, lending limits, interest rates payable on deposits, investments, mergers and acquisitions, borrowings, dividends, capital adequacy and other matters. However, Oklahoma banking law specifically empowers a state-chartered bank such as BancFirst to exercise the same powers as are conferred upon national banks by the laws of the United States and the regulations and policies of the Office of the Comptroller of the Currency, unless otherwise prohibited or limited by the State Banking Commissioner or the State Banking Board. Accordingly, unless a specific provision of Oklahoma law otherwise provides, a state-chartered bank is empowered to conduct all activities that a national bank may conduct.

National banks are authorized by the GLB Act to engage, through "financial subsidiaries," in any activity that is permissible for a financial holding company and any activity that the Secretary of the Treasury, in consultation with the Federal Reserve Board, determines is financial in nature or incidental to any such financial activity, except (1) insurance underwriting, (2) real estate development or real estate investment activities (unless otherwise permitted by law), (3) insurance company portfolio investments and (4) merchant banking. The authority of a national bank to invest in a financial subsidiary is subject to a number of conditions, including, among other things, requirements that the bank must be well managed and well capitalized (after deducting from the bank's capital outstanding investments in financial subsidiaries). The GLB Act provides that state nonmember banks, such as BancFirst, may invest in financial subsidiaries (assuming they have the requisite investment authority under applicable state law), subject to the same conditions that apply to national bank investments in financial subsidiaries.

As a state nonmember bank, BancFirst is subject to primary supervision, periodic examination and regulation by the State Banking Board and the FDIC, and Oklahoma law provides that BancFirst must maintain reserves against deposits as required by the FDI Act. The Oklahoma State Bank Commissioner is authorized by statute to accept an FDIC examination in lieu of a state examination. In practice, the FDIC and the Oklahoma State Banking Department alternate examinations of BancFirst. If, as a result of an examination of a bank, the Oklahoma Banking Department determines that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the bank's operations are unsatisfactory or that the management of the bank is violating or has violated any law or regulation, various remedies, including the remedy of injunction, are available to the Oklahoma Banking Department. Oklahoma law permits the acquisition of an unlimited number of wholly-owned bank subsidiaries so long as aggregate deposits at the time of acquisition in a multi-bank holding company do not exceed 20% of the total amount of deposits of insured depository institutions located in Oklahoma.

In addition to the provisions of the GLB Act that authorize state nonmember banks to invest in financial subsidiaries (assuming they have the requisite investment authority under applicable state law) on the same conditions that apply to national banks, Federal Deposit Insurance Corporation Improvement Act ("FDICIA") provides that FDIC-insured state banks such as BancFirst may engage directly or through a subsidiary in certain activities that are not permissible for a national bank, if the activity is authorized by applicable state law, the FDIC determines that the activity does not pose a significant risk to the DIF and the bank is in compliance with its applicable capital standards.

Securities Laws

The Company's common stock is publicly held and listed on the NASDAQ Global Select Market, and the Company is subject to the periodic reporting, information, proxy solicitation, insider trading, corporate governance and other requirements and restrictions of the Securities Exchange Act of 1934 and the regulations of the SEC promulgated thereunder as well as listing requirements of the NASDAQ. In addition, the Dodd-Frank Act includes provisions that affect corporate governance and executive compensation at most United States publicly traded companies, including the Company.

The Company is also subject to the accounting oversight and corporate governance requirements of the Sarbanes-Oxley Act of 2002, including:

- required executive certification of financial presentation;
- increased requirements for board audit committees and their members;
- enhanced disclosures of controls and procedures and internal control over financial reporting;
- enhanced controls over, and reporting of, insider trading and
- increased penalties for financial crimes and forfeiture of executive bonuses in certain circumstances.

Available Information

The Company maintains a website at www.bancfirst.com. The Company provides copies of the most recently filed 10-K, 10-Q and proxy statements, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after the Company electronically files the material with, or furnishes it to, the SEC. The website also provides links to the SEC's website (http://www.sec.gov) where all of the Company's filings with the SEC can be obtained immediately upon filing. You may also request a copy of the Company's filings, at no cost, by writing or telephoning the Company at the following address:

BancFirst Corporation

101 N. Broadway

Oklahoma City, Oklahoma 73102

ATTENTION: Randy Foraker

Executive Vice President

(405) 270-1044

1A. Risk Factors

In the course of conducting our business operations, we are exposed to a variety of risks that are inherent to the financial services industry. The following discusses some of the key inherent risk factors that could affect our business and operations. The risks and uncertainties described below are not the only ones we are facing. Other factors besides those discussed below or elsewhere in this report also could adversely affect our business and operations, and the risk factors discussed below should not be considered a complete list of potential risks that may affect us. Further, to the extent that any of the information contained in this report constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important factors that could cause our actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of us.

Risks Related to Our Business

Changes in economic conditions, especially in the State of Oklahoma, pose significant challenges for us and could adversely affect our financial condition and results of operations.

Our business is affected by conditions outside our control, including the rate of economic growth in general, the level of unemployment, increases in inflation and the level of interest rates. Economic conditions affect the level of demand for and the profitability of our products and services. A slowdown in the general economic recovery, particularly in Oklahoma, could negatively impact our business. Our bank subsidiary operates exclusively within the State of Oklahoma and, unlike larger national or superregional banks that serve a broader and more diverse geographic region; our lending is also primarily concentrated in the State of Oklahoma. As a result, our financial condition, results of operations and cash flows are subject to changes in the economic conditions in our state. Our continued success is largely dependent upon the continued growth or stability of the communities we serve. A decline in the economies of these communities could negatively impact our net income and profitability. Additionally, declines in the economies of these communities and of the State of Oklahoma in general could affect our ability to generate new loans or to receive repayments of existing loans, and our ability to attract new deposits, adversely affecting our financial condition.

We may be adversely affected by declining crude oil prices.

In recent years, decisions by members of the Organization of Petroleum Exporting Countries ("OPEC") impacting crude oil production levels has resulted in significant declines in market oil prices. Decreased market oil prices have compressed margins for many U.S. and Oklahoma-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. As of December 31, 2016, the price per barrel of crude oil was approximately $53 compared to a high of over $100 in 2014 and a low of approximately $30 at the beginning of 2016. If oil prices remain at these low levels for an extended period, we would expect to experience weaker energy loan demand and increased losses within our energy portfolio. Furthermore, a prolonged period of low oil prices could also have a negative impact on the energy producing economies and, in particular, the economies of states such as Oklahoma, where the energy industry is a significant driver of economic development. Although as of December 31, 2016, reserve base and service energy loans comprised less than 4% of our loan portfolio, the impact of lower oil prices could have an indirect impact on our other loan portfolio segments, for example, commercial real estate ("CRE").

A substantial portion of our loan portfolio is secured by real estate, in particular commercial real estate. Deterioration in the real estate markets could lead to losses, which could have a material negative effect on our financial condition and results of operations.

Loans secured by real estate constitute a significant portion of our loan portfolio. At December 31, 2016, this percentage was 67.0% compared to 66.9% at December 31, 2015. While our record of asset quality has historically been solid, we cannot guarantee that our record of asset quality will be maintained in future periods. The ability of our borrowers to repay their loans could be adversely impacted by a significant change in market conditions, which not only could result in our experiencing an increase in charge-offs, but also could necessitate increasing our provision for loan losses. In addition, because one to four family residential and commercial real estate loans represent the majority of our real estate loans outstanding, a decline in tenant occupancy due to such factors or for other reasons could adversely impact the ability of our borrowers to repay their loans on a timely basis, which could have a negative impact on our financial condition and results of operations.

Any future action by the U.S. Congress lowering the federal corporate income tax rate could result in a reduction of our deferred tax assets.

Deferred tax assets are reported as assets on our balance sheet and represent the decrease in taxes expected to be paid in the future because of future reversals of temporary differences in the bases of assets and liabilities as measured by enacted tax laws and their bases as reported in the financial statements. As of December 31, 2016, our net deferred tax asset was $12.7 million. The President of the U.S. and the majority political party in the U.S. Congress have announced plans to lower the federal corporate income tax rate from its current level of 35%. We currently record deferred tax assets at the blended federal-state tax rate of 38.68%. If these plans ultimately result in the enactment of new laws lowering the corporate income tax rate by a material amount, our deferred tax assets would need to be re-measured at the lower rate, resulting in a corresponding charge against our earnings.

Changes to the beneficial tax treatment of interest expense could adversely affect our financial condition and results of operations.

One of the proposals outlined in the presidential administration's tax reform blueprint disallows deductions for net interest expense. This would increase the cost of debt financing and could encourage our customers to raise capital through equity financing instead of debt financing. Our loan portfolio and interest income could be adversely impacted as a result.

If a significant number of customers fail to perform under their loans, our business, profitability and financial condition would be adversely affected.

There are inherent risks associated with our lending activities. As a lender, we face the risk that a significant number of our borrowers will fail to pay their loans as a result of other factors, including the impact of changes in interest rates and changes in the economic conditions in the markets where we operate. If borrower defaults cause losses in excess of our allowance for loan losses, it could have an adverse effect on our business, profitability and financial condition. We have established an evaluation process designed to recognize loan losses as they occur. While this evaluation process uses historical and other objective information, the classification of loans and the estimation of loan losses are dependent to a great extent on our experience and judgment. If charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and capital, and may have a material adverse effect on our financial condition and results of operations. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” located elsewhere in this report for further discussion related to our process for determining the appropriate level of the allowance for loan losses. We cannot assure you that our future loan losses will not have any material adverse effects on our business, profitability or financial condition.

Technological advances in payment processing is expected to negatively impact our interchange revenue.

Interchange fees, or “swipe” fees, are charges that merchants pay to the processors who, in turn, share that revenue with us and other card-issuing banks for processing electronic payment transactions. Rapid, significant technological changes continue to confront the payments industry. Technological advances and the growth of e-commerce have made it possible for non-depository institutions to offer products and services that traditionally were banking products, and for financial institutions and other companies to provide electronic and internet-based financial solutions for processing electronic payment transactions. These include developments in smart cards, e-commerce, mobile, and radio frequency and proximity payment devices, such as contactless cards. Ongoing or increased competition in payment processing may restrict our ability to generate interchange revenue in the future. For the year ended December 31, 2016, debit card interchange revenue represented 22.5% of our noninterest income.

New consumer protection laws may reduce our noninterest income.

We are subject to a number of federal and state consumer protection laws that extensively govern our relationship with our customers. The Dodd-Frank Act established the Consumer Financial Protection Bureau ("CFPB") with powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive acts and practices.” The CFPB also has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets for certain designated consumer laws and regulations. The other federal banking agencies enforce such consumer laws and regulations for banks and savings institutions under $10 billion in assets. These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit unfair, deceptive and abusive practices and restrict our ability to raise interest rates and charge NSF fees. A significant portion of our noninterest income is derived from service charge income, including NSF fees, which represented 25.1% of our noninterest income for the year ended December 31, 2016. Violations of applicable consumer protection laws can also result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys’ fees.

Fluctuations in interest rates could reduce our profitability.

We realize income primarily from the difference between interest earned on loans and investments and the interest paid on deposits and borrowings. We expect that we will periodically experience “gaps” in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-earning assets will be more sensitive to changes in market interest rates than our interest-bearing liabilities, or vice versa. Changes in market interest rates could either positively or negatively affect our net interest income and our profitability, depending on the magnitude, direction and duration of the change. If interest rates remain low, our net interest margin could experience further compression.

We are unable to predict fluctuations of market interest rates, which are affected by, among other factors, changes in inflation rates, economic growth, money supply, government debt, domestic and foreign financial markets and political developments, including terrorist acts and acts of war. Our asset-liability management strategy, which is designed to mitigate our risk from changes in market interest rates, may not be able to mitigate changes in interest rates from having a material adverse effect on our results of operations and financial condition.

Changes in monetary policies may have an adverse effect on our business.

Our results of operations are affected by credit policies of monetary authorities, particularly the Federal Reserve Board. Actions by monetary and fiscal authorities, including the Federal Reserve Board, could have an adverse effect on our deposit levels, loan demand or business earnings. See "Item 1 - Business-Supervision and Regulation." Our profitability is greatly dependent upon our earning a positive interest spread between our loan and securities portfolio, and our funding deposits and borrowings. Changes in the level of interest rates, or a prolonged unfavorable interest rate environment, or a decrease in our level of deposits that increases our cost of funds could negatively affect our profitability and financial condition.

The repeal of federal prohibitions on payment of interest on business checking accounts could increase our interest expense.

All federal prohibitions on the ability of financial institutions to pay interest on business checking accounts were repealed as part of the Dodd-Frank Act beginning on July 21, 2011. As a result, some financial institutions have commenced offering interest on business checking accounts to compete for customers. Our interest expense will increase and our net interest margin will decrease if we begin offering interest on business checking accounts to attract additional customers or maintain current customers, which could have a material adverse effect on our business, financial condition and results of operations.

Our information systems may experience an interruption or breach in security.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. Information security breaches and cybersecurity-related incidents may include, but are not limited to, attempts to access information, including customer and company information, malicious code, computer viruses and denial of service attacks that could result in unauthorized access, misuse, loss or destruction of data (including confidential customer information), account takeovers, unavailability of service or other events. These types of threats may derive from human error, fraud or malice on the part of external or internal parties, or may result from accidental technological failure. Further, to access our products and services our customers may use computers and mobile devices that are beyond our security control systems. Our technologies, systems, networks and software, and those of other financial institutions have been, and are likely to continue to be, the target of cybersecurity threats and attacks, which may range from uncoordinated individual attempts to sophisticated and targeted measures directed at us. The risk of a security breach or disruption, particularly through cyber-attack or cyber intrusion, has increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased.

Although we make significant efforts to maintain the security and integrity of our information systems and have implemented various measures to manage the risk of a security breach or disruption, there can be no assurance that our security efforts and measures will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well protected information, networks, systems and facilities remain potentially vulnerable because attempted security breaches, particularly cyber-attacks and intrusions, or disruptions will occur in the future, and because the techniques used in such attempts are constantly evolving and generally are not recognized until launched against a target, and in some cases are designed not to be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures, and thus it is virtually impossible for us to entirely mitigate this risk. While we maintain specific “cyber” insurance coverage, which would apply in the event of various breach scenarios, the amount of coverage may not be adequate in any particular case. Furthermore, because cyber threat scenarios are inherently difficult to predict and can take many forms, some breaches may not be covered under our cyber insurance coverage. A security breach or other significant disruption of our information systems or those related to our customers, merchants and our third party vendors, including as a result of cyber-attacks, could (i) disrupt the proper functioning of our networks and systems and therefore our operations and/or those of certain of our customers; (ii) result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of confidential, sensitive or otherwise valuable information of ours or our customers; (iii) result in a violation of applicable privacy, data breach and other laws, subjecting us to additional regulatory scrutiny and expose us to civil litigation, governmental fines and possible financial liability; (iv) require significant management attention and resources to remedy the damages that result; or (v) harm our reputation or cause a decrease in the number of customers that choose to do business with us. The occurrence of any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

We rely on certain external vendors.

We are reliant upon certain external vendors to provide products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements could be disruptive to our operations, which could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

We have a continuing need for technological change.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving our customers, the effective use of technology increases our efficiency and enables us to reduce costs. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow and expand our market area. Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage. Accordingly, we cannot assure you that we will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

Maintaining or increasing our market share depends on market acceptance and regulatory approval of new products and services.

Our success depends, in part, upon our ability to adapt our products and services to evolving industry standards and consumer demand. There is increasing pressure on financial services companies to provide products and services at lower prices. In addition, the widespread adoption of new technologies, including Internet-based services, could require us to make substantial expenditures to modify or adapt our existing products or services. A failure to achieve market acceptance of any new products we introduce, or a failure to introduce products that the market may demand, could have an adverse effect on our business, profitability, or growth prospects.

We operate in a highly regulated environment and may be adversely affected by changes in federal and state laws and regulations.

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal or state legislation could have a substantial impact on us and our results of operations. The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes. Other changes to statutes, regulations or regulatory policies or supervisory guidance, including changes in interpretation or implementation of statutes, regulations, policies or supervisory guidance, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations, policies or supervisory guidance could result in enforcement and other legal actions by federal or state authorities, including criminal and civil penalties, the loss of FDIC insurance, the revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties and/or reputational damage. In this regard, government authorities, including the bank regulatory agencies, are pursuing aggressive enforcement actions with respect to compliance and other legal matters involving financial activities, which heightens the risks associated with actual and perceived compliance failures. Any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

See the sections captioned “Supervision and Regulation” included in Item 1. Business, located elsewhere in this report.

Our recent results may not be indicative of future results.

We may not be able to sustain our historical rate of growth or may not be able to grow our business at all. Various factors, such as poor economic conditions, changes in interest rates, regulatory and legislative considerations and competition may also impede or inhibit our ability to expand our market presence. If we experience a significant decrease in our rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

Competition with other financial institutions could adversely affect our profitability.

We face vigorous competition from banks and other financial institutions, including savings and loan associations, savings banks, finance companies and credit unions. A portion of these banks and other financial institutions have substantially greater resources and lending limits, larger branch systems and other banking services that we do not offer. To a limited extent, we also compete with other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies and insurance companies. When new competitors seek to enter one of our markets, or when existing market participants seek to increase their market share, they sometimes undercut the pricing and/or credit terms prevalent in that market. This competition may reduce or limit our margins on banking and trust services, reduce our market share and adversely affect our results of operations and financial condition.

There can be no assurance that the integration of our acquisitions will be successful or will not result in unforeseen difficulties that may absorb significant management attention.

Our completed acquisitions, or any future acquisition, may not produce the revenue, cost savings, earnings or synergies that we anticipated. The process of integrating acquired companies into our business may also result in unforeseen difficulties. Unforeseen operating difficulties may absorb significant management attention, which we might otherwise devote to our existing business. Also, the process may require significant financial resources that we might otherwise allocate to other activities, including the ongoing development or expansion of our existing operations. Additionally, we may be exposed to potential asset quality issues or unknown or contingent liabilities of the banks, businesses, assets and liabilities we acquire. If these issues or liabilities exceed our estimates, our results of operations and financial condition may be negatively affected.

If we pursue a future acquisition, our management could spend a significant amount of time and effort identifying and completing the acquisition. If we make a future acquisition, we could issue equity securities which would dilute current stockholders' percentage ownership, incur substantial debt, assume contingent liabilities, be required to record an impairment of goodwill or any combination of the foregoing.

Changes in accounting standards could impact our financial statements and reported earnings.

Accounting standard-setting bodies, such as the Financial Accounting Standards Board, periodically change the financial accounting and reporting standards that affect the preparation of the consolidated financial statements. These changes are beyond our control and could have a meaningful impact on our consolidated financial statements.

Our accounting estimates and risk-management processes may not be effective in mitigating risk and loss.

We maintain an enterprise risk-management program that is designed to identify, quantify, monitor, report and control the risks that it faces. These include interest-rate risk, credit risk, liquidity risk, operational risk, reputational risk and compliance and litigation risk. While we assess and improve this program on an ongoing basis, there can be no assurance that its approach and framework for risk-management and related controls will effectively mitigate risk and limit losses in our business. To comply with generally accepted accounting principles, management must sometimes exercise judgment in selecting, determining and applying accounting methods, assumptions and estimates. This can arise, for example, in determining the allowance for loan losses or the fair value of assets or liabilities. The judgments required of management can involve difficult, subjective, or complex matters with a high degree of uncertainty, and several different judgments could be reasonable under the circumstances and yet result in significantly different results being reported. See "Critical Accounting Policies and Estimates" in Part II, Item 7. If management's judgments later prove to have been inaccurate, we may experience unexpected losses that could be substantial.

Additionally, the processes we use to estimate our probable loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models we use for determining our probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. The Sarbanes-Oxley Act of 2002 requires management and our auditors to evaluate and assess the effectiveness of our internal control over financial reporting. These requirements may be modified, supplemented or amended from time to time. Implementing these changes may take a significant amount of time and may require specific compliance training of our personnel. We have in the past discovered, and may in the future discover, areas of our internal control over financial reporting that need improvement. If we or our auditors discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in our financial statements and have an adverse effect on our stock price. We may not be able to effectively and timely implement necessary control changes and employee training to ensure continued compliance with the Sarbanes-Oxley Act and other regulatory and reporting requirements. Our historic growth and our planned expansion through acquisitions present challenges to maintaining the internal control and disclosure control standards applicable to public companies. If we fail to maintain effective internal controls we could be subject to regulatory scrutiny and sanctions, our ability to recognize revenue could be impaired and investors could lose confidence in the accuracy and completeness of our financial reports. We cannot assure you that we will continue to fully comply with the requirements of the Sarbanes-Oxley Act or that management or our auditors will conclude that our internal control over financial reporting is effective in future periods.

The soundness of other financial institutions could have a material adverse effect on our business, growth and profitability.

Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks and other institutional clients. Many of these transactions expose our business to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral we hold cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse effect on our financial condition and results of operations.

We are subject to liquidity risk.

Liquidity is the ability to fund increases in assets and meet obligations as they come due, all without incurring unacceptable losses. Banks are especially vulnerable to liquidity risk because of their role in the transformation of demand or short-term deposits into longer-term loans or other extensions of credit. We, like other financial-services companies, rely to a significant extent on external sources of funding (such as deposits and borrowings) for the liquidity needed in the conduct of our business. A number of factors beyond our control, however, could have a detrimental impact on the level or cost of that funding and thus on our liquidity. These include market disruptions, changes in our credit ratings or the sentiment of our investors, the loss of substantial deposit relationships and reputational damage. Unexpected declines or limits on the dividends declared and paid by our subsidiaries also could adversely affect our liquidity position. While our policies and controls are designed to ensure that we maintain adequate liquidity to conduct our business in the ordinary course even in a stressed environment, there can be no assurance that our liquidity position will never become compromised. In such an event, we may be required to sell assets at a loss in order to continue our operations. This could damage the performance and value of our business, prompt regulatory intervention and harm our reputation, and if the condition were to persist for any appreciable period of time, our viability as a going concern could be threatened. See “Quantitative and Qualitative Disclosures About Market Risk—Liquidity Risk” in Part II, Item 7A for a discussion of how we monitor and manage liquidity risk.

We have businesses other than banking.

In addition to commercial banking services, we provide life and other insurance products, as well as other business and financial services. We may in the future develop or acquire other non-banking businesses. As a result of other such businesses, our earnings could be subject to risks and uncertainties that are different from those to which our commercial banking services are subject. In developing and marketing new lines of business and/or new products and services we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, financial condition and results of operations.

We may need to raise additional capital in the future, and such capital may not be available when needed or at all.

We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, particularly if our asset quality or earnings were to deteriorate significantly. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control and our financial performance. Economic conditions and the loss of confidence in financial institutions may increase our cost of funding and limit access to certain customary sources of capital, including inter-bank borrowings, repurchase agreements and borrowings from the discount window of the Federal Reserve Board.

We cannot assure that such capital will be available on acceptable terms or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of debt purchasers, depositors or counterparties participating in the capital markets, or a downgrade of our debt ratings, may adversely affect our capital costs and our ability to raise capital and, in turn, our liquidity. Moreover, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital, and we would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a materially adverse effect on our businesses, financial condition and results of operations.

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

Our success to-date has been strongly influenced by our ability to attract and to retain senior management experienced in banking and financial services. Our ability to retain executive officers and the current management teams of each of our lines of business will continue to be important to the successful implementation of our strategies. We do not have employment or non-compete agreements with these key employees. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business and financial results.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property’s value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

The FASB’s recently adopted ASU 2016-13 will result in a significant change in how we recognize credit losses and may have a material impact on our financial condition or results of operations.

In June 2016, the Financial Accounting Standards Board, or FASB, issued Accout to acquire within 60 days. The shares indicated represent stock options granted under our current or previous stock option plans that are currently exercisable or will become exercisable within 60 days of February 28, 2010. Shares subject to options cannot be voted.

(4) Ownership percentage is reported based on 583,603,353 shares of common stock outstanding on February 28, 2010, plus, as to the holder thereof only and no other person, the number of shares (if any) that the person has the right to acquire as of February 28, 2010, or within 60 days from that date, through the exercise of all options and other rights.

The following table sets forth, as of February 28, 2010, the number of shares of common units of Williams Partners L.P. beneficially owned by each of our directors and nominees for directors, by the NEOs, and by all directors and executive officers as a group.

Name of Individual or Group	Shares of Common Units Owned Directly or Indirectly	Shares Underlying Options Exercisable Within 60 Days(1)	Total	Percent of Class(2)
Alan S. Armstrong(3)	20,000	0	20,000	*
Donald R. Chappel	10,000	0	10,000	*
Joseph R. Cleveland	0	0	0	*
Kathleen B. Cooper	0	0	0	*
Irl F. Engelhardt	0	0	0	*
William R. Granberry	0	0	0	*
William E. Green	1,180	0	1,180	*
Ralph A. Hill	500	0	500	*
Juanita H. Hinshaw	1,000	0	1,000	*
W. R. Howell	5,000	0	5,000	*
George A. Lorch	5,000	0	5,000	*
William G. Lowrie	2,320	0	2,320	*
Frank T. MacInnis	5,000	0	5,000	*
Steven J. Malcolm(4)	25,100	0	25,100	*
Janice D. Stoney	5,000	0	5,000	*
Phillip D. Wright	4,425	0	4,425	*
All directors and executive officers as a group (19 persons)	94,825	0	94,825	*

* Less than 1%.

(1) The SEC deems a person to have beneficial ownership of all shares that the person has the right to acquire within 60 days.

(2) Ownership percentage is reported based on 52,777,452 shares of common units outstanding on February 28, 2010.

(3) Represents 10,000 units held by the Shelly Stone Armstrong Trust dated August 10, 2004.

(4) Represents units beneficially owned by Mr. Malcolm that are held by The Steven J. Malcolm Revocable Trust dated January 19, 2000.

Table of Contents

The following table sets forth, as of February 28, 2010, the number of common units of Williams Pipeline Partners LP. owned by each of our directors and nominees for directors, by the NEOs and by all directors and executive officers as a group.

Name of Individual or Group	Shares of Common Units Owned Directly or Indirectly	Shares Underlying Options Exercisable Within 60 Days(1)	Total	Percent of Class(2)
Alan S. Armstrong	0	0	0	*
Donald R. Chappel	10,000	0	10,000	*
Joseph R. Cleveland	0	0	0	*
Kathleen B. Cooper	0	0	0	*
Irl F. Engelhardt	0	0	0	*
William R. Granberry	0	0	0	*
William E. Green	0	0	0	*
Ralph A. Hill	5,000	0	5,000	*
Juanita H. Hinshaw	1,000	0	1,000	*
W. R. Howell	10,000	0	10,000	*
George A. Lorch	5,000	0	5,000	*
William G. Lowrie	6,990	0	6,990	*
Frank T. MacInnis	5,000	0	5,000	*
Steven J. Malcolm(3)	10,000	0	10,000	*
Janice D. Stoney	5,000	0	5,000	*
Phillip D. Wright	10,100	0	10,100	*
All directors and executive officers as a group (19 persons)	78,590	0	78,590	*

* Less than 1%.

(1) The SEC deems a person to have beneficial ownership of all shares that the person has the right to acquire within 60 days.

(2) Ownership percentage is reported based on 22,607,430 shares of common units outstanding on February 28, 2010.

(3) Represents units beneficially owned by Mr. Malcolm that are held by The Steven J. Malcolm Revocable Trust dated January 19, 2000.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires the Company s directors and certain of its officers to file reports of their ownership of Williams common stock and of changes in such ownership with the SEC and the NYSE. Regulations also require Williams to identify in this proxy statement any person subject to this requirement who failed to file any such report on a timely basis. Based solely on a review of the copies of such reports furnished to the Company and written representations from certain reporting persons, we believe that all of our officers, directors, and greater than 10% stockholders complied with all Section 16(a) filing requirements applicable to them during the fiscal year ended December 31, 2009.

NAMED EXECUTIVE OFFICER PROFILES

The following individual executive profiles provide biographical information and summarize total targeted compensation for 2009 to our NEOs. These profiles are provided in addition to the detailed compensation tables required by the SEC.

Steven J. Malcolm
Chairman of the Board, Chief Executive Officer and President
Position held since September 2001.
Age: 61

Mr. Malcolm became Chairman of the Board in May 2002, Chief Executive Officer in January 2002, and President in September 2001.

For further information about Mr. Malcolm, please see his biography within the section titled Directors Continuing in Office.

2009 Target Compensation[1]

Long-Term Incentives (LTI)	
Performance-Based RSUs	$ 2,760,000
Stock Options	$ 2,760,000
Time-Based RSUs	$ 0
Annual Incentive Plan (AIP) at Target	$ 1,100,000
Base Pay	$ 1,100,000
Retirement Benefits	
Pension (year over year change)	$ 163,541
Restoration Plan (year over year change)	$ 1,236,255
401(k) Company Match	$ 14,700

Payment Upon Termination
(As of December 31, 2009)

Voluntary Termination	$ 0
Termination with Cause	$ 0
Involuntary Termination without Cause	$ 5,102,568
Retirement	$ 10,297,261
Death or Disability	$ 10,297,261
Change in Control	$ 32,053,003

Stock Ownership Requirements

Mr. Malcolm s ownership in our common stock exceeds the required ownership threshold of five times base salary.

[1] Please note that 2009 Compensation reflects target pay and consists of annual base pay, AIP at target, and the targeted long-term incentive grant. These amounts will differ from the Summary Compensation Table. The retirement benefits are valued in the same manner shown in the Summary Compensation Table.

2009 Target Compensation Chart

Donald R. Chappel
Senior Vice President and Chief Financial Officer
Position held since April 2003.
Age: 58

Prior to joining Williams, Mr. Chappel held various financial, administrative, and operational leadership positions. Mr. Chappel is included in Institutional Investor magazine s Best CFOs listing for 2010, 2008, 2007, and 2006. Mr. Chappel serves as Chief Financial Officer and a director of Williams Partners GP LLC, the general partner of Williams Partners L.P., and as Chief Financial Officer and a director of Williams Pipeline GP LLC, the general partner of Williams Pipeline Partners L.P.

2009 Target Compensation[1]

Long-Term Incentives (LTI)	
Performance-Based RSUs	$ 700,000
Stock Options	$ 600,000
Time-Based RSUs	$ 700,000
Annual Incentive Plan (AIP) at Target	$ 450,000
Base Pay	$ 600,000
Retirement Benefits	
Pension (year over year change)	$ 60,381
Restoration Plan (year over year change)	$ 322,999
401(k) Company Match	$ 14,700

Payment Upon Termination
(As of December 31, 2009)

Voluntary Termination	$ 0
Termination with Cause	$ 0
Involuntary Termination without Cause	$ 3,752,377
Retirement	$ 3,984,481
Death or Disability	$ 5,283,631
Change in Control	$ 13,561,666

Stock Ownership Requirements

Mr. Chappel s ownership in our common stock exceeds the required ownership threshold of three times base salary.

[1] Please note that 2009 Compensation reflects target pay and consists of annual base pay, AIP at target, and the targeted long-term incentive grant. These amounts will differ from the Summary Compensation Table. The retirement benefits are valued in the same manner shown in the Summary Compensation Table.

2009 Target Compensation Chart

Ralph A. Hill
Senior Vice President, Exploration and Production
Position held since December 1998.
Age: 50

Mr. Hill acts as President of our Exploration and Production business unit. He was Vice President and General Manager of the Exploration & Production business from 1993 to 1998, as well as Senior Vice President and General Manager of Petroleum Services from 1998 to 2003. Mr. Hill serves as the Chairman of Apco Oil and Gas International Inc. He also serves as a member of the board of directors of the Tulsa, Oklahoma division of the American Heart Association and has been a board member of numerous other nonprofit Boards. He joined Williams in June 1981 as a member of a management training program and has worked in numerous capacities within the Williams organization.

2009 Target Compensation[1]

Long-Term Incentives (LTI)	
Performance-Based RSUs	$ 595,000
Stock Options	$ 510,000
Time-Based RSUs	$ 595,000
Annual Incentive Plan (AIP) at Target	$ 315,250
Base Pay	$ 485,000
Retirement Benefits	
Pension (year over year change)	$ 121,556
Restoration Plan (year over year change)	$ 306,311
401(k) Company Match	$ 14,700

Payment Upon Termination
(As of December 31, 2009)

Voluntary Termination	$ 0
Termination with Cause	$ 0
Involuntary Termination without Cause	$ 3,176,318
Retirement	$ 3,407,289
Death or Disability	$ 4,497,986
Change in Control	$ 8,742,999

Stock Ownership Requirements

Mr. Hill s ownership in our common stock exceeds the required ownership threshold of three times base salary.

[1] Please note that 2009 Compensation reflects target pay and consists of annual base pay, AIP at target, and the targeted long-term incentive grant. These amounts will differ from the Summary Compensation Table. The retirement benefits are valued in the same manner shown in the Summary Compensation Table.

2009 Target Compensation Chart

Table of Contents

Phillip D. Wright
Senior Vice President, Gas Pipelines
Position held since January 2005.
Age: 54

Mr. Wright acts as President of our Gas Pipeline business unit. From October 2002 to January 2005, he served as Chief Restructuring Officer. From September 2001 to October 2002, Mr. Wright served as President and Chief Executive Officer of our subsidiary Williams Energy Services. From 1996 until September 2001, he was Senior Vice President, Enterprise Development and Planning for our energy services group. Mr. Wright serves as a director, Senior Vice President, and Chief Operating Officer of Williams Pipeline GP LLC, the general partner of Williams Pipeline Partners L.P., and a director and Senior Vice President, Gas Pipeline, of Williams Partners GP LLC, the general partner of Williams Partners L.P. Mr. Wright is former Chairman of the Interstate Natural Gas Association of America and former Chairman of the Association of Oil Pipelines of America.

2009 Target Compensation[1]

Long-Term Incentives (LTI)	
Performance-Based RSUs	$ 560,000
Stock Options	$ 480,000
Time-Based RSUs	$ 560,000
Annual Incentive Plan (AIP) at Target	$ 325,000
Base Pay	$ 500,000
Retirement Benefits	
Pension (year over year change)	$ 108,798
Restoration Plan (year over year change)	$ 311,117
401(k) Company Match	$ 9,800

Payment Upon Termination
(As of December 31, 2009)

Voluntary Termination	$ 0
Termination with Cause	$ 0
Involuntary Termination without Cause	$ 2,762,219
Retirement	$ 2,942,607
Death or Disability	$ 3,947,044
Change in Control	$ 8,210,669

Stock Ownership Requirements

Mr. Wright s ownership in our common stock exceeds the required ownership threshold of three times base salary.

[1] Please note that 2009 Compensation reflects target pay and consists of annual base pay, AIP at target, and the targeted long-term incentive grant. These amounts will differ from the Summary Compensation Table. The retirement benefits are valued in the same manner shown in the Summary Compensation Table.

2009 Target Compensation Chart

Table of Contents

Alan S. Armstrong
Senior Vice President, Midstream
Position held since February 2002.
Age: 47

Mr. Armstrong acts as President of our Midstream business unit. From 1999 to February 2002, Mr. Armstrong was Vice President, Gathering and Processing for Midstream. From 1998 to 1999 he was Vice President, Commercial Development for Midstream.
Mr. Armstrong serves as a director and Senior Vice President, Midstream, of Williams Partners GP LLC, the general partner of Williams Partners L.P. He also serves as chairman of the board of directors of Junior Achievement of Oklahoma, Inc., President of the Gas Processors Association, and a member of the Board for the Natural Gas Supply Association.

2009 Target Compensation[1]

Long-Term Incentives (LTI)		
Performance-Based RSUs	$	560,000
Stock Options	$	480,000
Time-Based RSUs	$	560,000
Annual Incentive Plan (AIP) at Target	$	315,250
Base Pay	$	485,000
Retirement Benefits		
Pension (year over year change)	$	84,470
Restoration Plan (year over year change)	$	209,325
401(k) Company Match	$	14,700

Payment Upon Termination
(As of December 31, 2009)

Voluntary Termination	$	0
Termination with Cause	$	0
Involuntary Termination without Cause	$	2,779,221
Retirement	$	2,959,608
Death or Disability	$	3,964,046
Change in Control	$	8,000,330

Stock Ownership Requirements

Mr. Armstrong s ownership in our common stock exceeds the required ownership threshold of three times base salary.

[1] Please note that 2009 Compensation reflects target pay and consists of annual base pay, AIP at target, and the targeted long-term incentive grant. These amounts will differ from the Summary Compensation Table. The retirement benefits are valued in the same manner shown in the Summary Compensation Table.

2009 Target Compensation Chart

COMPENSATION DISCUSSION AND ANALYSIS

Objective of Our Compensation Programs

The role of compensation is to attract and retain the talent needed to drive stockholder value and to help each of our businesses meet or exceed financial and operational performance targets. Our compensation program objective is to reward our NEOs and employees for successfully implementing our strategy to grow our business and create long-term stockholder value. To that end, we use relative and absolute Total Shareholder Return (TSR) to measure long-term performance, and Economic Value Added (EVA®)[1] to measure annual performance. We believe linking TSR and EVA® to how we incent and pay NEOs helps ensure that the business decisions that are made are aligned with the long-term interests of our stockholders.

Our Pay Philosophy

Our Pay Philosophy throughout the entire organization is to pay for performance, be competitive in the marketplace, and consider the value a job provides to the Company. Our compensation programs reward NEOs not just for accomplishing our goals, but also for how those goals are pursued. We strive to reward the right results and the right behaviors while fostering a culture of collaboration and teamwork.

The principles of our pay philosophy influence the design and administration of our pay programs. Decisions about how we pay NEOs are based on these principles. The Compensation Committee uses several different types of pay that are linked to both our short-term and long-term performance in the executive compensation program. Included are long-term incentives, annual cash incentives, base pay and benefits. The chart below illustrates the linkage between the types of pay we use and our pay principles.

Pay Principles	Long-term Incentives	Annual Cash Incentives	Base Pay	Benefits
Pay should reinforce business objectives and values	ü	ü	ü	
A significant portion of an NEO s total pay should be variable based on performance	ü	ü		
Incentive pay should balance short-term, intermediate, and long-term performance	ü	ü		
Incentives should align interest of NEOs with stockholders	ü	ü		
Pay opportunity should be competitive	ü	ü	ü	ü
A portion of pay should be provided to compensate for the core activities required for performing in the role			ü	ü
Pay should foster a culture of collaboration with shared focus and commitment to our Company	ü	ü		

2009 Compensation Summary

For 2009, we continued to focus on creating stockholder value by delivering solid financial and operational performance despite the economic downturn. Like most energy businesses, we have felt the effects of reduced energy demand resulting in excess energy supply that has contributed to lower commodity prices. We responded quickly to the changing landscape and made plans to cut spending despite the very adverse conditions. We also took several actions, described below, to ensure that our executive pay program remains affordable and competitive in the current market and after market conditions improve.

2009 Pay Decisions

As indicated above, significant consideration was given to the need to balance our pay philosophy and practices with affordability and sustainability. In order to maintain the balance, we continued to grant long-term incentives in the form of performance-based restricted stock units (RSUs), stock options, and time-based RSUs in 2009; however, the value granted to the NEOs was lower in 2009 than in 2008.

[1] Economic Value Added® (EVA®) is a registered trademark of Stern, Stewart & Co.

Consistent with our commitment to provide a meaningful connection between pay and performance, we have granted performance-based RSUs to our NEOs since 2004. Performance-based RSUs granted in 2007 for the 2007-2009 performance period did not meet threshold targets set at the beginning of the period as a result of the global economic crisis. Therefore, in accordance with the design of the plan, these awards did not distribute to the NEOs. This resulted in each NEO losing a significant portion of pay that was targeted for 2007.

Each year, we set performance targets for our Annual Incentive Plan (AIP) during the first quarter. In early 2009, the economy and energy demand continued to decline while plan expectations and targets were being set. During midyear, energy prices stabilized and business conditions improved leading to financial performance which exceeded our expectations. To reward this performance that exceeded established targets, the AIP paid at 155% of target.

Considering the very difficult economic environment and the competitive position of our base pay, the NEOs and other Company officers did not receive base pay increases in 2009.

2009 Plan Design Changes

The Compensation Committee regularly reviews our existing pay programs to ensure we are able to attract and retain the talent needed to deliver the strong financial and operating performance necessary to create stockholder value. As part of this process, in 2009 we conducted extensive reviews of our long-term and annual incentive plans.

Our long-term incentive plan has been adjusted in two respects. First, we reviewed the performance metric used with our performance-based RSU awards. In prior years, the metric was EVA® measured over three years. However, establishing a target level of performance for this metric at the beginning of 2009 would have been very difficult due to a declining economy and extraordinary uncertainties related to the commodity price environment. After this thorough review, we elected to use absolute and relative TSR as the metrics for the three-year performance-based RSUs. NEOs will earn their targeted performance-based RSUs for the 2009 to 2011 period only if we deliver real absolute TSR and also achieve solid TSR in relation to our comparator group of companies.

Second, in order to motivate and incent officers to increase stockholder value and restore some retention that had been lost due to the economic conditions, we changed the allocation of stock awards in our long-term incentive plan for our NEOs, excluding the CEO. Still, we continue to deliver a significant portion of equity in performance-based awards and stock options because these awards have the strongest alignment to stockholders. Shown below is the long-term incentive mix for 2009.

	CEO	**Executive Officers (excluding CEO)**
Performance-Based RSUs	50%	35%
Stock Options	50%	30%
Time-Based RSUs	0%	35%

As to our annual incentive plan, we completed an analysis of the performance metric utilized in our Annual Incentive Plan (AIP). The purpose of this review was to determine if EVA®, as described later, continues to be the most appropriate performance metric for our Company. The review consisted of:

- a market update on annual incentive plans;
- the Compensation Committee s and the CEO s perspective on annual incentive plan design;

a review of the Company s historical performance in relation to certain financial metrics;

an analysis of the correlation of these metrics to EVA® and the Company s stock price performance; and

an overview of metrics commonly used in annual incentive plans.

As a result of the review, we confirmed a strong correlation between EVA®, stock price performance, and other financial metrics. The review supported the continued use of EVA® improvement as the performance metric in our AIP.

Table of Contents

We also reviewed other design elements of the AIP, specifically the maximum amount payable under the plan and the reserve feature that allowed AIP awards above a certain level to be placed in reserve with payout contingent on future performance. We reviewed the prevalence among our comparator group and determined that the AIP s maximum annual incentive pool funding for NEOs would be adjusted down to 250% of target and the incentive reserve be eliminated, beginning in 2009. Any existing reserve balance for NEOs will continue to be at risk and will be paid or reduced in accordance with previous plan provisions.

The economic and commodity price environment during the first part of 2009 made establishing a target level of performance very challenging. Recognizing these challenges and uncertainties, the AIP performance necessary to move from threshold to target was doubled in 2009. Likewise, the performance required to move from target to stretch was doubled. This design change attempts to keep the AIP as a meaningful performance incentive throughout the year but better ensures a payout significantly above target only occurs if we significantly exceed established performance targets.

As shown, we were very active in 2009 working to ensure that our pay programs continued to be aligned with our compensation philosophy, would continue to be affordable and competitive, would drive and motivate performance, and would align management with our stockholders during these uncertain times.

Mitigating Risk

Although no compensation-related risk was identified as a top risk for 2009, the approach to determine if there were adverse compensation risk was similar to the process detailed in the Corporate Governance and Board Matters Corporate Governance Board oversight of Williams risk assurance process section of this proxy statement. After this thorough review and analysis, it was determined that we do not have material adverse compensation-related risks. Our compensation plans are effectively designed and functioning to reward positive performance and motivate NEOs and employees to behave in a manner consistent with our stockholder interests, business strategies and objectives, ethical standards and prudent business practices along with our Core Values & Beliefs that are the foundation on which we conduct business. Our Core Values & Beliefs can be found on our website at www.williams.com from the Who We Are tab. In fact, many elements of our executive pay program serve to mitigate excessive risk taking. For example:

Mix of Pay: The mix of pay weighted to long-term incentives, annual cash incentives and base pay is consistent with comparator company practices and avoids placing too much value on any one element of compensation, particularly the annual cash incentive. The mix of our pay program is intended to motivate NEOs to consider the impact of decisions on stockholders in the short, intermediate, and long terms.

Annual Cash Incentive: Our annual cash incentive plan does not allow for unlimited payouts. Cash incentive payments cannot exceed 250% of target levels.

Performance-based Awards:

To strengthen the relationship between pay and performance, our annual cash incentive and long-term incentive plans include performance-based awards. The entire annual cash incentive award is measured against performance targets, while a significant portion of the long-term equity awards provided to NEOs is in the form of performance-based restricted stock units and stock options. Performance-based restricted stock units have no value unless we achieve pre-determined three-year performance targets. Stock options will have no value unless the stock price increases from the date of grant.

To drive a long-term perspective, all restricted stock unit awards vest at the end of three years rather than vesting ratably on an annual basis.

NEOs incentive compensation performance is measured at the enterprise level rather than on a business unit level to ensure a focus on the overall success of the Company.

Stock Ownership Guidelines As discussed later in this Compensation Discussion and Analysis, all NEOs, consistent with their responsibilities to stockholders, must hold an equity interest in the Company equal to a stated percentage of their base pay.

Table of Contents

- Recoupment Policy   In the event we are required to restate our financial statements due to fraud or misconduct, we have a recoupment policy that enables us to recover incentive-based compensation from NEOs.

Our pay program is intended to motivate NEOs to achieve business objectives that generate stockholder returns while acting in ways that are consistent with our values.

Compensation Recommendations and Decisions

Role of Management

In order to make pay recommendations, management provides the CEO with data from the annual proxy statements of companies in our comparator group along with pay information compiled from nationally recognized executive and industry related salary surveys. The survey data is used to confirm that pay practices among companies in the comparator group are aligned with the market as a whole.

Role of the CEO

Before recommending base pay adjustments and long-term incentive awards to the Compensation Committee, our CEO reviews the competitive market information related to each of our other NEOs while also considering internal equity and individual performance.

For our annual cash incentive plan, the CEO s recommendation is based on EVA® attainment with a potential adjustment for individual performance. Individual performance includes business unit EVA® results for the business unit leaders, achievement of business goals, and demonstrated key leadership competencies (for more on leadership competencies, see the section entitled Base Pay in this Compensation Discussion and Analysis). The modifications made are fairly modest. For 2009 the adjustments made to the NEOs annual cash incentive awards were on average less than 2%.

Role of the Other NEOs

Our other NEOs have no role in setting compensation for any of the NEOs.

Role of the Compensation Committee

For all NEOs, except the CEO, the Compensation Committee reviews the CEO s recommendations, supporting market data, and individual performance assessments. In addition, the Compensation Committee s independent compensation consultant, Frederic W. Cook & Co., Inc., reviews all of the data and advises on the reasonableness of the CEO s pay recommendations.

For the CEO, the Board meets in executive session without management present to review the CEO s performance. In this session, the Board reviews:

- Evaluations of the CEO completed by each board member other than the CEO;
- The CEO s written assessment of his own performance compared with the stated goals;
- Evaluations of the CEO completed by each of the NEOs and other executive officers; and

EVA® performance of the Company relative to established targets as well as the financial metrics presented as a supplement to EVA® performance.

The Compensation Committee uses these evaluations and competitive market information provided by its independent compensation consultant to determine the CEO s base pay, annual cash incentive target, long-term incentive amounts and any performance adjustments to be made to the CEO s annual cash incentive payment.

Role of the Independent Compensation Consultant

Frederic W. Cook & Co., Inc., assists the Compensation Committee in determining or approving the compensation for our NEOs. Please refer to the section Corporate Governance and Board Matters Board and

Table of Contents

Committee Structure and Meetings Compensation Committee of this proxy statement for a discussion of the independent compensation consultant.

To assist the Compensation Committee in discussions and decisions about compensation for our CEO, the Committee s independent compensation consultant presents competitive market data that includes proxy data from the approved comparator group and published compensation data, using the same surveys and methodology used for our other NEOs (described in the Role of Management section in this Compensation Discussion and Analysis). Our comparator group is developed by the Committee s independent compensation consultant, with input from management, and is approved by the Compensation Committee.

2009 Comparator Group

How We Use Our Comparator Group

We refer to publicly available data showing how much our comparator group pays, as well as how that pay is divided among base pay, annual incentive, equity, and other forms of compensation. This allows the Compensation Committee to ensure competitiveness and appropriateness of proposed compensation packages. When setting pay, the Compensation Committee uses market median information of our comparator group, as opposed to market averages, to ensure that the impact of any unusual events that may occur at one or two companies during any particular year is diminished from the analysis. If an event is particularly unusual and surrounds unique circumstances, the data is completely removed from the assessment.

Composition of the Comparator Group

Each year the Compensation Committee reviews the prior year s comparator group to ensure that it is still appropriate. We made some changes for 2009. The 2008 group consisted of companies in the broader energy industry. In contrast, for 2009 we focused more on companies that work in the same industry segment and reflect where we compete for business and talent. The new comparator group is smaller than our prior group in terms of revenue, assets, and market capitalization.

Table of Contents

The comparator group established for 2009 includes the following 20 companies, which comprise a mix of both direct competitors and companies whose primary business was similar to at least one of our business segments. We typically aim for a comparator group of 15 to 25 companies so our comparisons will be valid.

		2008 Business Lines				2008	2008
Company Name	**Ticker**	**E&P**	**Midstream**	**Pipeline**	**2008 Revenue**	**Total Assets**	**Market Cap**
					(Dollars in millions)		
Anadarko Petroleum Corp	APC	X	X		$ 14,640	$ 48,923	$ 17,728
Apache Corp	APA	X			12,390	29,186	24,949
Centerpoint Energy Inc	CNP		X	X	11,322	19,676	4,384
Chesapeake Energy Corp	CHK	X	X		11,629	38,444	10,098
Devon Energy Corp	DVN	X	X		15,211	31,908	29,162
Dominion Resources Inc	D	X		X	16,290	42,265	20,912
El Paso Corp	EP	X		X	5,363	23,668	5,470
EOG Resources Inc	EOG	X			7,127	15,951	16,624
EQT Corporation	EQT	X	X		1,576	5,330	4,390
Hess Corp	HES	X			41,094	28,908	17,494
Murphy Oil Corp	MUR	X			27,441	11,149	8,459
NiSource Inc	NI			X	8,874	20,032	3,009
Noble Energy Inc	NBL	X			3,901	12,384	8,511
Oneok Inc	OKE		X	X	16,157	13,126	3,065
Plains All-American Pipeline	PAA		X	X	30,061	10,032	4,264
Questar Corp	STR	X	X	X	3,465	8,631	5,675
Sempra Energy	SRE			X	10,758	26,400	10,377
Southern Union Co	SUG		X	X	3,070	7,998	1,618
Spectra Energy Corp	SE		X	X	5,074	21,924	10,126
XTO Energy Inc.	XTO	X	X		7,695	38,254	20,446
Company Count:	**20**	**13**	**11**	**10**			
				25th Percentile	*5,291*	*12,075*	*4,389*
				Median	***11,040***	***20,978***	***9,305***
				75th Percentile	*15,448*	*29,867*	*17,553*
Williams Companies	**WMB**	**X**	**X**	**X**	**11,890**	**26,006**	**8,387**
				Percent Rank	***59.7%***	***62.3%***	***41.9%***

Characteristics of our Comparator Group

Companies in our comparator group have a range of revenues, assets, and market capitalization. Business consolidation and unique operating models today create some challenges in identifying comparator companies. Accordingly, we take a broader view of comparability to include organizations that are similar to us in some, but not all, respects. This results in compensation that is appropriately scaled and reflects comparable complexities in business operations.

The Pay Setting Process

Setting pay is an annual process that occurs during the first quarter of the year. A review is done to ensure that we are paying competitively, equitably and in a way that encourages and rewards performance that exceeded expectations.

The compensation data of our comparator group is the primary market data we use when benchmarking the competitive pay of our NEOs. Aggregate market data obtained from recognized third party executive compensation survey companies (e.g. Towers Watson, Mercer, Hewitt) is used to supplement and validate comparator group market data. Typically, the Compensation Committee is presented with a range of annual revenues of the companies whose data is included in the aggregate analysis provided by the third party survey, but does not know the identities of the specific companies included.

Although the Compensation Committee reviews relevant data as it designs compensation packages, setting pay is not an exact science. Since market data alone does not reflect the strategic competitive value of various roles within the Company, internal pay equity is also considered when making pay decisions. Because we take on an enterprise-wide perspective to promote collaboration and ensure our overall success, paying the NEOs equitably is important. Other considerations when making pay decisions for the NEOs include historical pay and tally sheets that include annual pay and benefit amounts, wealth accumulated over the past five years, and the total aggregate value of the NEOs equity awards and holdings.

Company and individual goals also influence the amount of compensation that is awarded to the NEOs. Individual goals are established for the NEOs that align directly to the Company s purpose and direction, including our 3Ps to Prosperity strategy. After successfully accomplishing the goals set out in the Game Plan for Growth, we focused our priorities on how to grow our business and create stockholder value. During these times of weakness in the economy and energy markets, our strong performance in the following areas is key to our success:

Protect our ability to execute our core business strategies

¡ Operate in a safety first manner that respects the environment

¡ Ensure our operations are effective, efficient and reliable

Preserve our financial strength and our reputation

¡ Control our cost and manage our cash in a manner that adapts to changing economic demands

¡ Remain disciplined in our approach to capital investments

¡ Build on our compliance track record in a way that demonstrates integrity and continuously improves our reputation

Position ourselves to reap strategic, value-creating growth opportunities when conditions improve

¡ Maintain the diverse knowledge and core capabilities of our organization so that we leverage the valuable experiences of our workforce

¡ Sustain the key competitive positions our businesses hold while making opportunistic, foothold moves into new areas and new basins

¡ Effectively engage with our customers, communities, key vendors and other stakeholders important to our success

Our success in executing the 3Ps to Prosperity strategy led to the improvement of EVA® and contributed to the following accomplishments in 2009:

We continued to invest in our natural gas businesses in key growth areas, as well as expand into new areas.

We made an entry into the prolific Marcellus Shale in Pennsylvania with two strategic joint ventures:

¡ Williams and Atlas Pipeline Partners L.P. formed a midstream joint venture that owns a gathering system that includes 1,800 miles of intrastate natural gas gathering lines in the Marcellus Shale. Williams owns 51 percent of the joint venture and operates the gathering system.

¡ Our Exploration & Production business unit also entered into the Marcellus Shale via an agreement to develop natural gas wells with Rex Energy Corporation. Under the agreement, Williams will acquire a right to earn a 50-percent interest in approximately 44,000 net acres for natural gas development.

We made strides on two key gas pipeline expansion projects in the Northeast:

¡ Phase II of the Sentinel expansion was placed into service, increasing firm transportation capacity into the northeastern United States by 102,000 dekatherms per day.

¡ Completion of a successful binding open season for the Northeast Supply Project, which is designed to provide East Coast markets with additional access to the natural gas supplies provided by the Transco pipeline, including the Marcellus Shale.

We continued to build upon our large-scale presence in western Colorado s Piceance Basin, with a number of accomplishments:

¡ A new 450-million-cubic-feet-per-day (MMcfd) Willow Creek natural gas processing plant was completed and achieved full processing operations. At peak production, the Willow Creek plant will boost the volume of NGLs recovered by Williams in the basin by more than five times the previous levels.

- We added to our substantial natural gas reserves in the Piceance Basin with a $258 million acquisition of 21,800 net acres for natural gas production. The new acreage could represent an estimated 795 billion cubic feet equivalent (Bcfe) of net reserves. Of the estimated reserves, approximately 150 Bcfe are proved.
- We completed the Colorado Hub Connection, a 26.4-mile pipeline and related facilities that connect a regional hub in the Piceance Basin to the Northwest Pipeline mainline system.

In addition to continuing to expand our natural gas businesses and drive stockholder value, we were recognized for our efforts to make the Company a great place to work for our employees:

- The Houston Business Journal named Williams as the #1 Best Place to Work in Houston among companies not based in Houston. This was the second year in a row Williams was recognized on the Best Place to Work in Houston list, and the first time it won the top spot.
- Utah Business magazine named Williams as a finalist in its Best Companies to Work for program, where the Company was recognized as one of the four best medium-sized companies in Utah.
- OKCBiz magazine recognized Williams on its Best Places to Work in Oklahoma list for the second year in a row.

We made significant advancements in our environmental, social and governance practices:

- We adopted an Indigenous People Policy, reflecting our commitment to operate in a way that respects the culture and values of indigenous people.
- We were recognized with two awards for Operational Excellence by the Colorado Oil and Gas Conservation Commission: reclamation for mitigating the visibility of operations and for reducing noxious weeds.
- Our exploration & production and gas pipeline business units received Continuing Excellence Awards for five and 15 years, respectively, of participation in the U.S. EPA Natural Gas STAR program.
- We adopted the model code of conduct on corporate political spending and accountability developed by the Center for Political Accountability.

When setting pay, we determine a target pay mix (distribution of pay among base pay, annual incentive, equity, and other forms of compensation) for the NEOs. The target pay mix for all NEOs can be found in the Named Executive Officer Profile section included in this proxy statement. Consistent with our pay-for-performance philosophy, the actual amounts paid, excluding benefits, are determined based on individual and Company performance. Because performance is a factor, the target and actual pay mix will vary specifically as it relates to the annual cash incentives.

How We Determine the Amount for Each Type of Pay

Long-term incentives, annual cash incentives, base pay, and benefits accomplish different objectives.

Long-Term Incentives

We award long-term incentives to reward performance and align NEOs with long-term stockholder interests by providing NEOs an ownership stake in the Company, encouraging sustained long-term performance, and providing an important retention element to their compensation program. Long-term incentives are provided in the form of equity and may include performance based restricted stock units, stock options, and time-based restricted stock units. Unlike the majority of our comparator companies, we award a significant portion of the annual long-term award in the form of performance-based restricted stock units. We believe this better aligns our NEOs interests with long-term stockholders by requiring that stated targets are met prior to earning these awards.

To determine the value for long-term incentives granted to an NEO each year, we consider the following factors:

- the proportion of long-term incentives relative to base pay;

- the NEO s impact on Company performance and ability to create value;
- long-term business objectives;
- awards made to executives in similar positions within our comparator group of companies;
- the market demand for the NEO s particular skills and experience;
- the amount granted to other NEO s in comparable positions at the Company;
- the NEO s demonstrated performance over the past few years; and
- the NEO s leadership performance.

The allocation of our long-term incentive program for 2009 is shown below. The long-term incentive mix for the CEO differs from the mix for the other NEOs. Since the CEO has more opportunity to influence our financial results, the Compensation Committee considers it appropriate that 100% of his long-term incentives are directly tied to the performance of the Company s stock price.

	CEO	**Other NEOs**
Performance-Based Restricted Stock Units	50%	35%
Stock Options	50%	30%
Time-Based Restricted Stock Units	0%	35%

The primary objectives for each type of equity awarded are shown below. The size of the circles in the chart indicates how closely each equity type aligns with each objective.

2009 Performance-Based Restricted Stock Units

Performance-based restricted stock unit awards further strengthen the relationship between pay and performance and over time will more closely link the long-term pay of our NEOs to the experience of our long-term stockholders. The performance-based restricted stock units awarded in 2009 will be earned only if we attain specific TSR targets.

We believe it is important to measure TSR on both an absolute and a relative basis. In absolute terms, we want to ensure we are delivering a suitable return to stockholders. Additionally, we believe awards should be influenced by how our TSR compares to the TSR of companies in our comparator group. The majority of our comparator companies do not have performance-based equity grants, but we believe this approach allows us to emphasize the importance of delivering value to the stockholder while also performing well against our comparator group of companies. It also ensures that our NEOs will only have the opportunity to earn an award that significantly exceeds targeted levels when we produce strong absolute and relative TSR results. Shown in the chart below are the absolute

Table of Contents

and relative TSR targets for the performance-based restricted stock unit awards for the 2009 to 2011 performance period and the continuum that will determine the resulting potential payout level:

2007 Performance-Based Restricted Stock Units

Since the performance cycle for our 2007 performance-based RSUs ended in 2009, the following is a chart of the threshold, target, and stretch goals that were established in early 2007.

EVA® (In millions)	**Payout Level as a % of Target (Attainment %)**
$123	Threshold (where incentives start to be earned)
$231	**100%**
$339	200%

As discussed earlier in the Compensation Discussion and Analysis, we did not attain threshold performance during the three-year period as a result of the global economic crisis. No performance-based RSU awards that were granted in 2007 will be paid out under this plan. This resulted in each NEO losing a significant portion of pay that was targeted for 2007. The performance goals for this award were set during a less volatile time based on market guidance and expectations for our Company s performance.

Stock Option Awards

For recipients, stock options have value only to the extent the price of our common stock is higher on the date the options are exercised than it was on the date the options were granted. Most of the companies in our comparator group grant stock options to their NEOs.

Time-Based Restricted Stock Units

We introduced time-based restricted stock unit grants in 2002, primarily to encourage NEOs to stay with the Company during a period of uncertainty and instability in our executive population. We continue to use this type of equity to retain executives due to continued volatility in the industry and the general economy. Time-based restricted stock units also facilitate stock ownership. The use of time-based restricted stock units is also consistent with the practices of our comparator group of companies. Most of the companies in our comparator group grant time-based RSUs to their NEOs.

Table of Contents

Grant Practices

The Compensation Committee typically approves our annual equity grant in February or early March of each year shortly after the annual earnings release. The grant date for awards is on or after the date of such approval to ensure the market has time to absorb material information disclosed in the earnings release and reflect that information in the stock price. Our grant practices in 2009 were consistent with prior years.

The grant date for off-cycle grants for individuals who are not NEOs, for reasons such as retention or new hires, is the first business day of the month following the approval of the grant. By using this consistent approach, we remove grant timing from the influence of the release of material information.

Annual Cash Incentives

We pay annual cash incentives to encourage and reward our NEOs for making decisions that improve our performance as measured by EVA®. EVA® measures the value created by a company. Simply stated, it is the financial return in a given period less the capital charge for that period. The calculation we use is as follows:

EVA®	=	Net Operating Profits after Taxes (NOPAT)	*Less*	Capital Charge (the amount of capital invested by Williams multiplied by the cost of capital)

Generating profits in excess of both operating and capital costs (debt and equity) creates EVA®. If EVA® improves, value has been created. The objectives of our EVA® -based incentive program are to:

- Motivate and incent management to choose strategies and investments that maximize long-term stockholder value;
- Offer sufficient incentive compensation to motivate management to put forth extra effort, take prudent risks and make tough decisions to maximize stockholder value;
- Provide sufficient total compensation to retain management; and
- Limit the cost of compensation to levels that will maximize the wealth of current stockholders without compromising the other objectives.

Annual Cash Incentives Target

The starting point to determine annual cash incentive targets (expressed as a percent of base pay) is competitive market information, which gives us an idea of what other companies target to pay in annual cash incentives for similar jobs. We also consider the internal value of each job - i.e., how important the job is to executing our strategy compared to other jobs in the Company- before the target is set for the year. The annual cash incentive targets as a percentage of base pay for the NEOs in 2009 are as follows:

CEO	100%
CFO	75%
Other NEOs	65%

Annual Cash Incentives Actual

For NEOs, the annual cash incentive plan is funded when we attain an established level of EVA® performance. Applying EVA® measurement to this annual cash incentive process encourages management to make business decisions that help drive long-term stockholder value. To determine the funding of the annual cash incentive, we use the following calculation for each NEO:

Base Pay received in 2009	X	Incentive Target %	X	EVA Goal Attainment %

Actual payments may be adjusted upwards to recognize individual performance that exceeded expectations, such as success toward our 3Ps to Prosperity and individual goals and successful demonstration of the leadership competencies discussed below. Payments may also be adjusted downwards if performance warrants.

How We Set the EVA® Goals

Setting the EVA® goals for the annual cash incentive plan begins with internal budgeting and planning. This rigorous process includes an evaluation of the challenges and opportunities for the Company and each of our business units. The key steps are as follows:

Business and financial plans are submitted by the business units and consolidated by the corporate planning department.

The business and financial plans are reviewed and analyzed by the CEO, CFO and other NEOs.

Using the plan guidance, Management establishes the EVA® goal and recommends it to the Compensation Committee.

The Compensation Committee reviews, discusses and makes adjustments as necessary to management s recommendations and sets the goal at the beginning of each fiscal year.

Thereafter, progress toward the goal is regularly monitored and reported to the Compensation Committee throughout the year.

2009 EVA® Goal for the Annual Cash Incentive Plan

The attainment percentage of EVA® goals results in payment of annual cash incentives along a continuum between threshold and stretch levels, which corresponds to 0% through 250% of the NEO s annual cash incentive target. The chart below shows the EVA® improvement goals for the 2009 annual cash incentive and the resulting payout level. It is important to note that setting the EVA® goal for 2009 was more challenging than in previous years. 2008 was a record year with strong Company performance including EVA® improvement. When the global financial crisis hit, our profitability was cut and the cost of capital increased. This was reflected in both our lower EVA® and stock price.

EVA® (In millions)	**Payout Level as a % of Target (Attainment %)**
($1,172)	Threshold (where incentives start to be earned)
($956)	**100%**
($740)	200%

As noted, EVA considers both financial earnings and a cost of capital in measuring performance. The two main components of EVA are NOPAT and a charge for the cost of capital. EVA, like other performance metrics, has been impacted by the economic environment. A decline in NOPAT caused by lower energy commodity prices and a considerable increase in the cost of capital impacted EVA® in 2009. However, our NOPAT performance exceeded expectations, which were set in early 2009, and led to an AIP payout level that exceeded target performance.

Based on EVA® performance relative to the established goals, the Compensation Committee certified performance results of ($825) million in EVA® and approved payment of the annual cash incentive plan at 155% of target.

The EVA® Calculation

EVA® is first calculated as previously discussed, NOPAT less Capital Charge. Our incentive program allows for the Compensation Committee to make adjustments to EVA® calculations to reflect certain business events. After studying companies that utilize EVA® as an incentive measure, we determined that it is standard practice to make adjustments to EVA® calculations to create better alignment with stockholders.

When determining which adjustments are appropriate, we are guided by the principle that incentive payments should not result in unearned windfalls or impose undue penalties. In other words, we make adjustments to ensure NEOs are not rewarded for positive results they did not facilitate nor are they penalized for certain unusual circumstances outside their control. We believe the adjustments improve the alignment of incentives with stockholder value creation and ensure EVA® is an incentive measure that effectively encourages NEOs to take actions to create value for stockholders. The categories of potential adjustments to our EVA® calculation are:

Gains, losses and impairments;

Mark-to-market, commodity price collar, and construction work-in-progress; and

Other unusual items that could result in unearned windfalls or undue penalties to NEOs such as certain litigation matters and natural disasters.

Management regularly reviews with the Compensation Committee a supplemental scorecard reflecting the Company s segment profit, earnings per share, cash flow from operations, and safety to provide updates regarding the Company s performance as well as to ensure alignment between these measures and EVA®. This scorecard provides the Committee with additional data to assist in determining final AIP awards. As discussed above, there is strong correlation between our EVA performance and other metrics included on the supplemental scorecard.

The Compensation Committee s outside independent compensation consultant annually compares our relative performance on various measures, including total stockholder return, earnings per share and cash flow, with our comparator group to ensure we are consistently delivering stockholder value. The Compensation Committee also uses this analysis to validate our EVA® results.

Base Pay

Base pay compensates the NEOs for carrying out the duties of their jobs, and serves as the foundation of our pay program. Most other major components of pay are set based on a relationship to base pay, including annual and long-term incentives, and retirement benefits.

Base pay for the NEOs, including the CEO, is set considering the market median, with potential individual variation from the median due to experience, skills, and sustained performance of the individual as part of our pay-for-performance philosophy. Performance is measured in two ways; through the Right Results obtained in the Right Way. Right Results considers the NEOs success in attaining their annual goals as they relate to the 3Ps to Prosperity, business unit strategies, and personal development plans. Right Way reflects the NEOs behavior as exhibited through our leadership competencies. The following table contains these competencies grouped within our five leadership areas.

MODEL THE WAY	**INSPIRE A SHARED VISION**	**CHAMPION INNOVATION**	**LEVERAGE TALENT**	**OPTIMIZE BUSINESS PERFORMANCE**
Caring About People	Enterprise Perspective	Change Leadership	Building Effective Teams	Business Acumen
Integrity	Vision and Strategic Perspective	Entrepreneurial Spirit	Communication	Customer and Market Focus
Loyalty and Commitment				Decision Making

Promoting Diversity and Creativity	Developing People Resources	
Willingness to Take Risks	Empowering Others	Drive for Results
	Managerial Courage	Functional/Technical Skills
	Motivating and Inspiring Others	

For 2009, no base pay increases were made to any NEO or other officers of the Company. The ratio of 2008 base pay to the market median remained appropriate when we considered the current environment and the experience, skills, and sustained performance of the NEOs. The following chart includes the 2009 market ratio for the NEOs.

Executive Officer	Position	% Increase from 2008	2009 Base Pay as a % of Market Median
Steven J. Malcolm	CEO	0%	106%
Donald R. Chappel	CFO	0%	108%
Alan S. Armstrong	Senior Vice President, Midstream	0%	102%
Ralph A. Hill	Senior Vice President, Exploration & Production	0%	102%
Phillip D. Wright	Senior Vice President, Gas Pipelines	0%	105%

Benefits

Consistent with our philosophy to emphasize pay for performance, our NEOs receive very few perquisites (perks) or supplemental benefits. They are as follows:

Retirement Restoration Benefits: NEOs participate in our qualified retirement program on the same terms as our other employees. We offer a retirement restoration plan to our NEOs to maintain a proportional level of pension benefits to our NEOs as provided to other employees. The Internal Revenue Code of 1986, as amended (the Internal Revenue Code), limits qualified pension benefits based on an annual compensation limit. For 2009, the limit was $245,000. Any reduction in an NEO s pension benefit in the tax-qualified pension plan due to this limit is made up for (subject to a cap) in the unfunded restoration retirement plan. Benefits for NEOs are calculated using the same benefit formula as that used to calculate benefits for all employees in the qualified pension plan. The value of pay in the form of stock option or other equity is not used in the formula to calculate benefits under the pension plan or restoration plan for NEOs, which is consistent with the treatment for all employees. Additionally, we do not provide a nonqualified benefit related to our qualified 401(k) defined contribution retirement plan.

Financial Planning Allowance: We offer financial planning to provide expertise on current tax laws to assist NEOs with personal financial planning and preparations for contingencies such as death and disability. In addition, by working with a financial planner, NEOs gain a better understanding of and appreciation for the programs the Company provides, which helps to maximize the retention and engagement aspects of the dollars the Company spends on these programs.

Home security: We pay home security system and monitoring for our CEO to ensure personal safety.

Personal Use of Company Aircraft: We provide limited personal use of the Company aircraft at the CEO s discretion. As shown in the footnotes to the 2009 Summary Compensation Table, the incremental cost associated with aircraft usage for personal reasons in 2009 was limited to Messrs. Malcolm, Hill, and Wright. The incremental cost to the Company of all trips was approximately $50,722. The CEO is required to use the Company aircraft for all air travel. Our policy for all other executive officers is to discourage personal use of the aircraft, but the CEO retains discretion to permit its use when he deems appropriate, such as when the destination is not well served by commercial airlines, personal emergencies, and the aircraft is not being used for business purposes.

Event Center: We have a suite and club seats at an event center that were purchased for business purposes. If it is not being used for business purposes, we make them available to our employees, including our NEOs, as a form of reward and recognition.

Executive Physicals: The Compensation Committee approved mandated physicals for the NEOs beginning in 2009. NEO physicals align with our wellness initiative as well as assist in mitigating risk. Mandated NEO physicals reduce vacancy succession risk because they help to identify and prevent issues that would leave a NEO role vacated unexpectedly.

Additional Components of our Executive Compensation Program

In addition to establishing the pay elements described above, we have adopted a number of policies to further the goals of the executive compensation program, particularly with respect to strengthening the alignment of our NEOs interests with stockholder long-term interests.

Recoupment Policy

In 2008, the Compensation Committee approved a recoupment policy to allow the Company to recover incentive-based compensation from NEOs in the event we are required to restate our financial statements due to fraud or intentional misconduct. The policy provides the Board discretion to determine situations where recovery of incentive pay is appropriate.

Stock Ownership Guidelines

All NEOs must hold an equity interest in the Company. The chart below shows the NEO stock ownership guidelines, which have been in effect since 2005.

Position	Holding Requirement as a % of Base Pay	Time Frame for Compliance
CEO	5 times	5 Years
NEO	3 times	5 Years

Annually the Compensation Committee reviews the guidelines for competitiveness and alignment with best practice and monitors the NEOs progress toward compliance. Shares owned outright, unvested performance-based and time-based restricted stock units count as owned for purposes of the program. Stock options are not included. The Compensation Committee maintains discretion to modify the guidelines in special circumstances of financial hardship such as illness of the NEO or a family member.

Derivative Transactions

Our insider trading policy applies to transactions in positions or interests whose value is based on the performance or price of our common stock. Because of the inherent potential for abuse, Williams discourages employees and directors from entering into short sales or use of equivalent derivative securities. In addition, our insider trading policy requires that officers, directors, and certain key employees seeking to enter into such a transaction obtain pre-clearance. There were no derivative transactions for 2009.

Accounting and Tax Treatment

We consider the impact of accounting and tax treatment when designing all aspects of pay, but the primary driver of our program design is to support our business objectives. Stock options and performance-based restricted stock units are intended to satisfy the requirements for performance-based compensation as defined in Section 162(m) of the Internal Revenue Code and are therefore considered a tax deductible expense. Time-based restricted stock units do not qualify as performance-based and may not be fully deductible.

The annual cash incentive plan satisfies the requirements for performance-based compensation as defined in Section 162(m) of the Internal Revenue Code and is therefore a tax deductible expense. For payments under our annual cash incentive plan to be considered performance-based compensation under Section 162(m), the Compensation Committee can only exercise negative discretion relative to actual performance when determining the amount to be paid. In order to ensure compliance with Section 162(m), the Compensation Committee has established a target in excess of the maximum individual payout allowed to NEOs under our annual cash incentive plan. Reductions are made each year and are not a reflection of the performance of the NEOs but rather ensure flexibility with respect to paying based upon performance.

Employment Agreements

We do not enter into employment agreements with our NEOs. We can remove a NEO when it is in the best interest of the Company.

Termination and Severance Arrangements

The NEOs are not covered under a severance plan. However the Compensation Committee exercises judgment and considers the circumstances surrounding each departure and may decide a severance package is appropriate. In designing a severance package, the Compensation Committee takes into consideration the NEO s term of employment, past accomplishments, reasons for separation from the Company, and competitive market practice. The only pay or benefits an employee has a right to receive upon termination of employment are those that have already vested or which vest under the terms in place when equity was granted.

Rationale for Change in Control Agreements

Our change in control program provides severance benefits for our NEOs. Our program includes a double trigger for benefits and equity vesting; there must be a change in control and the NEO s employment must terminate. While a double trigger for equity is not the competitive norm of our comparator group, this practice creates security for the NEOs but does not provide an incentive for the NEO to leave the Company. Our program is designed to encourage the NEOs to focus on the best interests of stockholders by alleviating their concerns about a possible detrimental impact to their compensation and benefits under a potential change in control, not to provide compensation advantages to NEOs for executing a transaction.

Our Compensation Committee reviews our change in control benefits annually to ensure they are consistent with competitive practice and aligned with our compensation philosophy. As part of the review, calculations are performed to determine the overall program costs to the Company if a change in control event were to occur and all covered NEOs were terminated as a result. An assessment of competitive norms including the reasonableness of the elements of compensation received is used to validate benefit levels for a change in control. In reviews of the change in control program to date, the Compensation Committee has concluded that the current benefits provided are appropriate and critical to attracting and retaining executive talent.

Table of Contents

The following chart details the benefits received if an NEO were to be terminated following a change in control as well as an analysis of those benefits as it relates to the Company, stockholders, and the NEO. Please also see the Change in Control Agreements section in this proxy statement for further discussion of our change in control program.

Change in Control Benefit	What does the benefit provide to the Company and stockholders?	What does the benefit provide to the NEO?
Multiple of 3x base pay plus annual cash incentive at target	Encourages NEOs to remain engaged and stay focused on successfully closing the deal.	Financial security for the NEO equivalent to three years of continued employment.
Accelerated vesting of stock awards	An incentive to stay during and after a change in control. If there is risk of forfeiture, NEOs may be less inclined to stay or to support the transaction.	The NEOs are kept whole, if they have a separation from service following a change in control.
Up to 18 months of medical or health coverage through COBRA	This is a minimal cost to the Company that creates a competitive benefit.	Access to health coverage.
3x the previous years retirement restoration allocation	This is a minimal cost to the Company that creates a competitive benefit.	May allow those NEOs who are nearing retirement to receive a cash payment to make up for lost allocations due to a change in control.
Reimbursement of legal fees to enforce benefit	Keeps NEOs focused on the Company and not concerned about whether the acquiring company will honor commitments after a change in control.	Security during a non-stable period of time.
Outplacement assistance	Keeps NEOs focused on supporting the transaction and less concerned about trying to secure another position.	Assists NEOs in finding a comparable executive position.
Gross up on excise and income tax	Ensures that the change in control benefits discussed above are delivered.	Eliminates the risk of paying the excise tax on a payment NEOs cannot control. The gross up helps to ensure the full intended benefit is delivered to the NEO.

Table of Contents

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

We have reviewed and discussed the foregoing Compensation Discussion and Analysis with management. Based on our review and discussions with management, we recommend to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement and in our Annual Report on Form 10-K for the year ended December 31, 2009.

By the members of the Compensation Committee of the Board of Directors:

W. R. Howell, Chairman
Kathleen B. Cooper
William R. Granberry
George A. Lorch
Frank T. MacInnis
Janice D. Stoney

Table of Contents

EXECUTIVE COMPENSATION AND OTHER INFORMATION

2009 Summary Compensation Table

The following table sets forth certain information with respect to the compensation of the NEOs earned during fiscal years 2009, 2008 and 2007.

and Principal n	Year	Salary(1)	Bonus	Stock Awards(2)	Option Awards(3)	Non-Equity Incentive Plan Compensation(4)	Change in Pension Value and Nonqualified Deferred Compensation Earnings(5)	All Other Compensation(6)	To
J. Malcolm	2009	$ 1,142,308	$	$ 2,116,863	$ 2,846,407	$ 1,903,360	$ 1,399,796	$ 71,100	$ 9,47
an, President &	2008	1,094,231		2,906,309	2,789,127	2,000,000	1,201,514	56,215	10,04
xecutive Officer	2007	1,050,000		2,731,000	1,818,000	2,373,086	369,208	46,484	8,38
R. Chappel	2009	623,077		1,242,734	618,783	$ 765,047	$ 383,380	$ 17,822	$ 3,65
Vice President,	2008	597,115		2,114,349	651,405	780,008	330,531	14,772	4,48
inancial Officer	2007	572,115		1,565,783	440,411	925,752	126,797	14,459	3,64
. Hill	2009	503,654		1,056,319	525,969	$ 566,473	$ 427,867	$ 37,001	$ 3,11
Vice President,	2008	480,962		1,606,867	495,071	579,633	363,151	29,586	3,55
tion & tion	2007	446,538		1,409,199	396,369	662,532	26,578	58,284	2,99
D. Wright	2009	519,231		994,187	495,029	$ 561,642	$ 419,915	$ 21,510	$ 3,01
Vice President,	2008	497,692		1,268,581	390,840	557,418	381,705	10,010	3,10
elines	2007	477,692		1,096,059	308,287	669,676	68,048	9,801	2,62
Armstrong	2009	503,654		994,187	495,029	$ 567,308	$ 293,795	$ 23,434	$ 2,87
Vice President,	2008	480,962		1,268,581	390,840	580,884	273,091	14,586	3,00
am	2007	446,538		1,096,059	308,287	664,410	32,110	16,615	2,56

(1) **Salary.** No salary increases were provided to NEOs in 2009. The increase in salary is due to a payroll timing issue resulting in a twenty-seventh bi-weekly pay period in 2009.

(2) **Stock Awards.** Awards were granted under the terms of the 2002 Incentive Plan and the 2007 Incentive Plan and include time-based and performance-based RSUs with the exception of the CEO, who receives only performance-based RSUs. Amounts shown are the grant date fair value of awards computed in accordance with FASB ASC Topic 718. The assumptions used to value the stock awards can be found in our Annual Report on Form 10-K for the year-ended December 31, 2009.

The potential maximum values of the performance-based RSUs, subject to changes in performance outcomes, are as follows:

	2009 Performance-Based RSU Maximum potential
Steven J. Malcolm	$ 4,233,727
Donald R. Chappel	1,073,769
Ralph A. Hill	912,700
Phillip D. Wright	859,015
Alan S. Armstrong	859,015

(3) **Option Awards.** Awards are granted under the terms of the 2002 Incentive Plan and the 2007 Incentive Plan and include non-qualified stock options. Amounts shown are the grant date fair value of awards computed in accordance with FASB ASC Topic 718. The assumptions used to value the option awards can be found in our Annual Report on Form 10-K for the year-ended December 31, 2009.

(4) **Non-Equity Incentive Plan.** As stated in the Compensation Discussion and Analysis in this proxy statement, the maximum annual incentive pool funding for NEOs was adjusted to 250% of target and the incentive reserve has been eliminated, beginning in 2009. Any existing reserve balance for NEOs will continue to be at risk and one-third will be paid if the threshold performance target is met or the balance will be reduced if threshold is not met in accordance with previous plan provisions. Threshold performance was met in 2009 and one-third of the respective reserve balance was paid to each NEO.

The annual cash incentive and reserve amounts paid in 2010 as it relates to 2009 performance are as follows:

	Reserve Balance	AIP for 2009	Amount of Reserve Paid in 2010	Total AIP plus Reserve for 2009
Steven J. Malcolm	$ 364,115	$ 1,782,000	$ 121,360	$ 1,903,360
Donald R. Chappel	90,151	735,000	30,047	765,047
Ralph A. Hill	109,431	530,000	36,473	566,473
Phillip D. Wright	94,934	530,000	31,642	561,642
Alan S. Armstrong	111,936	530,000	37,308	567,308

(5) **Change in Pension Value and Nonqualified Deferred Compensation Earnings.** The amount shown is the aggregate change from December 31, 2008 to December 31, 2009 in the actuarial present value of the accrued benefit under the qualified pension and supplemental plan. Please refer to the Pension Benefits table for further details of the present value of the accrued benefit. The primary reason for the increase in present value in 2008 and 2009 is due to the use of a reduced discount rate. The lower discount rate results in a larger present value amount. Likewise, the amounts shown for 2007 reflect the use of an increased discount rate which decreases the present value at the end of that year.

(6) **All Other Compensation.** Amounts shown represent payments made on behalf of the NEOs and includes life insurance premium, a 401(k) matching contribution, and perquisites (if applicable). Perquisites include financial planning services, mandated annual physical exam, home security monitoring system for the CEO and personal use of the Company aircraft. The incremental cost meth