

Hilltop Holdings Inc.
Form 10-Q
July 27, 2017
Table of Contents

0Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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

Commission File Number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	84-1477939 (I.R.S. Employer Identification No.)
--	--

200 Crescent Court, Suite 1330

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Dallas, TX
(Address of principal executive offices)

75201
(Zip Code)

(214) 855-2177

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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

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

The number of shares of the registrant's common stock outstanding at July 27, 2017 was 96,347,034.

Table of Contents

HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2017

TABLE OF CONTENTS

PART I — FINANCIAL INFORMATION

Item 1.	Financial Statements	
	<u>Consolidated Balance Sheets</u>	3
	<u>Consolidated Statements of Operations</u>	4
	<u>Consolidated Statements of Comprehensive Income</u>	5
	<u>Consolidated Statements of Stockholders' Equity</u>	6
	<u>Consolidated Statements of Cash Flows</u>	7
	<u>Notes to Consolidated Financial Statements</u>	8
	<u>Schedule I - Insurance Incurred and Cumulative Paid Losses and Allocated Loss and Loss Adjustment Expenses, Net of Reinsurance</u>	55
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	56
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	92
Item 4.	<u>Controls and Procedures</u>	95

PART II — OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	96
Item 1A.	<u>Risk Factors</u>	96
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	96
Item 6.	<u>Exhibits</u>	96

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	June 30, 2017	December 31, 2016
Assets		
Cash and due from banks	\$ 405,938	\$ 669,357
Federal funds sold	388	21,407
Securities purchased under agreements to resell	125,188	89,430
Assets segregated for regulatory purposes	167,565	180,993
Securities:		
Trading, at fair value	471,485	265,534
Available for sale, at fair value (amortized cost of \$761,217 and \$598,198, respectively)	763,206	598,007
Held to maturity, at amortized cost (fair value of \$355,860 and \$345,088, respectively)	359,847	351,831
	1,594,538	1,215,372
Loans held for sale	2,000,257	1,795,463
Non-covered loans, net of unearned income	6,118,211	5,843,499
Allowance for non-covered loan losses	(59,208)	(54,186)
Non-covered loans, net	6,059,003	5,789,313
Covered loans, net of allowance of \$1,359 and \$413, respectively	205,877	255,714
Broker-dealer and clearing organization receivables	1,552,525	1,497,741
Premises and equipment, net	183,994	190,361
FDIC indemnification asset	40,304	71,313
Covered other real estate owned	42,304	51,642
Other assets	618,368	613,453
Goodwill	251,808	251,808
Other intangible assets, net	40,516	44,695
Total assets	\$ 13,288,573	\$ 12,738,062
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	\$ 2,251,208	\$ 2,199,483
Interest-bearing	5,323,414	4,864,328
Total deposits	7,574,622	7,063,811

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Broker-dealer and clearing organization payables	1,395,314	1,347,128
Short-term borrowings	1,515,069	1,417,289
Securities sold, not yet purchased, at fair value	149,869	153,889
Notes payable	300,283	317,912
Junior subordinated debentures	67,012	67,012
Other liabilities	393,351	496,501
Total liabilities	11,395,520	10,863,542
Commitments and contingencies (see Notes 12 and 13)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, \$0.01 par value, 125,000,000 shares authorized; 96,333,042 and 98,543,774 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	963	985
Additional paid-in capital	1,529,903	1,572,877
Accumulated other comprehensive income	2,112	485
Retained earnings	356,564	295,568
Deferred compensation employee stock trust, net	845	903
Employee stock trust (12,455 and 15,492 shares, at cost, respectively)	(248)	(309)
Total Hilltop stockholders' equity	1,890,139	1,870,509
Noncontrolling interests	2,914	4,011
Total stockholders' equity	1,893,053	1,874,520
Total liabilities and stockholders' equity	\$ 13,288,573	\$ 12,738,062

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Interest income:				
Loans, including fees	\$ 113,793	\$ 98,468	\$ 203,784	\$ 190,001
Securities borrowed	9,597	6,326	17,650	13,915
Securities:				
Taxable	9,539	6,834	16,566	13,201
Tax-exempt	1,375	1,537	2,619	3,174
Other	2,002	1,037	3,928	2,065
Total interest income	136,306	114,202	244,547	222,356
Interest expense:				
Deposits	5,464	4,037	10,154	7,876
Securities loaned	7,481	4,916	13,821	10,903
Short-term borrowings	3,648	1,392	5,066	2,477
Notes payable	2,826	2,618	5,640	5,200
Junior subordinated debentures	744	655	1,455	1,300
Other	167	187	335	363
Total interest expense	20,330	13,805	36,471	28,119
Net interest income	115,976	100,397	208,076	194,237
Provision for loan losses	5,853	28,876	7,558	32,283
Net interest income after provision for loan losses	110,123	71,521	200,518	161,954
Noninterest income:				
Net realized gains (losses) on securities	14	(46)	14	—
Net gains from sale of loans and other mortgage production income	153,688	167,012	277,838	294,309
Mortgage loan origination fees	25,976	25,797	45,532	44,610
Securities commissions and fees	37,804	40,442	76,861	78,759
Investment and securities advisory fees and commissions	25,537	29,354	47,739	53,173
Net insurance premiums earned	36,020	38,721	72,160	78,454
Other	65,653	44,725	95,987	74,075
Total noninterest income	344,692	346,005	616,131	623,380
Noninterest expense:				

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Employees' compensation and benefits	214,413	217,398	400,972	400,159
Occupancy and equipment, net	27,919	26,971	55,212	54,804
Loss and loss adjustment expenses	33,184	37,211	54,884	59,170
Policy acquisition and other underwriting expenses	11,251	11,316	22,480	22,568
Other	79,484	74,469	153,195	155,853
Total noninterest expense	366,251	367,365	686,743	692,554
Income before income taxes	88,564	50,161	129,906	92,780
Income tax expense	25,754	18,439	40,789	32,862
Net income	62,810	31,722	89,117	59,918
Less: Net income attributable to noncontrolling interest	334	648	207	1,277
Income attributable to Hilltop	\$ 62,476	\$ 31,074	\$ 88,910	\$ 58,641
Earnings per common share:				
Basic	\$ 0.64	\$ 0.32	\$ 0.90	\$ 0.60
Diluted	\$ 0.63	\$ 0.32	\$ 0.90	\$ 0.60
Cash dividends declared per common share	\$ 0.06	\$ —	\$ 0.12	\$ —
Weighted average share information:				
Basic	98,154	98,457	98,295	98,305
Diluted	98,414	98,586	98,576	98,619

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended		Six Months Ended June	
	June 30, 2017	2016	30, 2017	2016
Net income	\$ 62,810	\$ 31,722	\$ 89,117	\$ 59,918
Other comprehensive income:				
Net unrealized gains on securities available for sale, net of tax of \$696, \$1,034, \$927 and \$3,424, respectively	1,224	1,874	1,636	6,153
Reclassification adjustment for gains (losses) included in net income, net of tax of \$(5), \$16, \$(5) and \$0, respectively	(9)	30	(9)	—
Comprehensive income	64,025	33,626	90,744	66,071
Less: comprehensive income attributable to noncontrolling interest	334	648	207	1,277
Comprehensive income applicable to Hilltop	\$ 63,691	\$ 32,978	\$ 90,537	\$ 64,794

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Deferred Compensation Employee Stock Trust, Net	Employee Stock Trust Shares	Amount	Total Hilltop Stockholders' Equity	Noncontrolling Interest
98,896	\$ 989	\$ 1,577,270	\$ 2,629	\$ 155,475	\$ 1,034	22	\$ (443)	\$ 1,736,954	\$ 1,171
—	—	—	—	58,641	—	—	—	58,641	1,277
—	—	—	6,153	—	—	—	—	6,153	—
500	5	3,845	—	—	—	—	—	3,850	—
—	—	4,768	—	—	—	—	—	4,768	—
12	—	217	—	—	—	—	—	217	—
(94)	(1)	(1,779)	—	—	—	—	—	(1,780)	—
(816)	(8)	(16,268)	—	—	—	—	—	(16,276)	—
—	—	—	—	—	(96)	(5)	96	—	—
—	—	—	—	—	—	—	—	—	1,471

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

98,498	\$ 985	\$ 1,568,053	\$ 8,782	\$ 214,116	\$ 938	17	\$ (347)	\$ 1,792,527	\$ 3,919
98,544	\$ 985	\$ 1,572,877	\$ 485	\$ 295,568	\$ 903	15	\$ (309)	\$ 1,870,509	\$ 4,011
—	—	—	—	88,910	—	—	—	88,910	207
e	—	—	1,627	—	—	—	—	1,627	—
—	—	5,687	—	—	—	—	—	5,687	—
k	—	—	—	—	—	—	—	—	—
d	7	212	—	—	—	—	—	212	—
k	—	—	—	—	—	—	—	—	—
244	3	(2,134)	—	—	—	—	—	(2,131)	—
of	(2,462)	(25)	(46,739)	—	(16,311)	—	—	(63,075)	—
k	—	—	—	(11,603)	—	—	—	(11,603)	—
—	—	—	—	—	(58)	(3)	61	3	—
g	—	—	—	—	—	—	—	—	(1,304)
96,333	\$ 963	\$ 1,529,903	\$ 2,112	\$ 356,564	\$ 845	12	\$ (248)	\$ 1,890,139	\$ 2,914

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2017	2016
Operating Activities		
Net income	\$ 89,117	\$ 59,918
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	7,558	32,283
Depreciation, amortization and accretion, net	(14,436)	(26,686)
Net realized gains on securities	(14)	—
Deferred income taxes	2,615	2,421
Other, net	5,264	7,663
Net change in securities purchased under agreements to resell	(35,758)	(43,814)
Net change in assets segregated for regulatory purposes	13,428	38,399
Net change in trading securities	(205,951)	(91,273)
Net change in broker-dealer and clearing organization receivables	(45,566)	(796,440)
Net change in FDIC indemnification asset	22,824	17,344
Net change in other assets	(48,794)	(90,113)
Net change in broker-dealer and clearing organization payables	75,004	676,621
Net change in other liabilities	(132,731)	(45,653)
Net change in securities sold, not yet purchased	(4,020)	48,191
Proceeds from sale of mortgage servicing rights asset	17,499	7,586
Net gains from sales of loans	(277,838)	(294,309)
Loans originated for sale	(7,151,419)	(7,487,620)
Proceeds from loans sold	7,221,859	7,610,371
Net cash used in operating activities	(461,359)	(375,111)
Investing Activities		
Proceeds from maturities and principal reductions of securities held to maturity	27,975	104,160
Proceeds from sales, maturities and principal reductions of securities available for sale	197,327	250,911
Purchases of securities held to maturity	(36,299)	(126,880)
Purchases of securities available for sale	(361,530)	(86,798)
Net change in loans	(195,832)	(281,489)
Purchases of premises and equipment and other assets	(13,771)	(19,097)
Proceeds from sales of premises and equipment and other real estate owned	18,071	51,192
Net cash received from Federal Home Loan Bank and Federal Reserve Bank stock	8,165	6,342
Net cash used in investing activities	(355,894)	(101,659)

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Financing Activities		
Net change in deposits	483,993	271,198
Net change in short-term borrowings	97,780	65,489
Proceeds from notes payable	173,052	132,460
Payments on notes payable	(190,631)	(51,458)
Proceeds from issuance of common stock	—	3,850
Payments to repurchase common stock	(16,009)	—
Dividends paid on common stock	(11,603)	—
Net cash distributed from (to) noncontrolling interest	(1,304)	1,471
Taxes paid on employee stock awards netting activity	(2,131)	(1,765)
Other, net	(332)	(259)
Net cash provided by financing activities	532,815	420,986
Net change in cash and cash equivalents	(284,438)	(55,784)
Cash and cash equivalents, beginning of period	690,764	669,445
Cash and cash equivalents, end of period	\$ 406,326	\$ 613,661
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	\$ 36,299	\$ 28,206
Cash paid for income taxes, net of refunds	\$ 26,703	\$ 28,685
Supplemental Schedule of Non-Cash Activities		
Conversion of loans to other real estate owned	\$ 5,644	\$ 11,615
Additions to mortgage servicing rights	\$ 2,490	\$ 9,893

See accompanying notes.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting and Reporting Policies

Nature of Operations

Hilltop Holdings Inc. (“Hilltop” and, collectively with its subsidiaries, the “Company”) is a financial holding company registered under the Bank Holding Company Act of 1956. The Company’s primary line of business is to provide business and consumer banking services from offices located throughout Texas through PlainsCapital Bank (the “Bank”). In addition, the Company provides an array of financial products and services through its broker-dealer, mortgage origination and insurance subsidiaries.

The Company, headquartered in Dallas, Texas, provides its products and services through three primary business units, PlainsCapital Corporation (“PCC”), Hilltop Securities Holdings LLC (“Securities Holdings”) and National Lloyds Corporation (“NLC”). PCC is a financial holding company that provides, through its subsidiaries, traditional banking, wealth and investment management and treasury management services primarily in Texas and residential mortgage lending throughout the United States. Securities Holdings is a holding company that provides, through its subsidiaries, investment banking and other related financial services, including municipal advisory, sales, trading and underwriting of taxable and tax-exempt fixed income securities, equity trading, clearing, securities lending, structured finance and retail brokerage services throughout the United States. NLC is a property and casualty insurance holding company that provides, through its subsidiaries, fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the southern United States.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (“GAAP”), and in conformity with the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of management, these financial statements contain all adjustments necessary for a fair statement of the results of the interim periods presented. Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016 (“2016 Form 10-K”). Results for interim periods are not necessarily indicative of results to be expected for a full year or any future period.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates regarding the allowance for loan losses, the fair values of financial instruments, the amounts receivable from the Federal Deposit Insurance Corporation (the “FDIC”) under loss-share agreements (the “FDIC Indemnification Asset”), reserves for losses and loss adjustment expenses (“LAE”), the mortgage loan indemnification liability, and the potential impairment of assets are particularly subject to change. The Company has applied its critical accounting policies and estimation methods consistently in all periods presented in these consolidated financial statements.

Hilltop owns 100% of the outstanding stock of PCC. PCC owns 100% of the outstanding stock of the Bank and 100% of the membership interest in PlainsCapital Equity, LLC. The Bank owns 100% of the outstanding stock of PrimeLending, a PlainsCapital Company (“PrimeLending”).

PrimeLending owns a 100% membership interest in PrimeLending Ventures Management, LLC (“Ventures Management”). Ventures Management is the managing member and owns 51% of the membership interest in both PrimeLending Ventures, LLC (“Ventures”) and Mutual of Omaha Mortgage, LLC.

PCC also owns 100% of the outstanding common securities of PCC Statutory Trusts I, II, III and IV (the “Trusts”), which are not included in the consolidated financial statements under the requirements of the Variable Interest Entities

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Subsections of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”), because the primary beneficiaries of the Trusts are not within the consolidated group.

Hilltop has a 100% membership interest in Securities Holdings, which operates through its wholly-owned subsidiaries, Hilltop Securities Inc. (“Hilltop Securities”), Hilltop Securities Independent Network Inc. (“HTS Independent Network”) (collectively, the “Hilltop Broker-Dealers”) and First Southwest Asset Management, LLC. Hilltop Securities is a broker-dealer registered with the Securities and Exchange Commission (the “SEC”) and Financial Industry Regulatory Authority (“FINRA”) and a member of the New York Stock Exchange (“NYSE”), HTS Independent Network is an introducing broker-dealer that is also registered with the SEC and FINRA, and First Southwest Asset Management, LLC is a registered investment adviser under the Investment Advisers Act of 1940.

Hilltop also owns 100% of NLC, which operates through its wholly owned subsidiaries, National Lloyds Insurance Company (“NLIC”) and American Summit Insurance Company (“ASIC”).

The consolidated financial statements include the accounts of the above-named entities. Intercompany transactions and balances have been eliminated. Noncontrolling interests have been recorded for minority ownership in entities that are not wholly owned and are presented in compliance with the provisions of Noncontrolling Interest in Subsidiary Subsections of the ASC.

Certain reclassifications have been made to the prior period consolidated financial statements to conform with the current period presentation. In preparing these consolidated financial statements, subsequent events were evaluated through the time the financial statements were issued. Financial statements are considered issued when they are widely distributed to all stockholders and other financial statement users, or filed with the SEC.

2. Recently Issued Accounting Standards

In May 2017, FASB issued ASU 2017-09 which provides clarity and reduces both diversity in practice and cost and complexity associated with changes to the terms or conditions of a share-based payment award and, specifically, which changes require an entity to apply modification accounting. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Adoption of the amendment is not expected to have a significant effect on the Company's consolidated financial statements.

In April 2017, FASB issued ASU 2017-08 which shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. The amendment is effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2018, using the using the modified retrospective transition method. As permitted within the amendment, the Company elected to early adopt and apply the provisions of this amendment as of January 1, 2017. This adoption had no effect on the Company's consolidated financial statements.

In January 2017, FASB issued ASU 2017-01 which provides guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendment is effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017, using the prospective method. Early adoption is permitted. Adoption of the amendment is not expected to have a significant effect on the Company's consolidated financial statements.

In October 2016, FASB issued ASU No. 2016-16 which addresses improvement in accounting for income tax consequences of intra-equity transfers of assets other than inventory. The amendment requires that an entity recognize the income tax consequences of the intra-equity transfer of an asset other than inventory when the transfer occurs. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017, using the modified retrospective transition method. Early adoption is permitted. The Company does not intend to adopt the provisions of the amendment early and does not expect such provisions to have a significant effect on the Company's consolidated financial statements.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

In August 2016, FASB issued ASU 2016-15 to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows and to eliminate the diversity in practice related to such classifications. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017 using a retrospective transition method. Early adoption is permitted. The Company does not intend to adopt the provisions of the amendment early and does not expect such provisions to have a significant effect on the Company's consolidated financial statements.

In June 2016, FASB issued ASU 2016-13 which sets forth a "current expected credit loss" (CECL) model which requires entities to measure all credit losses expected over the life of an exposure (or pool of exposures) for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. The amendment also requires enhanced disclosures to help financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2019 with a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. Although the Company does not intend to adopt the provisions of the amendment early, a cross-functional team is evaluating the provisions of the amendment and the impact on its future consolidated financial statements through the identification of data requirements and determination of necessary modifications to its existing credit loss model and processes. The extent of the change in allowance for loan losses will be impacted by the portfolio composition and quality at the adoption date as well as economic conditions and forecasts at that time.

In February 2016, FASB issued ASU 2016-02 related to leases. The new standard is intended to increase transparency and comparability among organizations and require lessees to record a right-to-use asset and liability representing the obligation to make lease payments for long-term leases. Accounting by lessors will remain largely unchanged. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted. Adoption will require a modified retrospective transition where the lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented. The Company does not intend to adopt the provisions of the amendment early. The Company is currently evaluating the provisions of the amendment on its consolidated financial statements but upon adoption expects to report higher assets and liabilities as a result of including additional leases on the consolidated balance sheets.

In January 2016, FASB issued ASU 2016-01 related to financial instruments. This amendment requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The amendment also impacts financial liabilities under the Fair Value Option and the presentation and disclosure requirements for financial instruments. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Adoption of the amendment is not expected to have a

significant effect on the Company's consolidated financial statements.

In July 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 by one year, to clarify the principles for recognizing revenue from contracts with customers. The FASB has subsequently issued several amendments to the standard, including clarification of principal versus agent considerations, narrow scope improvements and other technical corrections. The amendments outline a single comprehensive model for entities to depict the transfer of goods or services to customers in amounts that reflect the payment to which a company expects to be entitled in exchange for those goods or services. The amendments also require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017 and may be adopted using either a full retrospective transition method or a modified, cumulative-effect approach wherein the guidance is applied only to existing contracts as of the date of initial application and to new contracts entered into thereafter. The Company does not intend to adopt the provisions of the amendment early and expects to adopt using the cumulative-effect approach. The Company has gathered an inventory of contracts with customers and performed an in-depth assessment. The preliminary assessment suggests that the revenue recognition policies within the

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Company's broker-dealer segment will be affected when adopted. Specifically, the new guidance may require certain advisory and underwriting revenues and expenses to be recorded on a gross basis while the current guidance requires recognizing these revenues net of the related expenses. However, there are many aspects of this new accounting guidance that are still being interpreted to clarify and address certain implementation issues. The Company will continue to evaluate the impact on its future consolidated financial statements of both current and newly issued guidance associated with the amendment.

3. Fair Value Measurements

Fair Value Measurements and Disclosures

The Company determines fair values in compliance with The Fair Value Measurements and Disclosures Topic of the ASC (the "Fair Value Topic"). The Fair Value Topic defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. The Fair Value Topic defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The Fair Value Topic assumes that transactions upon which fair value measurements are based occur in the principal market for the asset or liability being measured. Further, fair value measurements made under the Fair Value Topic exclude transaction costs and are not the result of forced transactions.

The Fair Value Topic creates a fair value hierarchy that classifies fair value measurements based upon the inputs used in valuing the assets or liabilities that are the subject of fair value measurements. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs, as indicated below.

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities that the Company can access at the measurement date.

- Level 2 Inputs: Observable inputs other than Level 1 prices. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, yield curves, prepayment speeds, default rates, credit risks and loss severities), and inputs that are derived from or corroborated by market data, among others.
- Level 3 Inputs: Unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities. Level 3 inputs include pricing models and discounted cash flow techniques, among others.

Fair Value Option

The Company has elected to measure substantially all of PrimeLending's mortgage loans held for sale and retained mortgage servicing rights ("MSR") asset at fair value, under the provisions of the Fair Value Option. The Company elected to apply the provisions of the Fair Value Option to these items so that it would have the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. At June 30, 2017 and December 31, 2016, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was \$1.93 billion and \$1.75 billion, respectively, and the unpaid principal balance of those loans was \$1.85 billion and \$1.71 billion, respectively. The interest component of fair value is reported as interest income on loans in the accompanying consolidated statements of operations.

The Company holds a number of financial instruments that are measured at fair value on a recurring basis, either by the application of the Fair Value Option or other authoritative pronouncements. The fair values of those instruments are determined primarily using Level 2 inputs. Those inputs include quotes from mortgage loan investors and derivatives dealers and data from independent pricing services.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following tables present information regarding financial assets and liabilities measured at fair value on a recurring basis (in thousands).

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
June 30, 2017				
Trading securities	\$ 5,205	\$ 466,280	\$ —	\$ 471,485
Available for sale securities	20,503	742,703	—	763,206
Loans held for sale	—	1,897,752	30,037	1,927,789
Derivative assets	—	71,724	—	71,724
MSR asset	—	—	43,580	43,580
Securities sold, not yet purchased	73,477	76,392	—	149,869
Derivative liabilities	—	19,642	—	19,642

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
December 31, 2016				
Trading securities	\$ 9,481	\$ 256,053	\$ —	\$ 265,534
Available for sale securities	19,840	578,167	—	598,007
Loans held for sale	—	1,712,697	35,801	1,748,498
Derivative assets	—	57,036	—	57,036
MSR asset	—	—	61,968	61,968
Securities sold, not yet purchased	60,715	93,174	—	153,889
Derivative liabilities	—	35,737	—	35,737

The following tables include a rollforward for those financial instruments measured at fair value using Level 3 inputs (in thousands).

Balance at Beginning of Period	Purchases/ Additions	Sales/ Reductions	Total Gains or Losses (Realized or Unrealized)	
			Included in Net Income	Included in Other Comprehensive Income (Loss)
				Balance at End of Period

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Three months
ended June 30, 2017

Loans held for sale	\$ 30,214	\$ 8,675	\$ (6,722)	\$ (2,130)	\$ —	\$ 30,037
MSR asset	45,573	1,266	—	(3,259)	—	43,580
Total	\$ 75,787	\$ 9,941	\$ (6,722)	\$ (5,389)	\$ —	\$ 73,617

Six months ended
June 30, 2017

Loans held for sale	\$ 35,801	\$ 16,503	\$ (17,423)	\$ (4,844)	\$ —	\$ 30,037
MSR asset	61,968	2,490	(17,499)	(3,379)	—	43,580
Total	\$ 97,769	\$ 18,993	\$ (34,922)	\$ (8,223)	\$ —	\$ 73,617

Three months
ended June 30, 2016

Trading securities	\$ 1	\$ —	\$ —	\$ —	\$ —	\$ 1
Loans held for sale	40,545	19,803	(10,894)	(3,809)	—	45,645
MSR asset	39,863	8,254	(7,586)	(7,040)	—	33,491
Total	\$ 80,409	\$ 28,057	\$ (18,480)	\$ (10,849)	\$ —	\$ 79,137

Six months ended
June 30, 2016

Trading securities	\$ 1	\$ —	\$ —	\$ —	\$ —	\$ 1
Loans held for sale	25,880	43,039	(15,131)	(8,143)	—	45,645
MSR asset	52,285	9,893	(7,586)	(21,101)	—	33,491
Total	\$ 78,166	\$ 52,932	\$ (22,717)	\$ (29,244)	\$ —	\$ 79,137

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

All net realized and unrealized gains (losses) in the table above are reflected in the accompanying consolidated financial statements. Excluding the trading securities sold during the three months ended September 30, 2016, the unrealized gains (losses) relate to financial instruments still held at June 30, 2017.

For Level 3 financial instruments measured at fair value on a recurring basis at June 30, 2017, the significant unobservable inputs used in the fair value measurements were as follows.

Financial instrument	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
Loans held for sale	Discounted cash flows / Market comparable	Projected price	92 - 95 % (95 %)
MSR asset	Discounted cash flows	Constant prepayment rate	10.92 %
		Discount rate	11.14 %

The fair value of certain loans held for sale that cannot be sold through normal sale channels or are non-performing is measured using Level 3 inputs. The fair values of such loans are generally based upon estimates of expected cash flows using unobservable inputs, including listing prices of comparable assets, uncorroborated expert opinions, and/or management's knowledge of underlying collateral.

The MSR asset, which is included in other assets within the Company's consolidated balance sheets, is valued by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair value of the MSR asset is impacted by a variety of factors. Prepayment rates and discount rates, the most significant unobservable inputs, are discussed further in Note 7 to the consolidated financial statements.

The Company had no transfers between Levels 1 and 2 during the periods presented.

The following tables present those changes in fair value of instruments recognized in the consolidated statements of operations that are accounted for under the Fair Value Option (in thousands).

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

	Three Months Ended June 30, 2017			Three Months Ended June 30, 2016		
	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value
Loans held for sale	\$ 22,231	\$ —	\$ 22,231	\$ 15,483	\$ —	\$ 15,483
MSR asset	(3,259)	—	(3,259)	(7,040)	—	(7,040)

	Six Months Ended June 30, 2017			Six Months Ended June 30, 2016		
	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value
Loans held for sale	\$ 31,093	\$ —	\$ 31,093	\$ 15,930	\$ —	\$ 15,930
MSR asset	(3,379)	—	(3,379)	(21,101)	—	(21,101)

The Company also determines the fair value of certain assets and liabilities on a non-recurring basis. In addition, facts and circumstances may dictate a fair value measurement when there is evidence of impairment. Assets and liabilities measured on a non-recurring basis include the items discussed below.

Impaired Loans — The Company reports impaired loans based on the underlying fair value of the collateral through specific allowances within the allowance for loan losses. Purchased credit impaired (“PCI”) loans with a fair value of \$172.9 million, \$822.8 million and \$73.5 million were acquired by the Company upon completion of the merger with PCC (the “PlainsCapital Merger”), the FDIC-assisted transaction whereby the Bank acquired certain assets and assumed certain liabilities of Edinburg, Texas-based First National Bank (“FNB”) on September 13, 2013 (the “FNB Transaction”), and the acquisition of SWS Group, Inc. (“SWS”) in a stock and cash transaction (the “SWS Merger”), whereby SWS’s banking subsidiary, Southwest Securities, FSB was merged into the Bank, respectively (collectively, the “Bank Transactions”). Substantially all PCI loans acquired in the FNB Transaction are covered by FDIC loss-share agreements. The fair value of PCI loans was determined using Level 3 inputs, including estimates of expected cash flows

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

that incorporated significant unobservable inputs regarding default rates, loss severity rates assuming default, prepayment speeds on acquired loans accounted for in pools (“Pooled Loans”), and estimated collateral values.

At June 30, 2017, estimates for these significant unobservable inputs were as follows.

	PCI Loans					
	PlainsCapital		FNB		SWS	
	Merger		Transaction		Merger	
Weighted average default rate	53	%	44	%	59	%
Weighted average loss severity rate	63	%	20	%	29	%
Weighted average prepayment speed	0	%	8	%	0	%

At June 30, 2017, the resulting weighted average expected loss on PCI loans associated with the PlainsCapital Merger, FNB Transaction and SWS Merger was 33%, 9% and 17%, respectively.

The Company obtains updated appraisals of the fair value of collateral securing impaired collateral-dependent loans at least annually, in accordance with regulatory guidelines. The Company also reviews the fair value of such collateral on a quarterly basis. If the quarterly review indicates that the fair value of the collateral may have deteriorated, the Company orders an updated appraisal of the fair value of the collateral. Because the Company obtains updated appraisals when evidence of a decline in the fair value of collateral exists, it typically does not adjust appraised values.

Other Real Estate Owned — The Company determines fair value primarily using independent appraisals of other real estate owned (“OREO”) properties. The resulting fair value measurements are classified as Level 2 or Level 3 inputs, depending upon the extent to which unobservable inputs determine the fair value measurement. The Company considers a number of factors in determining the extent to which specific fair value measurements utilize unobservable inputs, including, but not limited to, the inherent subjectivity in appraisals, the length of time elapsed since the receipt of independent market price or appraised value, and current market conditions. At June 30, 2017, the most significant unobservable input used in the determination of fair value of OREO was a discount to independent appraisals for estimated holding periods of OREO properties. Level 3 inputs were used to determine the initial fair value at acquisition of a large group of smaller balance properties that were acquired in the FNB Transaction. In the FNB Transaction, the Bank acquired OREO of \$135.2 million, all of which is covered by FDIC loss-share agreements. At June 30, 2017 and December 31, 2016, the estimated fair value of covered OREO was \$42.3 million and \$51.6 million, respectively, and the underlying fair value measurements utilized Level 2 and Level 3 inputs. The

fair value of non-covered OREO at June 30, 2017 and December 31, 2016 was \$4.6 million and \$4.5 million, respectively, and is included in other assets within the consolidated balance sheets. During the reported periods, all fair value measurements for non-covered OREO subsequent to initial recognition utilized Level 2 inputs.

The following table presents information regarding certain assets and liabilities measured at fair value on a non-recurring basis for which a change in fair value has been recorded during reporting periods subsequent to initial recognition (in thousands).

June 30, 2017	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value	Total Gains (Losses) for the		Total Gains (Losses) for the	
					Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Non-covered impaired loans	\$ —	\$ —	\$ 55,013	\$ 55,013	\$ (274)	\$ 168	\$ (470)	\$ 135
Covered impaired loans	—	—	48,677	48,677	(611)	(242)	(977)	90
Non-covered other real estate owned	—	3,258	—	3,258	(108)	(12)	(123)	(12)
Covered other real estate owned	—	5,385	—	5,385	(943)	(1,967)	(2,135)	(11,732)

The Fair Value of Financial Instruments Subsection of the ASC requires disclosure of the fair value of financial assets and liabilities, including the financial assets and liabilities previously discussed. There have been no changes to the methods for determining estimated fair value for financial assets and liabilities which are described in detail in Note 3 to the consolidated financial statements included in the Company's 2016 Form 10-K.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following tables present the carrying values and estimated fair values of financial instruments not measured at fair value on either a recurring or non-recurring basis (in thousands).

June 30, 2017	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Financial assets:					
Cash and cash equivalents	\$ 406,326	\$ 406,326	\$ —	\$ —	\$ 406,326
Securities purchased under agreements to resell	125,188	—	125,188	—	125,188
Assets segregated for regulatory purposes	167,565	167,565	—	—	167,565
Held to maturity securities	359,847	—	355,860	—	355,860
Loans held for sale	72,468	—	72,468	—	72,468
Non-covered loans, net	6,059,003	—	492,859	5,755,032	6,247,891
Covered loans, net	205,877	—	—	309,698	309,698
Broker-dealer and clearing organization receivables	1,552,525	—	1,552,525	—	1,552,525
FDIC indemnification asset	40,304	—	—	24,875	24,875
Other assets	62,882	—	57,420	5,462	62,882
Financial liabilities:					
Deposits	7,574,622	—	7,567,319	—	7,567,319
Broker-dealer and clearing organization payables	1,395,314	—	1,395,314	—	1,395,314
Short-term borrowings	1,515,069	—	1,515,069	—	1,515,069
Debt	367,295	—	364,785	—	364,785
Other liabilities	3,881	—	3,881	—	3,881

December 31, 2016	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Financial assets:					
Cash and cash equivalents	\$ 690,764	\$ 690,764	\$ —	\$ —	\$ 690,764
Securities purchased under agreements to resell	89,430	—	89,430	—	89,430

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Assets segregated for regulatory purposes	180,993	180,993	—	—	180,993
Held to maturity securities	351,831	—	345,088	—	345,088
Loans held for sale	46,965	—	46,965	—	46,965
Non-covered loans, net	5,789,313	—	502,077	5,459,975	5,962,052
Covered loans, net	255,714	—	—	367,444	367,444
Broker-dealer and clearing organization receivables	1,497,741	—	1,497,741	—	1,497,741
FDIC indemnification asset	71,313	—	—	60,173	60,173
Other assets	62,904	—	58,697	4,207	62,904
Financial liabilities:					
Deposits	7,063,811	—	7,058,837	—	7,058,837
Broker-dealer and clearing organization payables	1,347,128	—	1,347,128	—	1,347,128
Short-term borrowings	1,417,289	—	1,417,289	—	1,417,289
Debt	384,924	—	378,822	—	378,822
Other liabilities	3,708	—	3,708	—	3,708

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

4. Securities

The fair value of trading securities is summarized as follows (in thousands).

	June 30, 2017	December 31, 2016
U.S. Treasury securities	\$ 1,874	\$ 5,940
U.S. government agencies:		
Bonds	32,944	36,303
Residential mortgage-backed securities	233,443	2,539
Commercial mortgage-backed securities	9,739	15,171
Collateralized mortgage obligations	1,668	5,607
Corporate debt securities	75,240	60,699
States and political subdivisions	98,619	89,946
Unit investment trusts	8,920	41,409
Private-label securitized product	4,843	4,292
Other	4,195	3,628
Totals	\$ 471,485	\$ 265,534

The Hilltop Broker-Dealers enter into transactions that represent commitments to purchase and deliver securities at prevailing future market prices to facilitate customer transactions and satisfy such commitments. Accordingly, the Hilltop Broker-Dealers' ultimate obligations may exceed the amount recognized in the financial statements. These securities, which are carried at fair value and reported as securities sold, not yet purchased in the consolidated balance sheets, had a value of \$149.9 million and \$153.9 million at June 30, 2017 and December 31, 2016, respectively.

The amortized cost and fair value of available for sale and held to maturity securities are summarized as follows (in thousands).

June 30, 2017	Available for Sale			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

U.S. Treasury securities	\$ 31,740	\$ 173	\$ (42)	\$ 31,871
U.S. government agencies:				
Bonds	91,077	873	(138)	91,812
Residential mortgage-backed securities	242,019	879	(2,452)	240,446
Commercial mortgage-backed securities	12,200	22	(23)	12,199
Collateralized mortgage obligations	212,647	104	(2,636)	210,115
Corporate debt securities	75,534	2,551	(11)	78,074
States and political subdivisions	76,234	1,557	(112)	77,679
Commercial mortgage-backed securities	499	8	—	507
Equity securities	19,267	1,250	(14)	20,503
Totals	\$ 761,217	\$ 7,417	\$ (5,428)	\$ 763,206

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2016	Available for Sale			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. Treasury securities	\$ 31,701	\$ 144	\$ (44)	\$ 31,801
U.S. government agencies:				
Bonds	121,838	881	(67)	122,652
Residential mortgage-backed securities	135,371	708	(2,941)	133,138
Commercial mortgage-backed securities	8,771	2	(58)	8,715
Collateralized mortgage obligations	117,879	29	(3,206)	114,702
Corporate debt securities	76,866	2,354	(91)	79,129
States and political subdivisions	86,353	1,498	(336)	87,515
Commercial mortgage-backed securities	499	16	—	515
Equity securities	18,920	1,263	(343)	19,840
Totals	\$ 598,198	\$ 6,895	\$ (7,086)	\$ 598,007

June 30, 2017	Held to Maturity			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. government agencies:				
Bonds	\$ 40,514	\$ 43	\$ (915)	\$ 39,642
Residential mortgage-backed securities	18,009	179	—	18,188
Commercial mortgage-backed securities	57,867	396	(399)	57,864
Collateralized mortgage obligations	194,664	150	(2,466)	192,348
States and political subdivisions	48,793	205	(1,180)	47,818
Totals	\$ 359,847	\$ 973	\$ (4,960)	\$ 355,860

December 31, 2016	Held to Maturity			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. government agencies:				
Bonds	\$ 40,513	\$ —	\$ (1,287)	\$ 39,226
Residential mortgage-backed securities	19,606	13	(6)	19,613
Commercial mortgage-backed securities	31,767	102	(593)	31,276
Collateralized mortgage obligations	217,954	128	(3,372)	214,710
States and political subdivisions	41,991	70	(1,798)	40,263

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Totals	\$ 351,831	\$ 313	\$ (7,056)	\$ 345,088
--------	------------	--------	------------	------------

17

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Information regarding available for sale and held to maturity securities that were in an unrealized loss position is shown in the following tables (dollars in thousands).

	June 30, 2017			December 31, 2016		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Available for Sale						
U.S. treasury securities:						
Unrealized loss for less than twelve months	6	\$ 24,143	\$ 39	7	\$ 21,694	\$ 44
Unrealized loss for twelve months or longer	2	2,598	3	—	—	—
	8	26,741	42	7	21,694	44
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	9	74,954	138	1	14,908	67
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	9	74,954	138	1	14,908	67
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	13	122,941	2,232	12	109,398	2,941
Unrealized loss for twelve months or longer	1	5,846	220	—	—	—
	14	128,787	2,452	12	109,398	2,941
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	2	9,091	23	2	7,127	58
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	2	9,091	23	2	7,127	58
Collateralized mortgage obligations:						
	17	134,762	1,537	11	91,144	2,340

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Unrealized loss for less than twelve months						
Unrealized loss for twelve months or longer	9	29,341	1,099	8	19,320	866
	26	164,103	2,636	19	110,464	3,206
Corporate debt securities:						
Unrealized loss for less than twelve months	1	1,987	11	3	5,899	91
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	1	1,987	11	3	5,899	91
States and political subdivisions:						
Unrealized loss for less than twelve months	24	11,727	103	32	17,549	322
Unrealized loss for twelve months or longer	1	458	9	1	450	14
	25	12,185	112	33	17,999	336
Equity securities:						
Unrealized loss for less than twelve months	1	195	—	—	—	—
Unrealized loss for twelve months or longer	2	6,947	14	2	11,107	343
	3	7,142	14	2	11,107	343
Total available for sale:						
Unrealized loss for less than twelve months	73	379,800	4,083	68	267,719	5,863
Unrealized loss for twelve months or longer	15	45,190	1,345	11	30,877	1,223
	88	\$ 424,990	\$ 5,428	79	\$ 298,596	\$ 7,086

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	June 30, 2017		Unrealized	December 31, 2016		Unrealized
	Number of	Fair Value	Losses	Number of	Fair Value	Losses
	Securities			Securities		
Held to Maturity						
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	3	\$ 32,099	\$ 915	4	\$ 33,225	\$ 1,287
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	3	32,099	915	4	33,225	1,287
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	—	—	—	2	13,178	6
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	2	13,178	6
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	2	12,882	399	5	18,891	588
Unrealized loss for twelve months or longer	—	—	—	1	1,401	5
	2	12,882	399	6	20,292	593
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	17	166,859	2,466	19	187,669	3,372
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	17	166,859	2,466	19	187,669	3,372
States and political subdivisions:						
Unrealized loss for less than twelve months	63	27,712	1,176	71	29,862	1,790
Unrealized loss for twelve months or longer	2	671	4	1	462	8

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

	65	28,383	1,180	72	30,324	1,798
Total held to maturity:						
Unrealized loss for less than twelve months	85	239,552	4,956	101	282,825	7,043
Unrealized loss for twelve months or longer	2	671	4	2	1,863	13
	87	\$ 240,223	\$ 4,960	103	\$ 284,688	\$ 7,056

During the three and six months ended June 30, 2017 and 2016, the Company did not record any other-than-temporary impairments (“OTTI”). Factors considered in the Company’s analysis include the reasons for the unrealized loss position, the severity and duration of the unrealized loss position, credit worthiness, and forecasted performance of the investee. While some of the securities held in the Company’s investment portfolio have decreased in value since the date of acquisition, the severity of loss and the duration of the loss position are not believed to be significant enough to warrant recording any OTTI of the securities. The Company does not intend to sell, nor does the Company believe that it is likely that the Company will be required to sell, these securities before the recovery of the cost basis.

Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The amortized cost and fair value of securities, excluding trading and available for sale equity securities, at June 30, 2017 are shown by contractual maturity below (in thousands).

	Available for Sale Amortized		Held to Maturity Amortized	
	Cost	Fair Value	Cost	Fair Value
Due in one year or less	\$ 107,694	\$ 107,905	\$ 4,258	\$ 4,262
Due after one year through five years	97,514	99,481	3,323	3,346
Due after five years through ten years	39,674	41,380	26,786	26,327
Due after ten years	29,703	30,670	54,940	53,525
	274,585	279,436	89,307	87,460
Residential mortgage-backed securities	242,019	240,446	18,009	18,188
Collateralized mortgage obligations	212,647	210,115	194,664	192,348
Commercial mortgage-backed securities	12,699	12,706	57,867	57,864
	\$ 741,950	\$ 742,703	\$ 359,847	\$ 355,860

The Company realized net gains of \$7.0 million and \$5.8 million from its trading securities portfolio during the three months ended June 30, 2017 and 2016, respectively, and net gains from its trading securities portfolio of \$12.9 million and \$11.5 million during the six months ended June 30, 2017 and 2016, respectively. In addition, the Hilltop Broker-

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Dealers realized net gains from trading activities primarily associated with the structured finance business of \$10.5 million and \$23.7 million during the three months ended June 30, 2017 and 2016, respectively, and \$17.0 million and \$29.3 million during the six months ended June 30, 2017 and 2016, respectively. All such realized net gains are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of \$624.0 million and \$695.1 million (with a fair value of \$619.7 million and \$688.1 million, respectively) at June 30, 2017 and December 31, 2016, respectively, were pledged to secure public and trust deposits, federal funds purchased and securities sold under agreements to repurchase, and for other purposes as required or permitted by law. Substantially all of these pledged securities were included in our available for sale and held to maturity securities portfolios at June 30, 2017 and December 31, 2016.

Mortgage-backed securities and collateralized mortgage obligations consist primarily of Government National Mortgage Association (“GNMA”), Federal National Mortgage Association (“FNMA”) and Federal Home Loan Mortgage Corporation (“FHLMC”) pass-through and participation certificates. GNMA securities are guaranteed by the full faith and credit of the United States, while FNMA and FHLMC securities are fully guaranteed by those respective United States government-sponsored agencies, and conditionally guaranteed by the full faith and credit of the United States.

At June 30, 2017 and December 31, 2016, NLC had investments on deposit in custody for various state insurance departments with aggregate carrying values of \$9.3 million and \$9.2 million, respectively.

5. Non-Covered Loans and Allowance for Non-Covered Loan Losses

Non-covered loans refer to loans not covered by the FDIC loss-share agreements. Covered loans are discussed in Note 6 to the consolidated financial statements. Non-covered loans summarized by portfolio segment are as follows (in thousands).

	June 30, 2017	December 31, 2016
Commercial and industrial	\$ 1,750,305	\$ 1,696,453
Real estate	2,969,199	2,816,767

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Construction and land development	863,082	786,850
Consumer	42,766	41,352
Broker-dealer (1)	492,859	502,077
	6,118,211	5,843,499
Allowance for non-covered loan losses	(59,208)	(54,186)
Total non-covered loans, net of allowance	\$ 6,059,003	\$ 5,789,313

(1) Represents margin loans to customers and correspondents associated with our broker-dealer segment operations.

In connection with the Bank Transactions, the Company acquired non-covered loans both with and without evidence of credit quality deterioration since origination. The following table presents the carrying values and the outstanding balances of non-covered PCI loans (in thousands).

	June 30, 2017	December 31, 2016
Carrying amount	\$ 44,345	\$ 51,432
Outstanding balance	59,426	67,988

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Changes in the accretable yield for non-covered PCI loans were as follows (in thousands).

	Three Months Ended		Six Months Ended June	
	June 30, 2017	2016	30, 2017	2016
Balance, beginning of period	\$ 11,442	\$ 16,168	\$ 13,116	\$ 17,744
Reclassifications from nonaccretable difference, net(1)	438	1,604	577	3,947
Disposals of loans	(61)	—	(61)	—
Accretion	(2,026)	(2,543)	(3,839)	(6,462)
Balance, end of period	\$ 9,793	\$ 15,229	\$ 9,793	\$ 15,229

(1) Reclassifications from nonaccretable difference are primarily due to net increases in expected cash flows in the quarterly recasts. Reclassifications to nonaccretable difference occur when accruing loans are moved to non-accrual and expected cash flows are no longer predictable and the accretable yield is eliminated.

The remaining nonaccretable difference for non-covered PCI loans was \$21.0 million and \$22.8 million at June 30, 2017 and December 31, 2016, respectively.

Impaired loans exhibit a clear indication that the borrower's cash flow may not be sufficient to meet contractual principal and interest payments, which generally occurs when a loan is 90 days past due unless the asset is both well secured and in the process of collection. Non-covered impaired loans include non-accrual loans, troubled debt restructurings ("TDRs"), PCI loans and partially charged-off loans. The amounts shown in the following tables include loans accounted for on an individual basis, as well as acquired Pooled Loans. For Pooled Loans, the recorded investment with allowance and the related allowance consider impairment measured at the pool level. Non-covered impaired loans, segregated between those considered to be PCI loans and those without credit impairment at acquisition, are summarized by class in the following tables (in thousands).

	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
June 30, 2017					
PCI					
Commercial and industrial:					
Secured	\$ 20,269	\$ 3,382	\$ 3,738	\$ 7,120	\$ 66
Unsecured	—	—	—	—	—

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Real estate:					
Secured by commercial properties	33,575	8,512	16,056	24,568	2,249
Secured by residential properties	13,102	2,272	7,838	10,110	270
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	4,357	1,073	1,260	2,333	303
Consumer	2,679	32	182	214	102
Broker-dealer	—	—	—	—	—
	73,982	15,271	29,074	44,345	2,990
Non-PCI					
Commercial and industrial:					
Secured	12,253	6,797	2,911	9,708	750
Unsecured	745	717	—	717	—
Real estate:					
Secured by commercial properties	12,136	11,235	410	11,645	3
Secured by residential properties	1,816	1,545	—	1,545	—
Construction and land development:					
Residential construction loans	15	—	—	—	—
Commercial construction loans and land development	659	—	632	632	106
Consumer	317	208	—	208	—
Broker-dealer	—	—	—	—	—
	27,941	20,502	3,953	24,455	859
	\$ 101,923	\$ 35,773	\$ 33,027	\$ 68,800	\$ 3,849

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2016	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	\$ 25,354	\$ 3,234	\$ 5,438	\$ 8,672	\$ 557
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	38,005	11,097	17,413	28,510	1,907
Secured by residential properties	13,606	7,401	3,088	10,489	200
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	5,780	1,391	2,076	3,467	377
Consumer	3,223	237	57	294	56
Broker-dealer	—	—	—	—	—
	85,968	23,360	28,072	51,432	3,097
Non-PCI					
Commercial and industrial:					
Secured	6,311	3,313	1,372	4,685	115
Unsecured	946	925	—	925	—
Real estate:					
Secured by commercial properties	10,134	10,000	—	10,000	—
Secured by residential properties	1,344	1,116	—	1,116	—
Construction and land development:					
Residential construction loans	28	28	—	28	—
Commercial construction loans and land development	738	48	679	727	167
Consumer	246	244	—	244	—
Broker-dealer	—	—	—	—	—
	19,747	15,674	2,051	17,725	282
	\$ 105,715	\$ 39,034	\$ 30,123	\$ 69,157	\$ 3,379

Average recorded investment in non-covered impaired loans is summarized by class in the following table (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Commercial and industrial:				
Secured	\$ 16,950	\$ 25,590	\$ 15,093	\$ 25,538
Unsecured	748	41	821	47
Real estate:				
Secured by commercial properties	37,189	37,533	37,362	38,680
Secured by residential properties	11,461	12,092	11,630	12,133
Construction and land development:				
Residential construction loans	—	—	14	111
Commercial construction loans and land development	3,170	4,090	3,580	4,512
Consumer	462	483	480	609
Broker-dealer	—	—	—	—
	\$ 69,980	\$ 79,829	\$ 68,980	\$ 81,630

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Non-covered non-accrual loans, excluding those classified as held for sale, are summarized by class in the following table (in thousands).

	June 30, 2017	December 31, 2016
Commercial and industrial:		
Secured	\$ 13,101	\$ 8,590
Unsecured	717	925
Real estate:		
Secured by commercial properties	11,645	11,034
Secured by residential properties	2,020	1,197
Construction and land development:		
Residential construction loans	—	28
Commercial construction loans and land development	632	727
Consumer	208	244
Broker-dealer	—	—
	\$ 28,323	\$ 22,745

At June 30, 2017 and December 31, 2016, non-covered non-accrual loans included non-covered PCI loans of \$3.9 million and \$5.0 million, respectively, for which discount accretion has been suspended because the extent and timing of cash flows from these non-covered PCI loans can no longer be reasonably estimated. In addition to the non-covered non-accrual loans in the table above, \$1.2 million and \$1.7 million of real estate loans secured by residential properties and classified as held for sale were in non-accrual status at June 30, 2017 and December 31, 2016, respectively.

Interest income, including recoveries and cash payments, recorded on non-covered impaired loans was \$0.1 million and \$0.1 million during the three months ended June 30, 2017 and 2016, respectively, and \$0.4 million and \$0.2 million during the six months ended June 30, 2017 and 2016, respectively. Except as noted above, non-covered PCI loans are considered to be performing due to the application of the accretion method.

The Bank classifies loan modifications as TDRs when it concludes that it has both granted a concession to a debtor and that the debtor is experiencing financial difficulties. Loan modifications are typically structured to create affordable payments for the debtor and can be achieved in a variety of ways. The Bank modifies loans by reducing interest rates and/or lengthening loan amortization schedules. The Bank may also reconfigure a single loan into two or

more loans (“A/B Note”). The typical A/B Note restructure results in a “bad” loan which is charged off and a “good” loan or loans, the terms of which comply with the Bank’s customary underwriting policies. The debt charged off on the “bad” loan is not forgiven to the debtor.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Information regarding TDRs granted during the three and six months ended June 30, 2017 and 2016, respectively, is shown in the following tables (dollars in thousands). At June 30, 2017 and December 31, 2016, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

	Three Months Ended June 30, 2017			Three Months Ended June 30, 2016		
	Number of Loans	Balance at Extension	Balance at End of Period	Number of Loans	Balance at Extension	Balance at End of Period
Commercial and industrial:						
Secured	—	\$ —	\$ —	—	\$ —	\$ —
Unsecured	—	—	—	—	—	—
Real estate:						
Secured by commercial properties	—	—	—	—	—	—
Secured by residential properties	—	—	—	—	—	—
Construction and land development:						
Residential construction loans	—	—	—	—	—	—
Commercial construction loans and land development	1	655	632	—	—	—
Consumer	—	—	—	—	—	—
Broker-dealer	—	—	—	—	—	—
	1	\$ 655	\$ 632	—	\$ —	\$ —

	Six Months Ended June 30, 2017			Six Months Ended June 30, 2016		
	Number of Loans	Balance at Extension	Balance at End of Period	Number of Loans	Balance at Extension	Balance at End of Period
Commercial and industrial:						
Secured	1	\$ 1,357	\$ 1,279	1	\$ 1,196	\$ 950
Unsecured	—	—	—	—	—	—
Real estate:						
Secured by commercial properties	1	1,481	1,417	—	—	—
Secured by residential properties	—	—	—	—	—	—
Construction and land development:						
Residential construction loans	—	—	—	—	—	—

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Commercial construction loans and land development	1	655	632	—	—	—
Consumer	—	—	—	—	—	—
Broker-dealer	—	—	—	—	—	—
	3	\$ 3,493	\$ 3,328	1	\$ 1,196	\$ 950

All of the non-covered loan modifications included in the tables above involved payment term extensions. The Bank did not grant principal reductions on any restructured non-covered loans during the six months ended June 30, 2017 and 2016.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following table presents information regarding TDRs granted during the twelve months preceding June 30, 2017 and 2016, respectively, for which a payment was at least 30 days past due (dollars in thousands).

	Twelve Months Preceding June 30, 2017			Twelve Months Preceding June 30, 2016		
	Number of Loans	Balance at Extension	Balance at End of Period	Number of Loans	Balance at Extension	Balance at End of Period
Commercial and industrial:						
Secured	—	\$ —	\$ —	2	\$ 1,286	\$ 1,022
Unsecured	—	—	—	—	—	—
Real estate:						
Secured by commercial properties	1	1,481	1,417	1	1,084	995
Secured by residential properties	—	—	—	—	—	—
Construction and land development:						
Residential construction loans	—	—	—	—	—	—
Commercial construction loans and land development	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Broker-dealer	—	—	—	—	—	—
	1	\$ 1,481	\$ 1,417	3	\$ 2,370	\$ 2,017

An analysis of the aging of the Bank's non-covered loan portfolio is shown in the following tables (in thousands).

June 30, 2017	Loans Past Due			Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non-PCI) Past Due 90 Days or More
	30-59 Days	60-89 Days	90 Days or More					
Commercial and industrial:								
Secured	\$ 2,242	\$ 5,269	\$ 2,745	\$ 10,256	\$ 1,630,746	\$ 7,120	\$ 1,648,122	\$ 2,745
Unsecured	102	2	—	104	102,079	—	102,183	—
Real estate:								
	410	5,150	—	5,560	2,161,203	24,568	2,191,331	—

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Secured by commercial properties								
Secured by residential properties	546	452	557	1,555	766,203	10,110	777,868	557
Construction and land development:								
Residential construction loans	1,788	—	—	1,788	158,735	—	160,523	—
Commercial construction loans and land development	945	3	—	948	699,278	2,333	702,559	—
Consumer	239	31	—	270	42,282	214	42,766	—
Broker-dealer	—	—	—	—	492,859	—	492,859	—
	\$ 6,272	\$ 10,907	\$ 3,302	\$ 20,481	\$ 6,053,385	\$ 44,345	\$ 6,118,211	\$ 3,302

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More Past Due	Total Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non-PCI) Past Due 90 Days or More Past Due
December 31, 2016								
Commercial and industrial:								
Secured	\$ 4,727	\$ 704	\$ 6,770	\$ 12,201	\$ 1,576,239	\$ 8,672	\$ 1,597,112	\$ 3,095
Unsecured	596	1	909	1,506	97,835	—	99,341	1
Real estate:								
Secured by commercial properties	550	9,417	1,492	11,459	1,915,126	28,510	1,955,095	—
Secured by residential properties	506	361	369	1,236	849,947	10,489	861,672	—
Construction and land development:								
Residential construction loans	—	28	—	28	128,624	—	128,652	—
Commercial construction loans and land development	2,500	1,784	48	4,332	650,399	3,467	658,198	—
Consumer	176	31	—	207	40,851	294	41,352	—
Broker-dealer	—	—	—	—	502,077	—	502,077	—
	\$ 9,055	\$ 12,326	\$ 9,588	\$ 30,969	\$ 5,761,098	\$ 51,432	\$ 5,843,499	\$ 3,096

In addition to the non-covered loans shown in the tables above, \$45.5 million and \$44.4 million of loans included in loans held for sale (with an unpaid principal balance of \$46.0 million and \$44.9 million, respectively) were 90 days past due and accruing interest at June 30, 2017 and December 31, 2016, respectively. These loans are guaranteed by U.S. government agencies and include loans that are subject to repurchase, or have been repurchased, by PrimeLending.

Management tracks credit quality trends on a quarterly basis related to: (i) past due levels, (ii) non-performing asset levels, (iii) classified loan levels, (iv) net charge-offs, and (v) general economic conditions in the state and local

markets.

The Bank utilizes a risk grading matrix to assign a risk grade to each of the loans in its portfolio. A risk rating is assigned based on an assessment of the borrower's management, collateral position, financial capacity, and economic factors. The general characteristics of the various risk grades are described below.

Pass – “Pass” loans present a range of acceptable risks to the Bank. Loans that would be considered virtually risk-free are rated Pass – low risk. Loans that exhibit sound standards based on the grading factors above and present a reasonable risk to the Bank are rated Pass – normal risk. Loans that exhibit a minor weakness in one or more of the grading criteria but still present an acceptable risk to the Bank are rated Pass – high risk.

Special Mention – “Special Mention” loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in a deterioration of the repayment prospects for the loans and weaken the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to require adverse classification.

Substandard – “Substandard” loans are inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Many substandard loans are considered impaired.

PCI – “PCI” loans exhibited evidence of credit deterioration at acquisition that made it probable that all contractually required principal payments would not be collected.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following tables present the internal risk grades of non-covered loans, as previously described, in the portfolio by class (in thousands).

June 30, 2017	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	\$ 1,581,767	\$ 7,939	\$ 51,296	\$ 7,120	\$ 1,648,122
Unsecured	99,865	1,060	1,258	—	102,183
Real estate:					
Secured by commercial properties	2,126,761	1,514	38,488	24,568	2,191,331
Secured by residential properties	761,621	3,292	2,845	10,110	777,868
Construction and land development:					
Residential construction loans	160,523	—	—	—	160,523
Commercial construction loans and land development	696,643	2,792	791	2,333	702,559
Consumer	42,312	—	240	214	42,766
Broker-dealer	492,859	—	—	—	492,859
	\$ 5,962,351	\$ 16,597	\$ 94,918	\$ 44,345	\$ 6,118,211

December 31, 2016	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	\$ 1,531,895	\$ 72	\$ 56,473	\$ 8,672	\$ 1,597,112
Unsecured	97,646	—	1,695	—	99,341
Real estate:					
Secured by commercial properties	1,888,231	3,693	34,661	28,510	1,955,095
Secured by residential properties	846,420	—	4,763	10,489	861,672
Construction and land development:					
Residential construction loans	128,624	—	28	—	128,652
Commercial construction loans and land development	653,808	—	923	3,467	658,198
Consumer	40,789	6	263	294	41,352
Broker-dealer	502,077	—	—	—	502,077
	\$ 5,689,490	\$ 3,771	\$ 98,806	\$ 51,432	\$ 5,843,499

Allowance for Loan Losses

The allowance for both originated and acquired loans is subject to regulatory examinations, which may take into account such factors as the methodology used to calculate the allowance and the size of the allowance. The Company's analysis of the level of the allowance for loan losses to ensure that it is appropriate for the estimated credit losses in the portfolio consistent with the Interagency Policy Statement on the Allowance for Loan and Lease Losses and the Receivables and Contingencies Topics of the ASC is described in detail in Note 5 to the consolidated financial statements included in the Company's 2016 Form 10-K.

During 2016, the Bank discovered irregularities with respect to a non-covered loan that is currently in default. As a result, the Bank increased its provision for loan losses and recorded a \$24.5 million charge-off during the second quarter of 2016, representing the entire outstanding principal balance of the loan. During the three months ended June 30, 2017, the Bank recorded an insurance receivable and related other noninterest income of \$15.0 million from coverage provided by an insurance policy for forgery.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Changes in the allowance for non-covered loan losses, distributed by portfolio segment, are shown below (in thousands).

Three Months Ended June 30, 2017	Commercial and		Construction and			Broker-Dealer Total
	Industrial	Real Estate	Land Development	Consumer		
Balance, beginning of period	\$ 21,679	\$ 26,112	\$ 6,879	\$ 464	\$ 23	\$ 55,157
Provision charged to operations	735	2,779	766	165	448	4,893
Loans charged off	(1,200)	(218)	—	(127)	—	(1,545)
Recoveries on charged off loans	620	61	—	22	—	703
Balance, end of period	\$ 21,834	\$ 28,734	\$ 7,645	\$ 524	\$ 471	\$ 59,208

Six Months Ended June 30, 2017	Commercial and		Construction and			Broker-Dealer Total
	Industrial	Real Estate	Land Development	Consumer		
Balance, beginning of period	\$ 21,369	\$ 25,236	\$ 7,002	\$ 424	\$ 155	\$ 54,186
Provision charged to operations	1,210	3,701	654	221	316	6,102
Loans charged off	(1,805)	(300)	(11)	(161)	—	(2,277)
Recoveries on charged off loans	1,060	97	—	40	—	1,197
Balance, end of period	\$ 21,834	\$ 28,734	\$ 7,645	\$ 524	\$ 471	\$ 59,208

Three Months Ended June 30, 2016	Commercial and		Construction and			Broker-Dealer Total
	Industrial	Real Estate	Land Development	Consumer		
Balance, beginning of period	\$ 20,169	\$ 22,272	\$ 5,561	\$ 334	\$ 114	\$ 48,450
Provision charged to (recapture from) operations	25,503	2,216	727	(16)	263	28,693
Loans charged off	(25,433)	(1,298)	—	(37)	1	(26,767)

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Recoveries on charged off loans	481	112	—	44	—	637
Balance, end of period	\$ 20,720	\$ 23,302	\$ 6,288	\$ 325	\$ 378	\$ 51,013

Six Months Ended	Commercial and		Construction and			Total
	Industrial	Real Estate	Land Development	Consumer	Broker-Dealer	
June 30, 2016						
Balance, beginning of period	\$ 19,845	\$ 18,983	\$ 6,064	\$ 314	\$ 209	\$ 45,415
Provision charged to operations	26,520	5,448	224	16	170	32,378
Loans charged off	(26,783)	(1,298)	—	(89)	(1)	(28,171)
Recoveries on charged off loans	1,138	169	—	84	—	1,391
Balance, end of period	\$ 20,720	\$ 23,302	\$ 6,288	\$ 325	\$ 378	\$ 51,013

The non-covered loan portfolio was distributed by portfolio segment and impairment methodology as shown below (in thousands).

	Commercial and	Real Estate	Construction and	Consumer	Broker-Dealer	Total
June 30, 2017	Industrial		Land Development			
Loans individually evaluated for impairment	\$ 9,718	\$ 10,984	\$ 632	\$ 171	\$ —	\$ 21,505
Loans collectively evaluated for impairment	1,733,467	2,923,537	860,117	42,381	492,859	6,052,361
PCI Loans	7,120	34,678	2,333	214	—	44,345
	\$ 1,750,305	\$ 2,969,199	\$ 863,082	\$ 42,766	\$ 492,859	\$ 6,118,211

	Commercial and	Real Estate	Construction and	Consumer	Broker-Dealer	Total
December 31, 2016	Industrial		Land Development			
Loans individually evaluated for	\$ 4,508	\$ 9,704	\$ 727	\$ 205	\$ —	\$ 15,144

impairment Loans collectively evaluated for impairment	1,683,273	2,768,064	782,656	40,853	502,077	5,776,923
PCI Loans	8,672	38,999	3,467	294	—	51,432
	\$ 1,696,453	\$ 2,816,767	\$ 786,850	\$ 41,352	\$ 502,077	\$ 5,843,499

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The allowance for non-covered loan losses was distributed by portfolio segment and impairment methodology as shown below (in thousands).

June 30, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	\$ 750	\$ 3	\$ 106	\$ —	\$ —	\$ 859
Loans collectively evaluated for impairment	21,018	26,212	7,236	422	471	55,359
PCI Loans	66	2,519	303	102	—	2,990
	\$ 21,834	\$ 28,734	\$ 7,645	\$ 524	\$ 471	\$ 59,208

December 31, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	\$ 115	\$ —	\$ 167	\$ —	\$ —	\$ 282
Loans collectively evaluated for impairment	20,697	23,129	6,458	368	155	50,807
PCI Loans	557	2,107	377	56	—	3,097
	\$ 21,369	\$ 25,236	\$ 7,002	\$ 424	\$ 155	\$ 54,186

6. Covered Assets and Indemnification Asset

The Bank acquired certain assets and assumed certain liabilities of FNB in connection with an FDIC-assisted transaction on September 13, 2013 (the “Bank Closing Date”). As part of the Purchase and Assumption Agreement by and among the FDIC (as receiver of FNB), the Bank and the FDIC (the “P&A Agreement”), the Bank and the FDIC entered into loss-share agreements covering future losses incurred on certain acquired loans and OREO. The Company

refers to acquired commercial and single family residential loan portfolios and OREO that are subject to the loss-share agreements as “covered loans” and “covered OREO”, respectively, and these assets are presented as separate line items in the Company’s consolidated balance sheets. Collectively, covered loans and covered OREO are referred to as “covered assets”. Pursuant to the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets: (i) 80% of net losses on the first \$240.4 million of net losses incurred; (ii) 0% of net losses in excess of \$240.4 million up to and including \$365.7 million of net losses incurred; and (iii) 80% of net losses in excess of \$365.7 million of net losses incurred. Net losses are defined as book value losses plus certain defined expenses incurred in the resolution of assets, less subsequent recoveries. Under the loss-share agreement for commercial assets, the amount of subsequent recoveries that are reimbursable to the FDIC for a particular asset is limited to book value losses and expenses actually billed plus any book value charge-offs incurred prior to the Bank Closing Date. There is no limit on the amount of subsequent recoveries reimbursable to the FDIC under the loss-share agreement for single family residential assets. The loss-share agreements for commercial and single family residential assets are in effect for five years and ten years, respectively, from the Bank Closing Date, and the loss recovery provisions to the FDIC are in effect for eight years and ten years, respectively, from the Bank Closing Date. The asset arising from the loss-share agreements, referred to as the “FDIC Indemnification Asset,” is measured separately from the covered loan portfolio because the agreements are not contractually embedded in the covered loans and are not transferable should the Bank choose to dispose of the covered loans.

In accordance with the loss-share agreements, the Bank may be required to make a “true-up” payment to the FDIC approximately ten years following the Bank Closing Date if its actual net realized losses over the life of the loss-share agreements are less than the FDIC’s initial estimate of losses on covered assets. The “true-up” payment is calculated using a defined formula set forth in the P&A Agreement. At June 30, 2017, the Bank has recorded a related “true-up” payment accrual of \$15.9 million based on the current estimate of aggregate realized losses on covered assets over the life of the loss-share agreements.

Covered Loans and Allowance for Covered Loan Losses

Loans acquired in the FNB Transaction that are subject to a loss-share agreement are referred to as “covered loans” and reported separately in the consolidated balance sheets. Covered loans are reported exclusive of the cash flow reimbursements that may be received from the FDIC.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The Bank's portfolio of acquired covered loans had a fair value of \$1.1 billion as of the Bank Closing Date, with no carryover of any allowance for loan losses. Acquired covered loans were preliminarily segregated between those considered to be PCI loans and those without credit impairment at acquisition.

In connection with the FNB Transaction, the Bank acquired loans both with and without evidence of credit quality deterioration since origination. The Company's accounting policies for acquired covered loans, including covered PCI loans, are consistent with the accounting policies for acquired non-covered loans, as described in Note 5 to the consolidated financial statements. The Company has established under its PCI accounting policy a framework to aggregate certain acquired covered loans into various loan pools based on a minimum of two layers of common risk characteristics for the purpose of determining their respective fair values as of their acquisition dates, and for applying the subsequent recognition and measurement provisions for income accretion and impairment testing.

The following table presents the carrying value of the covered loans summarized by portfolio segment (in thousands).

	June 30, 2017	December 31, 2016
Commercial and industrial	\$ 1,649	\$ 2,697
Real estate	199,845	244,469
Construction and land development	5,742	8,961
	207,236	256,127
Allowance for covered loans	(1,359)	(413)
Total covered loans, net of allowance	\$ 205,877	\$ 255,714

The following table presents the carrying value and the outstanding contractual balance of covered PCI loans (in thousands).

	June 30, 2017	December 31, 2016
Carrying amount	\$ 99,595	\$ 133,754
Outstanding balance	208,689	266,098

Changes in the accretable yield for covered PCI loans were as follows (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Balance, beginning of period	\$ 142,466	\$ 169,133	\$ 143,731	\$ 176,719
Reclassifications from nonaccretable difference, net(1)	11,618	8,810	23,024	18,443
Transfer of loans to covered OREO(2)	(662)	(62)	(780)	(171)
Accretion	(25,115)	(20,277)	(37,668)	(37,387)
Balance, end of period	\$ 128,307	\$ 157,604	\$ 128,307	\$ 157,604

- (1) Reclassifications from nonaccretable difference are primarily due to net increases in expected cash flows in the quarterly recasts, but may also include the reclassification and immediate income recognition of nonaccretable difference due to the favorable resolution of loans accounted for individually. Reclassifications to nonaccretable difference occur when accruing loans are moved to non-accrual and expected cash flows are no longer predictable and the accretable yield is eliminated.
- (2) Transfer of loans to covered OREO is the difference between the value removed from the pool and the expected cash flows for the loan.

The remaining nonaccretable difference for covered PCI loans was \$58.6 million and \$94.5 million at June 30, 2017 and December 31, 2016, respectively. During the three and six months ended June 30, 2017 and 2016, a combination of factors affecting the inputs to the Bank's quarterly recast process led to the reclassifications from nonaccretable difference to accretable yield. These transfers resulted from revised cash flows that reflect better-than-expected performance of the covered PCI loan portfolio as a result of the Bank's strategic decision to dedicate resources to the liquidation of covered loans during the noted periods.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Covered impaired loans include non-accrual loans, TDRs, PCI loans and partially charged-off loans. The amounts shown in the following tables include Pooled Loans, as well as loans accounted for on an individual basis. For Pooled Loans, the recorded investment with allowance and the related allowance consider impairment measured at the pool level.

Covered impaired loans, segregated between those considered to be PCI loans and those without credit impairment at acquisition, are summarized by class in the following tables (in thousands).

June 30, 2017	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	\$ 4,498	\$ —	\$ 412	\$ 412	\$ 28
Unsecured	6,562	—	169	169	10
Real estate:					
Secured by commercial properties	97,991	3,339	27,182	30,521	652
Secured by residential properties	133,871	66,016	23	66,039	5
Construction and land development:					
Residential construction loans	698	—	—	—	—
Commercial construction loans and land development	18,240	1,404	1,050	2,454	626
	261,860	70,759	28,836	99,595	1,321
Non-PCI					
Commercial and industrial:					
Secured	93	96	—	96	—
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	—	—	—	—	—
Secured by residential properties	4,146	3,400	—	3,400	—

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	19	14	—	14	—
	4,258	3,510	—	3,510	—
	\$ 266,118	\$ 74,269	\$ 28,836	\$ 103,105	\$ 1,321

	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
December 31, 2016					
PCI					
Commercial and industrial:					
Secured	\$ 10,579	\$ 1,024	\$ 189	\$ 1,213	\$ 13
Unsecured	3,259	299	—	299	—
Real estate:					
Secured by commercial properties	143,934	26,415	26,222	52,637	271
Secured by residential properties	148,384	73,240	1,161	74,401	60
Construction and land development:					
Residential construction loans	766	—	—	—	—
Commercial construction loans and land development	23,522	5,204	—	5,204	—
	330,444	106,182	27,572	133,754	344
Non-PCI					
Commercial and industrial:					
Secured	52	52	—	52	—
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	396	310	—	310	—
Secured by residential properties	4,175	3,537	—	3,537	—
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	24	20	—	20	—
	4,647	3,919	—	3,919	—
	\$ 335,091	\$ 110,101	\$ 27,572	\$ 137,673	\$ 344

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Average investment in covered impaired loans is summarized by class in the following table (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Commercial and industrial:				
Secured	\$ 644	\$ 4,497	\$ 887	\$ 4,783
Unsecured	171	1,606	234	1,601
Real estate:				
Secured by commercial properties	37,752	87,157	41,734	91,587
Secured by residential properties	71,734	88,493	73,689	92,354
Construction and land development:				
Residential construction loans	—	343	—	331
Commercial construction loans and land development	2,537	12,664	3,846	16,209
	\$ 112,838	\$ 194,760	\$ 120,390	\$ 206,865

Covered non-accrual loans are summarized by class in the following table (in thousands).

	June 30, 2017	December 31, 2016
Commercial and industrial:		
Secured	\$ 96	\$ 52
Unsecured	—	—
Real estate:		
Secured by commercial properties	—	730
Secured by residential properties	2,904	3,035
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	14	19
	\$ 3,014	\$ 3,836

At June 30, 2017, there were no covered PCI loans included within non-accrual loans for which discount accretion has been suspended. At December 31, 2016, covered non-accrual loans included covered PCI loans of \$0.4 million, for which discount accretion has been suspended because the extent and timing of cash flows from these covered PCI

loans can no longer be reasonably estimated.

Interest income, including recoveries and cash payments, recorded on covered impaired loans was \$0.2 million and \$0.3 million during the three and six months ended June 30, 2017, respectively, while interest income recorded on covered impaired loans during the three and six months ended June 30, 2016 was nominal. Except as noted above, covered PCI loans are considered to be performing due to the application of the accretion method.

The Bank classifies loan modifications of covered loans as TDRs in a manner consistent with that of non-covered loans as discussed in Note 5 to the consolidated financial statements. The Bank did not grant any TDRs during the three and six months ended June 30, 2017 and 2016. Pooled Loans are not in the scope of the disclosure requirements for TDRs. At June 30, 2017 and December 31, 2016, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

There were no TDRs granted during the twelve months preceding June 30, 2017 and 2016, respectively, for which a payment was at least 30 days past due.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

An analysis of the aging of the Bank's covered loan portfolio is shown in the following tables (in thousands).

June 30, 2017	Loans Past Due 30 Days	Loans Past Due 60 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non-PCI) Past 90 Days or More
Commercial and industrial:								
Secured	\$ —	\$ —	\$ 96	\$ 96	\$ 972	\$ 412	\$ 1,480	\$ —
Unsecured	—	—	—	—	—	169	169	—
Real estate:								
Secured by commercial properties	—	—	—	—	14,541	30,521	45,062	—
Secured by residential properties	1,600	796	944	3,340	85,404	66,039	154,783	38
Construction and land development:								
Residential construction loans	—	—	—	—	—	—	—	—
Commercial construction loans and land development	—	—	—	—	3,288	2,454	5,742	—
	\$ 1,600	\$ 796	\$ 1,040	\$ 3,436	\$ 104,205	\$ 99,595	\$ 207,236	\$ 38

December 31, 2016	Loans Past Due 30 Days	Loans Past Due 60 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non-PCI) Past 90 Days or More
Commercial and industrial:								
Secured	\$ —	\$ 6	\$ 96	\$ 102	\$ 1,083	\$ 1,213	\$ 2,398	\$ 44
Unsecured	—	—	—	—	—	299	299	—
Real estate:	96	229	—	325	19,132	52,637	72,094	—

Secured by commercial properties								
Secured by residential properties	3,511	1,345	1,479	6,335	91,639	74,401	172,375	129
Construction and land development:								
Residential construction loans	—	—	—	—	—	—	—	—
Commercial construction loans and land development	15	—	—	15	3,742	5,204	8,961	—
	\$ 3,622	\$ 1,580	\$ 1,575	\$ 6,777	\$ 115,596	\$ 133,754	\$ 256,127	\$ 173

The Bank assigns a risk grade to each of its covered loans in a manner consistent with the existing loan review program and risk grading matrix used for non-covered loans, as described in Note 5 to the consolidated financial statements. The following tables present the internal risk grades of covered loans in the portfolio by class (in thousands).

June 30, 2017	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	\$ 507	\$ —	\$ 561	\$ 412	\$ 1,480
Unsecured	—	—	—	169	169
Real estate:					
Secured by commercial properties	13,550	—	991	30,521	45,062
Secured by residential properties	81,821	445	6,478	66,039	154,783
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	2,214	—	1,074	2,454	5,742
	\$ 98,092	\$ 445	\$ 9,104	\$ 99,595	\$ 207,236

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2016	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	\$ 592	\$ —	\$ 593	\$ 1,213	\$ 2,398
Unsecured	—	—	—	299	299
Real estate:					
Secured by commercial properties	17,996	—	1,461	52,637	72,094
Secured by residential properties	90,563	461	6,950	74,401	172,375
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	2,281	—	1,476	5,204	8,961
	\$ 111,432	\$ 461	\$ 10,480	\$ 133,754	\$ 256,127

The Bank's impairment methodology for covered loans is consistent with the methodology for non-covered loans, and is discussed in detail in Notes 5 and 6 to the consolidated financial statements included in the Company's 2016 Form 10-K.

Changes in the allowance for covered loan losses, distributed by portfolio segment, are shown below (in thousands).

Three months ended June 30, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Balance, beginning of period	\$ 16	\$ 736	\$ 1	\$ 753
Provision charged to operations	28	309	623	960
Loans charged off	—	(362)	—	(362)
Recoveries on charged off loans	3	1	4	8
Balance, end of period	\$ 47	\$ 684	\$ 628	\$ 1,359

Six months ended June 30, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Balance, beginning of period	\$ 35	\$ 378	\$ —	\$ 413
Provision charged to operations	12	822	622	1,456
Loans charged off	(6)	(521)	—	(527)
Recoveries on charged off loans	6	5	6	17
Balance, end of period	\$ 47	\$ 684	\$ 628	\$ 1,359

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Three months ended June 30, 2016				
Balance, beginning of period	\$ 438	\$ 742	\$ 37	\$ 1,217
Provision charged to (recapture from) operations	(383)	674	(108)	183
Loans charged off	—	(26)	(30)	(56)
Recoveries on charged off loans	—	10	101	111
Balance, end of period	\$ 55	\$ 1,400	\$ —	\$ 1,455

	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Six months ended June 30, 2016				
Balance, beginning of period	\$ 758	\$ 774	\$ —	\$ 1,532
Provision charged to (recapture from) operations	(697)	651	(49)	(95)
Loans charged off	(6)	(42)	(52)	(100)
Recoveries on charged off loans	—	17	101	118
Balance, end of period	\$ 55	\$ 1,400	\$ —	\$ 1,455

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The covered loan portfolio was distributed by portfolio segment and impairment methodology as shown below (in thousands).

June 30, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	1,068	103,285	3,288	107,641
PCI Loans	581	96,560	2,454	99,595
	\$ 1,649	\$ 199,845	\$ 5,742	\$ 207,236

December 31, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	1,185	117,431	3,757	122,373
PCI Loans	1,512	127,038	5,204	133,754
	\$ 2,697	\$ 244,469	\$ 8,961	\$ 256,127

The allowance for covered loan losses was distributed by portfolio segment and impairment methodology as shown below (in thousands).

June 30, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	9	27	2	38
PCI Loans	38	657	626	1,321
	\$ 47	\$ 684	\$ 628	\$ 1,359

December 31, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	22	47	—	69
PCI Loans	13	331	—	344
	\$ 35	\$ 378	\$ —	\$ 413

Covered Other Real Estate Owned

A summary of the activity in covered OREO is as follows (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Balance, beginning of period	\$ 45,374	\$ 78,890	\$ 51,642	\$ 99,090
Additions to covered OREO	3,404	4,739	5,127	9,281
Dispositions of covered OREO	(5,531)	(14,028)	(12,330)	(29,005)
Valuation adjustments in the period	(943)	(1,967)	(2,135)	(11,732)
Balance, end of period	\$ 42,304	\$ 67,634	\$ 42,304	\$ 67,634

During the three and six months ended June 30, 2017 and 2016, the Bank wrote down certain covered OREO assets to fair value to reflect new appraisals on certain OREO acquired in the FNB Transaction and OREO acquired from the foreclosure on certain FNB loans acquired in the FNB Transaction. Although the Bank recorded a fair value discount on the acquired assets upon acquisition, in some cases additional downward valuations were required.

These additional downward valuation adjustments reflect changes to the assumptions regarding the fair value of the OREO, including in some cases the intended use of the OREO due to the availability of more information, as well as the passage of time. The process of determining fair value is subjective in nature and requires the use of significant estimates and assumptions. Although the Bank makes market-based assumptions when valuing acquired assets, new information may come to light that causes estimates to increase or decrease. When the Bank determines, based on subsequent information, that its estimates require adjustment, the Bank records the adjustment. The accounting for such adjustments

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

requires that the decreases to the initially recorded fair value be recorded at the time such new information is received, while increases to fair value are recorded when the asset is subsequently sold.

FDIC Indemnification Asset

A summary of the activity in the FDIC Indemnification Asset is as follows (in thousands).

	Three Months Ended		Six Months Ended June 30,	
	June 30, 2017	2016	2017	2016
Balance, beginning of period	\$ 47,940	\$ 80,522	\$ 71,313	\$ 91,648
FDIC Indemnification Asset accretion (amortization)	(4,236)	69	(8,185)	156
Transfers to due from FDIC and other	(3,400)	(6,131)	(22,824)	(17,344)
Balance, end of period	\$ 40,304	\$ 74,460	\$ 40,304	\$ 74,460

As of June 30, 2017, the Bank had billed and collected \$143.7 million from the FDIC, which represented reimbursable covered losses and expenses through March 31, 2017.

7. Mortgage Servicing Rights

The following tables present the changes in fair value of the Company's MSR asset, as included in other assets within the consolidated balance sheets, and other information related to the serviced portfolio (dollars in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Balance, beginning of period	\$ 45,573	\$ 39,863	\$ 61,968	\$ 52,285
Additions	1,266	8,254	2,490	9,893

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Sales	—	(7,586)	(17,499)	(7,586)
Changes in fair value:				
Due to changes in model inputs or assumptions (1)	(2,064)	(5,494)	(1,207)	(18,336)
Due to customer payoffs	(1,195)	(1,546)	(2,172)	(2,765)
Balance, end of period	\$ 43,580	\$ 33,491	\$ 43,580	\$ 33,491

	June 30, 2017	December 31, 2016
Mortgage loans serviced for others	\$ 3,761,484	\$ 5,480,943
MSR asset as a percentage of serviced mortgage loans	1.16 %	1.13 %

(1) Primarily represents normal customer payments, changes in discount rates and prepayment speed assumptions, which are primarily affected by changes in interest rates and the refinement of other MSR model assumptions.

The key assumptions used in measuring the fair value of the Company's MSR asset were as follows.

	June 30, 2017	December 31, 2016
Weighted average constant prepayment rate	10.92 %	10.47 %
Weighted average discount rate	11.14 %	10.95 %
Weighted average life (in years)	6.8	6.9

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

A sensitivity analysis of the fair value of the Company's MSR asset to certain key assumptions is presented in the following table (in thousands).

	June 30, 2017	December 31, 2016
Constant prepayment rate:		
Impact of 10% adverse change	\$ (1,648)	\$ (2,297)
Impact of 20% adverse change	(3,222)	(4,471)
Discount rate:		
Impact of 10% adverse change	(1,701)	(2,539)
Impact of 20% adverse change	(3,269)	(4,882)

This sensitivity analysis presents the effect of hypothetical changes in key assumptions on the fair value of the MSR asset. The effect of such hypothetical change in assumptions generally cannot be extrapolated because the relationship of the change in one key assumption to the change in the fair value of the MSR asset is not linear. In addition, in the analysis, the impact of an adverse change in one key assumption is calculated independent of any impact on other assumptions. In reality, changes in one assumption may change another assumption.

Contractually specified servicing fees, late fees and ancillary fees earned of \$5.0 million and \$5.7 million during the three months ended June 30, 2017 and 2016, respectively, and \$11.5 million and \$11.7 million during the six months ended June 30, 2017 and 2016, respectively, were included in other noninterest income within the consolidated statements of operations.

8. Deposits

Deposits are summarized as follows (in thousands).

June 30, 2017	December 31, 2016
------------------	----------------------

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Noninterest-bearing demand	\$ 2,251,208	\$ 2,199,483
Interest-bearing:		
NOW accounts	1,049,901	1,252,832
Money market	2,156,458	1,626,218
Brokered - money market	125,601	125,272
Demand	394,313	384,847
Savings	226,108	279,911
Time	1,216,037	1,145,859
Brokered - time	154,996	49,389
	\$ 7,574,622	\$ 7,063,811

9. Short-term Borrowings

Short-term borrowings are summarized as follows (in thousands).

	June 30, 2017	December 31, 2016
Federal funds purchased	\$ 97,475	\$ 87,125
Securities sold under agreements to repurchase	416,594	195,164
Federal Home Loan Bank	800,000	1,000,000
Short-term bank loans	201,000	135,000
	\$ 1,515,069	\$ 1,417,289

Federal funds purchased and securities sold under agreements to repurchase generally mature daily, on demand, or on some other short-term basis. The Bank and the Hilltop Broker-Dealers execute transactions to sell securities under

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

agreements to repurchase with both customers and other broker-dealers. Securities involved in these transactions are held by the Bank, the Hilltop Broker-Dealers or a third-party dealer.

Information concerning federal funds purchased and securities sold under agreements to repurchase is shown in the following tables (dollars in thousands).

	Six Months Ended June 30,			
	2017		2016	
Average balance during the period	\$	500,830	\$	363,665
Average interest rate during the period		0.86	%	0.53 %
	June 30,		December	
	2017		31,	
Average interest rate at end of period		0.83	%	0.42 %
Securities underlying the agreements at end of period:				
Carrying value	\$	420,387	\$	209,877
Estimated fair value	\$	431,891	\$	206,641

Federal Home Loan Bank (“FHLB”) short-term borrowings mature over terms not exceeding 365 days and are collateralized by FHLB Dallas stock, nonspecified real estate loans and certain specific commercial real estate loans. Other information regarding FHLB short-term borrowings is shown in the following tables (dollars in thousands).

	Six Months Ended June 30,			
	2017		2016	
Average balance during the period	\$	355,249	\$	231,456
Average interest rate during the period		0.92	%	0.46 %
	June 30,		December	
	2017		31,	
Average interest rate at end of period		1.20	%	0.55 %

The Hilltop Broker-Dealers use short-term bank loans periodically to finance securities owned, margin loans to customers and correspondents, and underwriting activities. Interest on the borrowings varies with the federal funds rate. The weighted average interest rate on the borrowings at June 30, 2017 and December 31, 2016 was 2.07% and 1.59%, respectively.

10. Notes Payable

Notes payable consisted of the following (in thousands).

	June 30, 2017	December 31, 2016
Senior Notes due April 2025, net of discount of \$1,618 and \$1,689, respectively	\$ 148,382	\$ 148,311
FHLB notes, net of premium of \$506 and \$627, respectively, with maturities ranging from October 2017 to June 2030	99,802	102,596
Insurance company note payable due March 2035, paid off in June 2017	—	20,000
NLIC note payable due May 2033	10,000	10,000
NLIC note payable due September 2033	10,000	10,000
ASIC note payable due April 2034	7,500	7,500
Insurance company line of credit due December 31, 2017	3,000	3,000
Ventures line of credit due January 2018	18,073	16,505
Mutual line of credit due October 2017	3,526	—
	\$ 300,283	\$ 317,912

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

11. Income Taxes

The Company applies an estimated annual effective rate to interim period pre-tax income to calculate the income tax provision for the quarter in accordance with the principal method prescribed by the accounting guidance established for computing income taxes in interim periods. The Company's effective tax rate was 29.1% and 36.8% during the three months ended June 30, 2017 and 2016, respectively, and 31.4% and 35.4% during the six months ended June 30, 2017 and 2016, respectively. The effective tax rates during the three and six months ended June 30, 2017 were lower than the statutory rate primarily due to a nontaxable increase to other noninterest income recorded as a part of the resolution of the SWS matter as discussed in Note 12 to the consolidated financial statements, as the SWS Merger was a tax-free reorganization under Section 368(a) of the Internal Revenue Code. The effective tax rates during the three and six months ended June 30, 2016 were slightly lower than the statutory rate primarily due to the recognition of excess tax benefits on share-based payment awards.

12. Commitments and Contingencies

Legal Matters

The Company is subject to loss contingencies related to litigation, claims, investigations and legal and administrative cases and proceedings arising in the ordinary course of business. The Company evaluates these contingencies based on information currently available, including advice of counsel. The Company establishes accruals for those matters when a loss contingency is considered probable and the related amount is reasonably estimable. Any accruals are periodically reviewed and may be adjusted as circumstances change. A portion of the Company's exposure with respect to loss contingencies may be offset by applicable insurance coverage. In determining the amounts of any accruals or estimates of possible loss contingencies, the Company does not take into account the availability of insurance coverage, other than that provided by reinsurers in the insurance segment.

Assessments of litigation and claims exposures are difficult due to many factors that involve inherent unpredictability. Those factors include the following: the varying stages of the proceedings, particularly in the early stages; unspecified, unsupported, or uncertain damages; damages other than compensatory, such as punitive damages; a matter presenting meaningful legal uncertainties, including novel issues of law; multiple defendants and jurisdictions; whether discovery has begun or is complete; whether meaningful settlement discussions have commenced; and

whether the claim involves a class action and if so, how the class is defined. As a result of some of these factors, the Company may be unable to estimate reasonably possible losses with respect to some or all of the pending and threatened litigation and claims asserted against the Company.

Following completion of Hilltop's acquisition of SWS, several purported holders of shares of SWS common stock (the "Petitioners") filed petitions in the Court of Chancery of the State of Delaware (the "Court") seeking appraisal for their shares pursuant to Section 262 of the Delaware General Corporation Law. These petitions were consolidated as *In re SWS Group, Inc.*, C.A. No. 10554-VCG. On May 30, 2017, the Court issued its Memorandum Opinion in the matter. The Court found the "fair value" of the shares of SWS common stock as of the date of the transaction was \$6.38 per share. Accordingly, Hilltop paid cash of \$6.38 per share, plus statutory interest from the effective date of the merger until the date of payment, to the Petitioners and the other stockholders of SWS who properly demanded appraisal rights under Delaware law, collectively representing 7,438,453 shares. Each outstanding share of SWS common stock, other than shares held by Hilltop, in treasury by SWS or by stockholders who properly demanded appraisal rights under Delaware law, was converted into the right to receive 0.2496 shares of Hilltop common stock and \$1.94 in cash, the aggregate value of which was \$6.92 per share of SWS common stock as of the effective date of the merger. The resolution of this matter resulted in 1,856,638 shares of HTH common stock, which had been held in escrow during the pendency of the proceeding, being returned to the Company's pool of authorized but unissued shares of common stock and a pre-tax net increase to other noninterest income of \$11.6 million during the second quarter of 2017. This change in common stock is reflected in repurchases of common stock within the consolidated statements of stockholders' equity. On July 20, 2017, certain Petitioners filed a notice to appeal the Court's Memorandum Opinion. The Company intends to vigorously defend this matter.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The Company is involved in information-gathering requests and investigations (both formal and informal), as well as reviews, examinations and proceedings (collectively, "Inquiries") by various governmental regulatory agencies, law enforcement authorities and self-regulatory bodies regarding certain of its businesses, business practices and policies, as well as the conduct of persons with whom it does business. Additional Inquiries will arise from time to time. In connection with those Inquiries, the Company receives document requests, subpoenas and other requests for information. The Inquiries, including the Inquiry described below, could develop into administrative, civil or criminal proceedings or enforcement actions that could result in consequences that have a material effect on the Company's consolidated financial position, results of operations or cash flows as a whole. Such consequences could include adverse judgments, findings, settlements, penalties, fines, orders, injunctions, restitution, or alterations in the Company's business practices, and could result in additional expenses and collateral costs, including reputational damage.

As a part of an industry-wide Inquiry, PrimeLending received a subpoena from the Office of Inspector General of the U.S. Department of Housing and Urban Development regarding mortgage-related practices, including those relating to origination practices for loans insured by the Federal Housing Administration (the "FHA"). On August 20, 2014, PrimeLending received a Civil Investigative Demand from the United States Department of Justice (the "DOJ") related to this Inquiry. According to the Civil Investigative Demand, the DOJ is conducting an investigation to determine whether PrimeLending has violated the False Claims Act in connection with originating and underwriting single-family residential mortgage loans insured by the FHA. The DOJ has advised PrimeLending that, based upon its review of a sample of loans for which an FHA insurance claim was paid by the U.S. Department of Housing and Urban Development ("HUD"), some of the loans do not meet FHA underwriting guidelines. PrimeLending, based upon its own review of the loan sample, does not agree with the sampling methodology and loan analysis employed by the DOJ. Remedies in these proceedings or settlements may include statutory damages, indemnification, fines and/or penalties. Many institutions have settled these matters on terms that included large monetary penalties. PrimeLending has fully cooperated with this Inquiry, continues to discuss this matter with the DOJ and adjusts its indemnification reserve based upon such discussions.

While the final outcome of litigation and claims exposures or of any Inquiries is inherently unpredictable, management is currently of the opinion that the outcome of pending and threatened litigation and Inquiries will not, except related to specific matters disclosed above, have a material effect on the Company's business, consolidated financial position, results of operations or cash flows as a whole. However, in the event of unexpected future developments, it is reasonably possible that an adverse outcome in any matter, including the matters discussed above, could be material to the Company's business, consolidated financial position, results of operations or cash flows for any particular reporting period of occurrence.

Indemnification Liability Reserve

The mortgage origination segment may be responsible to agencies, investors, or other parties for errors or omissions relating to its representations and warranties that each loan sold meets certain requirements, including representations as to underwriting standards and the validity of certain borrower representations in connection with the loan. If determined to be at fault, the mortgage origination segment either repurchases the affected loan from or indemnifies the claimant against loss. The mortgage origination segment has established an indemnification liability reserve for such probable losses.

Generally, the mortgage origination segment first becomes aware that an agency, investor, or other party believes a loss has been incurred on a sold loan when it receives a written request from the claimant to repurchase the loan or reimburse the claimant's losses. Upon completing its review of the claimant's request, the mortgage origination segment establishes a specific claims reserve for the loan if it concludes its obligation to the claimant is both probable and reasonably estimable.

An additional reserve has been established for probable agency, investor or other party losses that may have been incurred, but not yet reported to the mortgage origination segment based upon a reasonable estimate of such losses. Factors considered in the calculation of this reserve include, but are not limited to, the total volume of loans sold exclusive of specific claimant requests, actual claim settlements and the severity of estimated losses resulting from future

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

claims, and the mortgage origination segment's history of successfully curing defects identified in claim requests. While the mortgage origination segment's sales contracts typically include borrower early payment default repurchase provisions, these provisions have not been a primary driver of claims to date, and therefore, are not a primary factor considered in the calculation of this reserve.

At June 30, 2017 and December 31, 2016, the mortgage origination segment's indemnification liability reserve totaled \$22.4 million and \$18.2 million, respectively. The provision for indemnification losses was \$1.1 million and \$1.2 million during the three months ended June 30, 2017 and 2016, respectively, and \$2.0 million and \$2.1 million during the six months ended June 30, 2017 and 2016, respectively.

The following tables provide for a rollforward of claims activity for loans put-back to the mortgage origination segment based upon an alleged breach of a representation or warranty with respect to a loan sold and related indemnification liability reserve activity (in thousands).

Representation and Warranty Specific Claims
Activity - Origination Loan Balance

Three Months Ended

	June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Balance, beginning of period	\$ 39,245	\$ 54,202	\$ 40,669	\$ 57,298
Claims made	8,650	5,006	17,029	9,554
Claims resolved with no payment	(9,991)	(4,502)	(18,088)	(10,617)
Repurchases	(226)	(714)	(1,688)	(1,871)
Indemnification payments	(5,124)	(116)	(5,368)	(488)
Balance, end of period	\$ 32,554	\$ 53,876	\$ 32,554	\$ 53,876

Indemnification Liability Reserve Activity

Three Months Ended

	June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Balance, beginning of period	\$ 18,952	\$ 17,147	\$ 18,239	\$ 16,640
Additions for new sales	1,145	1,245	1,992	2,123
Repurchases	(23)	(70)	(125)	(182)
Early payment defaults	(60)	(43)	(129)	(133)
Indemnification payments	(671)	(63)	(713)	(232)
Change in reserves for loans sold in prior years	3,024	—	3,103	—

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Balance, end of period	\$ 22,367	\$ 18,216	\$ 22,367	\$ 18,216
			December	
	June 30,	31,		
	2017	2016		
Reserve for Indemnification Liability:				
Specific claims	\$ 1,039	\$ 1,661		
Incurred but not reported claims	21,328	16,578		
Total	\$ 22,367	\$ 18,239		

Although management considers the total indemnification liability reserve to be appropriate, there may be changes in the reserve over time to address incurred losses, due to unanticipated adverse changes in the economy and historical loss patterns, discrete events adversely affecting specific borrowers or industries, and/or actions taken by institutions or investors. The impact of such matters is considered in the reserving process when probable and estimable.

Other Contingencies

In connection with the FNB Transaction, the Bank entered into two loss-share agreements with the FDIC that collectively cover \$1.2 billion of loans and OREO acquired in the FNB Transaction. Pursuant to the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets:

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

(i) 80% of net losses on the first \$240.4 million of net losses incurred; (ii) 0% of net losses in excess of \$240.4 million up to and including \$365.7 million of net losses incurred; and (iii) 80% of net losses in excess of \$365.7 million of net losses incurred. Net losses are defined as book value losses plus certain defined expenses incurred in the resolution of assets, less subsequent recoveries. Under the loss-share agreement for commercial assets, the amount of subsequent recoveries that are reimbursable to the FDIC for a particular asset is limited to book value losses and expenses actually billed plus any book value charge-offs incurred prior to the Bank Closing Date. There is no limit on the amount of subsequent recoveries reimbursable to the FDIC under the loss-share agreement for single family residential assets. The loss-share agreements for commercial and single family residential assets are in effect for five years and ten years, respectively, from the Bank Closing Date and the loss recovery provisions to the FDIC are in effect for eight years and ten years, respectively, from the Bank Closing Date. As part of the loss-share agreements, the Bank is subject to annual FDIC compliance audits. As discussed in Note 6 to the consolidated financial statements, and in accordance with the loss-share agreements, the Bank may be required to make a “true-up” payment to the FDIC approximately ten years following the Bank Closing Date if its actual net realized losses over the life of the loss-share agreements are less than the FDIC’s initial estimate of losses on covered assets. The “true-up” payment is calculated using a defined formula set forth in the P&A Agreement. While the ultimate amount of any “true-up” payment is unknown at this time and will vary based upon the amount of future losses or recoveries within our covered loan portfolio, the Bank has recorded a related “true-up” payment accrual of \$15.9 million at June 30, 2017 based on the current estimate of aggregate realized losses on covered assets over the life of the loss-share agreements. The initial estimate of the FDIC Indemnification Asset at the Bank Closing Date was recorded at the present value of 80% of \$240.4 million. As of June 30, 2017, the Bank projects that the sum of actual plus projected covered losses and reimbursable expenses subject to the loss-share agreements will be less than \$240.4 million. As of June 30, 2017, the Bank had billed \$179.6 million of covered net losses to the FDIC, of which 80%, or \$143.7 million, were reimbursable under the loss-share agreements. As of June 30, 2017, the Bank had received aggregate reimbursements of \$143.7 million from the FDIC, which represented reimbursable covered losses and expenses through March 31, 2017.

13. Financial Instruments with Off-Balance Sheet Risk

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit that involve varying degrees of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received. The contract amounts of those instruments reflect the extent of involvement (and therefore the exposure to credit loss) the Bank has in particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require payment of fees. Because some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers.

In the aggregate, the Bank had outstanding unused commitments to extend credit of \$2.0 billion at June 30, 2017 and outstanding financial and performance standby letters of credit of \$33.9 million at June 30, 2017.

The Bank uses the same credit policies in making commitments and standby letters of credit as it does for on-balance sheet instruments. The amount of collateral obtained, if deemed necessary, in these transactions is based on management's credit evaluation of the borrower. Collateral held varies but may include real estate, accounts receivable, marketable securities, interest-bearing deposit accounts, inventory, and property, plant and equipment.

In the normal course of business, the Hilltop Broker-Dealers execute, settle, and finance various securities transactions that may expose the Hilltop Broker-Dealers to off-balance sheet risk in the event that a customer or counterparty does not fulfill its contractual obligations. Examples of such transactions include the sale of securities not yet purchased by

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

customers or for the accounts of the Hilltop Broker-Dealers, use of derivatives to support certain non-profit housing organization clients, clearing agreements between the Hilltop Broker-Dealers and various clearinghouses and broker-dealers, secured financing arrangements that involve pledged securities, and when-issued underwriting and purchase commitments.

14. Stock-Based Compensation

Pursuant to the Hilltop Holdings Inc. 2012 Equity Incentive Plan (the “2012 Plan”), the Company may grant nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units (“RSUs”), performance awards, dividend equivalent rights and other awards to employees of the Company, its subsidiaries and outside directors of the Company. In the aggregate, 4,000,000 shares of common stock may be delivered pursuant to awards granted under the 2012 Plan. At June 30, 2017, 1,578,148 shares of common stock remained available for issuance pursuant to the 2012 Plan, including shares that may be delivered pursuant to outstanding awards. Compensation expense related to the 2012 Plan was \$3.2 million and \$2.7 million during the three months ended June 30, 2017 and 2016, respectively, and \$5.9 million and \$5.0 million during the six months ended June 30, 2017 and 2016, respectively.

During the six months ended June 30, 2017 and 2016, Hilltop granted 7,513 and 11,343 shares of common stock, respectively, pursuant to the 2012 Plan to certain non-employee members of the Company’s Board of Directors for services rendered to the Company.

Restricted Stock Awards and RSUs

The following table summarizes information about nonvested Restricted Stock Award and RSU activity for the six months ended June 30, 2017 (shares in thousands).

Restricted Stock Awards	RSUs
Weighted Average	Weighted Average

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

	Outstanding	Grant Date Fair Value	Outstanding	Grant Date Fair Value
Balance, December 31, 2016	4	\$ 19.95	1,456	\$ 19.83
Granted	-	\$ -	429	\$ 27.11
Vested/Released	-	\$ -	(315)	\$ 23.63
Forfeited	-	\$ -	(50)	\$ 23.56
Balance, June 30, 2017	4	\$ 19.95	1,520	\$ 20.97

Vested/Released Restricted Stock Awards and RSUs include an aggregate of 76,986 shares withheld to satisfy employee statutory tax obligations during the six months ended June 30, 2017. Pursuant to certain RSU award agreements, an aggregate of 1,000 vested RSUs at June 30, 2017 require deferral of the settlement in shares and statutory tax obligations to a future date.

At June 30, 2017, unrecognized compensation expense related to outstanding Restricted Stock Awards of \$9 thousand is expected to be recognized over a weighted average period of 0.14 years.

During the six months ended June 30, 2017, the Compensation Committee of the Board of Directors of the Company awarded certain executives and key employees an aggregate of 411,922 RSUs pursuant to the 2012 Plan. At June 30, 2017, 321,326 of these outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 89,439 of these outstanding RSUs will cliff vest based upon the achievement of certain performance goals over a three-year period.

At June 30, 2017, in the aggregate, 1,215,974 of the outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 303,800 outstanding RSUs cliff vest based upon the achievement of certain performance goals over a three-year period. At June 30, 2017, unrecognized compensation expense related to outstanding RSUs of \$19.3 million is expected to be recognized over a weighted average period of 1.65 years.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

15. Regulatory Matters

Banking and Hilltop

PlainsCapital and Hilltop are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory — and possibly additional discretionary — actions by regulators that, if undertaken, could have a direct, material effect on the consolidated financial statements. The regulations require PlainsCapital and Hilltop to meet specific capital adequacy guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company performs reviews of the classification and calculation of risk-weighted assets to ensure accuracy and compliance with the Basel III regulatory capital requirements. The capital classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Quantitative measures established by regulation to ensure capital adequacy require the companies to maintain minimum amounts and ratios (set forth in the following table) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of common equity Tier 1, Tier 1 and total capital (as defined) to risk-weighted assets (as defined).

In order to avoid limitations on capital distributions, including dividend payments, stock repurchases and certain discretionary bonus payments to executive officers, Basel III also implemented a capital conservation buffer, which requires a banking organization to hold a buffer above its minimum risk-based capital requirements. This buffer will help to ensure that banking organizations conserve capital when it is most needed, allowing them to better weather periods of economic stress. The buffer is measured relative to risk-weighted assets. The phase-in of the capital conservation buffer requirements began on January 1, 2016 for Hilltop and the Bank. Based on the actual ratios as shown in the table below, Hilltop and the Bank exceed each of the capital conservation buffer requirements in effect as of June 30, 2017, as well as the fully phased-in requirements through 2019.

The following table shows PlainsCapital's and Hilltop's actual capital amounts and ratios in accordance with Basel III compared to the regulatory minimum capital requirements including conservation buffer in effect at the end of the period and on a fully phased-in basis as if such requirements were currently in effect as measured at June 30, 2017 and December 31, 2016, respectively (dollars in thousands). Based on actual capital amounts and ratios shown in the following table, PlainsCapital's ratios place it in the "well capitalized" (as defined) capital category under regulatory requirements.

	Actual Amount	Ratio	Minimum Capital Requirements Including Conservation Buffer In Effect at End of Period Ratio	Fully Phased In Ratio	To Be Well Capitalized Ratio
June 30, 2017					
Tier 1 capital (to average assets):					
PlainsCapital	\$ 1,118,299	12.11 %	4.0	% 4.0	% 5.0
Hilltop	1,666,286	13.07 %	4.0	% 4.0	% N/A
Common equity Tier 1 capital (to risk-weighted assets):					
PlainsCapital	1,118,299	13.95 %	5.75	% 7.0	% 6.5
Hilltop	1,616,937	17.53 %	5.75	% 7.0	% N/A
Tier 1 capital (to risk-weighted assets):					
PlainsCapital	1,118,299	13.95 %	7.25	% 8.5	% 8.0
Hilltop	1,666,286	18.07 %	7.25	% 8.5	% N/A
Total capital (to risk-weighted assets):					
PlainsCapital	1,180,356	14.72 %	9.25	% 10.5	% 10.0
Hilltop	1,713,164	18.57 %	9.25	% 10.5	% N/A

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	Actual Amount	Ratio	Minimum Capital Requirements Including Conservation Buffer In Effect at End of Period Ratio	Fully Phased In Ratio	To Be Well Capitalized Ratio
December 31, 2016					
Tier 1 capital (to average assets):					
PlainsCapital	\$ 1,108,484	12.35 %	4.0	% 4.0	% 5.0
Hilltop	1,652,101	13.51 %	4.0	% 4.0	% N/A
Common equity Tier 1 capital (to risk-weighted assets):					
PlainsCapital	1,108,484	14.64 %	5.125	% 7.0	% 6.5
Hilltop	1,602,400	18.30 %	5.125	% 7.0	% N/A
Tier 1 capital (to risk-weighted assets):					
PlainsCapital	1,108,484	14.64 %	6.625	% 8.5	% 8.0
Hilltop	1,652,101	18.87 %	6.625	% 8.5	% N/A
Total capital (to risk-weighted assets):					
PlainsCapital	1,164,767	15.38 %	8.625	% 10.5	% 10.0
Hilltop	1,693,240	19.34 %	8.625	% 10.5	% N/A

Broker-Dealer

Pursuant to the net capital requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), Hilltop Securities has elected to determine its net capital requirements using the alternative method. Accordingly, Hilltop Securities is required to maintain minimum net capital, as defined in Rule 15c3-1 promulgated under the Exchange Act, equal to the greater of \$250,000 and \$1,000,000, respectively, or 2% of aggregate debit balances, as defined in Rule 15c3-3 promulgated under the Exchange Act. Additionally, the net capital rule of the NYSE provides that equity capital may not be withdrawn or cash dividends paid if resulting net capital would be less than 5% of the aggregate debit items. HTS Independent Network follows the primary (aggregate indebtedness) method, as defined in Rule 15c3-1 promulgated under the Exchange Act, which requires the maintenance of the larger of minimum net capital of \$250,000 or 1/15 of aggregate indebtedness.

At June 30, 2017, the net capital position of each of the Hilltop Broker-Dealers was as follows (in thousands).

	Hilltop Securities	HTS Independent Network
Net capital	\$ 168,071	\$ 3,302
Less: required net capital	10,287	250
Excess net capital	\$ 157,784	\$ 3,052
Net capital as a percentage of aggregate debit items	32.7	%
Net capital in excess of 5% aggregate debit items	\$ 142,354	

Under certain conditions, Hilltop Securities may be required to segregate cash and securities in a special reserve account for the benefit of customers under Rule 15c3-3 promulgated under the Exchange Act. Assets segregated under the provisions of the Exchange Act are not available for general corporate purposes. At June 30, 2017 and December 31, 2016, Hilltop Securities held cash of \$167.6 million and \$181.0 million, respectively, segregated in special reserve bank accounts for the benefit of customers. Hilltop Securities was not required to segregate cash and securities in special reserve accounts for the benefit of proprietary accounts of introducing broker-dealers at June 30, 2017 and December 31, 2016. The fair values of any segregated assets included in special reserve accounts were determined using Level 1 inputs.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Mortgage Origination

As a mortgage originator, PrimeLending and its subsidiaries are subject to minimum net worth and liquidity requirements established by the HUD and the GNMA, as applicable. On an annual basis, PrimeLending and its subsidiaries submit audited financial statements to HUD and GNMA, as applicable, documenting their respective compliance with its minimum net worth and liquidity requirements. As of June 30, 2017, PrimeLending and its subsidiaries' net worth and liquidity exceeded the amounts required by both HUD and GNMA, as applicable.

Insurance

The statutory financial statements of the Company's insurance subsidiaries, which are domiciled in the State of Texas, are presented on the basis of accounting practices prescribed or permitted by the Texas Department of Insurance. Texas has adopted the statutory accounting practices of the National Association of Insurance Commissioners ("NAIC") as the basis of its statutory accounting practices with certain differences that are not significant to the insurance company subsidiaries' statutory equity.

A summary of statutory capital and surplus and statutory net income (loss) of each insurance subsidiary is as follows (in thousands).

	June 30, 2017	December 31, 2016
Capital and surplus:		
National Lloyds Insurance Company	\$ 91,179	\$ 131,328
American Summit Insurance Company	23,139	30,462

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Statutory net income (loss):				

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

National Lloyds Insurance Company	\$ (7,152)	\$ (7,196)	\$ (6,516)	\$ (3,639)
American Summit Insurance Company	(309)	234	523	1,086

Regulations of the Texas Department of Insurance require insurance companies to maintain minimum levels of statutory surplus to ensure their ability to meet their obligations to policyholders. At June 30, 2017, the Company's insurance subsidiaries had statutory surplus in excess of the minimum required.

The NAIC has adopted a risk based capital ("RBC") formula for insurance companies that establishes minimum capital requirements indicating various levels of available regulatory action on an annual basis relating to insurance risk, asset credit risk, interest rate risk and business risk. The RBC formula is used by the NAIC and certain state insurance regulators as an early warning tool to identify companies that require additional scrutiny or regulatory action. At June 30, 2017, the Company's insurance subsidiaries' RBC ratio exceeded the level at which regulatory action would be required.

16. Stockholders' Equity

Dividend Declaration

On July 27, 2017, the Company announced that its board of directors declared a quarterly cash dividend of \$0.06 per common share, payable on August 31, 2017, to all common stockholders of record as of the close of business on August 15, 2017.

Stock Repurchase Program

The Company's board of directors reauthorized the stock repurchase program originally approved during the second quarter of 2016 through January 2018, under which the Company may repurchase, in the aggregate, up to \$50.0 million

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

of its outstanding common stock. Under the stock repurchase program, the Company may repurchase shares in open-market purchases or through privately negotiated transactions as permitted under Rule 10b-18 promulgated under the Exchange Act. The extent to which the Company repurchases its shares and the timing of such repurchases depends upon market conditions and other corporate considerations, as determined by Hilltop's management team. During the six months ended June 30, 2017, the Company paid \$16.0 million to repurchase an aggregate of 605,431 shares of common stock at an average price of \$26.42 per share. These shares were returned to the Company's pool of authorized but unissued shares of common stock. The purchases were funded from available cash balances. The Company's accounting treatment and policy regarding stock repurchases is discussed in detail in Note 1 to the consolidated financial statements included in the Company's 2016 Form 10-K.

17. Derivative Financial Instruments

The Company uses various derivative financial instruments to mitigate interest rate risk. The Bank's interest rate risk management strategy involves effectively managing the re-pricing characteristics of certain assets and liabilities to mitigate potential adverse impacts from changes in interest rates on the net interest margin. PrimeLending has interest rate risk relative to interest rate lock commitments ("IRLCs") and its inventory of mortgage loans held for sale. PrimeLending is exposed to such interest rate risk from the time an IRLC is made to an applicant to the time the related mortgage loan is sold. To mitigate interest rate risk, PrimeLending executes forward commitments to sell mortgage-backed securities ("MBSs"). Additionally, PrimeLending has interest rate risk relative to its MSR asset and uses derivative instruments, including interest rate swaps, swaptions, and U.S. Treasury bond futures and options to hedge this risk. The Hilltop Broker-Dealers use forward commitments to both purchase and sell MBSs to facilitate customer transactions and as a means to hedge related exposure to interest rate risk in certain inventory positions.

Non-Hedging Derivative Instruments and the Fair Value Option

As discussed in Note 3 to the consolidated financial statements, the Company has elected to measure substantially all mortgage loans held for sale at fair value under the provisions of the Fair Value Option. The election provides the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without applying complex hedge accounting provisions. The fair values of PrimeLending's IRLCs, forward commitments, interest rate swaps and swaptions, and U.S. Treasury bond futures and options are recorded in other assets or other liabilities, as appropriate, and changes in the fair values of these derivative instruments are recorded as a component of net gains from sale of loans and other mortgage production income. The fair value of PrimeLending's derivative instruments increased \$8.8 million during the three months ended June 30, 2017, compared with a decrease of \$0.7 million during the three months ended June 30, 2016, while the fair values of PrimeLending's derivatives increased \$9.5 million and \$11.8 million during the six months ended June 30, 2017 and 2016, respectively. Changes

in fair value are attributable to changes in the volume of IRLCs, mortgage loans held for sale, commitments to purchase and sell MBSs and MSR assets, and changes in market interest rates. Changes in market interest rates also conversely affect the value of PrimeLending's mortgage loans held for sale and its MSR asset, which are measured at fair value under the Fair Value Option. The effect of the change in market interest rates on PrimeLending's loans held for sale and MSR asset is discussed in Note 3 to the consolidated financial statements. The fair values of the Hilltop Broker-Dealers' and the Bank's derivative instruments are recorded in other assets or other liabilities, as appropriate. The fair values of the Hilltop Broker-Dealers' derivatives increased \$9.9 million and \$2.6 million during the three months ended June 30, 2017 and 2016, respectively, while the fair values of the Bank's derivatives increased \$15 thousand during the three months ended June 30, 2017, compared with a decrease of \$0.1 million during the three months ended June 30, 2016. The fair values of the Hilltop Broker-Dealers' derivatives increased \$16.2 million and \$9.5 million during the six months ended June 30, 2017 and 2016, respectively, while the fair values of the Bank's derivatives increased \$0.1 million during the six months ended June 30, 2017, compared with a decrease of \$0.6 million during the six months ended June 30, 2016. The changes in fair value were recorded as a component of other noninterest income.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Derivative positions are presented in the following table (in thousands).

	June 30, 2017		December 31, 2016	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Derivative instruments:				
IRLCs	\$ 1,506,302	\$ 33,945	\$ 944,550	\$ 23,269
Customer-based written options	7,355	45	—	—
Customer-based purchased options	7,355	(45)	—	—
Commitments to purchase MBSs	3,907,444	5,400	3,616,922	(1,155)
Commitments to sell MBSs	6,580,127	12,881	5,609,250	(532)
Interest rate swaps and swaptions	32,032	(144)	32,452	(283)
U.S. Treasury bond futures and options (1)	187,000	—	297,000	—

(1) Changes in the fair value of these contracts are settled daily with PrimeLending's counterparty.

PrimeLending had cash collateral advances totaling \$3.7 million to offset net liability derivative positions on its commitments to sell MBSs at June 30, 2017, compared to a payable of \$19.1 million on its net liability derivative position on its commitments to sell MBSs at December 31, 2016. In addition, PrimeLending advanced cash collateral totaling \$3.2 million on its U.S. Treasury bond futures and options at both June 30, 2017 and December 31, 2016. These amounts are included in other assets within the consolidated balance sheets.

18. Balance Sheet Offsetting

Certain financial instruments, including resale and repurchase agreements, securities lending arrangements and derivatives, may be eligible for offset in the consolidated balance sheets and/or subject to master netting arrangements or similar agreements. The following tables present the assets and liabilities subject to enforceable master netting arrangements, repurchase agreements, or similar agreements with offsetting rights (in thousands).

Net Amounts	Gross Amounts Not Offset in the Balance Sheet
-------------	--

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

	Gross Amounts of Recognized Assets	Gross Amounts of Assets Offset in the Balance Sheet	Presented in the Balance Sheet	Financial Instruments	Cash Collateral Net Pledged	Amount
June 30, 2017						
Securities borrowed: Institutional counterparties	\$ 1,459,990	\$ —	\$ 1,459,990	\$ (1,409,709)	\$ —	\$ 50,281
Interest rate options: Customer counterparties	45	—	45	—	—	45
Reverse repurchase agreements: Institutional counterparties	125,188	—	125,188	(124,426)	—	762
Forward MBS derivatives: Institutional counterparties	19,232 \$ 1,604,455	(280) \$ (280)	18,952 \$ 1,604,175	(11,638) \$ (1,545,773)	— \$ —	7,314 \$ 58,402
December 31, 2016						
Securities borrowed: Institutional counterparties	\$ 1,436,069	\$ —	\$ 1,436,069	\$ (1,385,664)	\$ —	\$ 50,405
Reverse repurchase agreements: Institutional counterparties	89,430	—	89,430	(89,369)	—	61
Forward MBS derivatives: Institutional counterparties	21,366 \$ 1,546,865	(3,893) \$ (3,893)	17,473 \$ 1,542,972	(9,012) \$ (1,484,045)	— \$ —	8,461 \$ 58,927

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet Financial Instruments	Cash Collateral Pledged	Net Amount
June 30, 2017						
Securities loaned:						
Institutional counterparties	\$ 1,312,985	\$ —	\$ 1,312,985	\$ (1,265,212)	\$ —	\$ 47,773
Interest rate options:						
Institutional counterparties	45	—	45	—	—	45
Interest rate swaps and swaptions:						
Institutional counterparties	162	(18)	144	(1,186)	—	(1,042)
Repurchase agreements:						
Institutional counterparties	266,700	—	266,700	(266,700)	—	—
Customer counterparties	149,894	—	149,894	(149,894)	—	—
Forward MBS derivatives:						
Institutional counterparties	671	—	671	(671)	—	—
	\$ 1,730,457	\$ (18)	\$ 1,730,439	\$ (1,683,663)	\$ —	\$ 46,776
December 31, 2016						
Securities loaned:						
Institutional counterparties	\$ 1,283,676	\$ —	\$ 1,283,676	\$ (1,237,868)	\$ —	\$ 45,808
Interest rate swaps and swaptions:						
Institutional counterparties	297	(14)	283	(3,000)	—	(2,717)

Repurchase agreements:						
Institutional counterparties	39,970	—	39,970	(39,970)	—	—
Customer counterparties	155,194	—	155,194	(155,194)	—	—
Forward MBS derivatives:						
Institutional counterparties	19,159	—	19,159	(19,159)	—	—
	\$ 1,498,296	\$ (14)	\$ 1,498,282	\$ (1,455,191)	\$ —	\$ 43,091

Secured Borrowing Arrangements

Secured Borrowings (Repurchase Agreements) — The Company participates in transactions involving securities sold under repurchase agreements, which are secured borrowings and generally mature within one to thirty days from the transaction date. Securities sold under repurchase agreements are reflected at the amount of cash received in connection with the transactions. The Company may be required to provide additional collateral based on the fair value of the underlying securities, which is monitored on a daily basis.

Securities Lending Activities — The Company's securities lending activities include lending securities for other broker-dealers, lending institutions and its own clearing and retail operations. These activities involve lending securities to other broker-dealers to cover short sales, to complete transactions in which there has been a failure to deliver securities by the required settlement date and as a conduit for financing activities.

When lending securities, the Company receives cash or similar collateral and generally pays interest (based on the amount of cash deposited) to the other party to the transaction. Securities lending transactions are executed pursuant to written agreements with counterparties that generally require securities loaned to be marked-to-market on a daily basis. The Company receives collateral in the form of cash in an amount generally in excess of the fair value of securities loaned. The Company monitors the fair value of securities loaned on a daily basis, with additional collateral obtained or refunded, as necessary. Collateral adjustments are made on a daily basis through the facilities of various clearinghouses. The Company is a principal in these securities lending transactions and is liable for losses in the event of a failure of any other party to honor its contractual obligation. Management sets credit limits with each counterparty and reviews these limits regularly to monitor the risk level with each counterparty. The Company is subject to credit risk through its securities lending activities if securities prices decline rapidly because the value of the Company's collateral could fall below the amount of the indebtedness it secures. In rapidly appreciating markets, credit risk increases due to short positions. The Company's securities lending business subjects the Company to credit risk if a counterparty fails to perform or if collateral securing its obligations is insufficient. In securities transactions, the Company is subject to credit risk during the period between the execution of a trade and the settlement by the customer.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following tables present the remaining contractual maturities of repurchase agreement and securities lending transactions accounted for as secured borrowings (in thousands). The Company had no repurchase-to-maturity transactions outstanding at both June 30, 2017 and December 31, 2016.

	Remaining Contractual Maturities				Total
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	
June 30, 2017					
Repurchase agreement transactions:					
U.S. Treasury and agency securities	\$ 199,803	\$ —	\$ —	\$ —	\$ 199,803
Asset-backed securities	—	216,791	—	—	216,791
Securities lending transactions:					
Corporate securities	8,586	—	—	—	8,586
Equity securities	1,304,399	—	—	—	1,304,399
Total	\$ 1,512,788	\$ 216,791	\$ —	\$ —	\$ 1,729,579

Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above	\$ 1,729,579
Amount related to agreements not included in offsetting disclosure above	\$ —

	Remaining Contractual Maturities				Total
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	
December 31, 2016					
Repurchase agreement transactions:					
U.S. Treasury and agency securities	\$ 195,164	\$ —	\$ —	\$ —	\$ 195,164
Securities lending transactions:					
Corporate securities	14,816	—	—	—	14,816
Equity securities	1,268,860	—	—	—	1,268,860
Total	\$ 1,478,840	\$ —	\$ —	\$ —	\$ 1,478,840

Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above	\$ 1,478,840
--	--------------

Amount related to agreements not included in offsetting disclosure above

\$ —

19. Broker-Dealer and Clearing Organization Receivables and Payables

Broker-dealer and clearing organization receivables and payables consisted of the following (in thousands).

	June 30, 2017	December 31, 2016
Receivables:		
Securities borrowed	\$ 1,459,990	\$ 1,436,069
Securities failed to deliver	45,933	33,834
Trades in process of settlement	32,379	10,223
Other	14,223	17,615
	\$ 1,552,525	\$ 1,497,741
Payables:		
Securities loaned	\$ 1,312,985	\$ 1,283,676
Correspondents	28,082	31,040
Securities failed to receive	50,920	31,724
Other	3,327	688
	\$ 1,395,314	\$ 1,347,128

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

20. Reserve for Losses and Loss Adjustment Expenses

A summary of NLC's reserve for unpaid losses and LAE, as included in other liabilities within the consolidated balance sheets, is as follows (in thousands).

	June 30, 2017	December 31, 2016
Reserve for unpaid losses and allocated LAE balance, net	\$ 33,608	\$ 25,203
Reinsurance recoverables on unpaid losses	3,249	9,434
Unallocated LAE	1,309	1,189
Reserve for unpaid losses and LAE balance, gross	\$ 38,166	\$ 35,826

A summary of claims loss reserve development activity is presented in the following table (dollars in thousands).

Year	Six Months Ended June 30,		June 30, 2017		
	Accident 2017	Paid	Incurred	Total of IBNR Reserves Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
2012		\$ 112,723	\$ 114,554	\$ 33	16,675
2013		110,318	111,074	53	15,736
2014		82,620	84,175	237	13,172
2015		84,162	88,082	1,842	14,968
2016		79,433	86,448	4,718	21,405
2017		31,551	49,997	7,283	10,546
Total		500,807	\$ 534,330		
		85	All outstanding reserves prior to 2012, net of reinsurance		

\$ 33,608	Reserve for unpaid losses and allocated LAE, net of reinsurance
-----------	--

21. Reinsurance Activity

NLC limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risk. Substantial amounts of business are ceded, and these reinsurance contracts do not relieve NLC from its obligations to policyholders. Such reinsurance includes quota share, excess of loss, catastrophe, and other forms of reinsurance on essentially all property and casualty lines of insurance. Net insurance premiums earned, losses and LAE and policy acquisition and other underwriting expenses are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE and unearned insurance premiums ceded to them are reported as assets. Failure of reinsurers to honor their obligations could result in losses to NLC; consequently, allowances are established for amounts deemed uncollectible as NLC evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. At June 30, 2017, reinsurance receivables had a carrying value of \$3.5 million, which is included in other assets within the consolidated balance sheet. There was no allowance for uncollectible accounts at June 30, 2017, based on NLC's quality requirements.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The effects of reinsurance on premiums written and earned are summarized as follows (in thousands).

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017		2016		2017		2016	
	Written	Earned	Written	Earned	Written	Earned	Written	Earned
Premiums from direct business	\$ 37,792	\$ 36,753	\$ 42,675	\$ 40,177	\$ 73,588	\$ 73,952	\$ 81,754	\$ 81,063
Reinsurance assumed	3,358	2,910	3,146	2,714	6,227	5,728	5,825	5,382
Reinsurance ceded	(2,974)	(3,643)	(4,246)	(4,170)	(6,187)	(7,520)	(7,745)	(7,991)
Net premiums	\$ 38,176	\$ 36,020	\$ 41,575	\$ 38,721	\$ 73,628	\$ 72,160	\$ 79,834	\$ 78,454

The effects of reinsurance on incurred losses are as follows (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Loss and LAE incurred	\$ 33,352	\$ 55,461	\$ 55,654	\$ 78,950
Reinsurance recoverables	(168)	(18,250)	(770)	(19,780)
Net loss and LAE incurred	\$ 33,184	\$ 37,211	\$ 54,884	\$ 59,170

Catastrophic coverage

At June 30, 2017, NLC had catastrophic excess of loss reinsurance coverage of losses per event in excess of \$8 million retention by NLIC and \$1.5 million retention by ASIC. ASIC maintained an underlying layer of coverage, providing \$6.5 million in excess of its \$1.5 million retention to bridge to the primary program. The reinsurance in excess of \$8 million is comprised of four layers of protection: \$17 million in excess of \$8 million retention and/or loss; \$25 million in excess of \$25 million loss; \$25 million in excess of \$50 million loss and \$50 million in excess of \$75 million loss. NLIC and ASIC retain no participation in any of the layers, beyond the first \$8 million and \$1.5 million, respectively. At June 30, 2017, total retention for any one catastrophe that affects both NLIC and ASIC was

limited to \$8 million in the aggregate.

Effective January 1, 2017, NLC renewed its underlying excess of loss contract that provides \$10 million aggregate coverage in excess of NLC's per event retention and aggregate retention for sub-catastrophic events. NLC retains no participation beyond the first \$1 million, which is consistent with 2016.

22. Segment and Related Information

The Company currently has four reportable business segments that are organized primarily by the core products offered to the segments' respective customers. These segments reflect the manner in which operations are managed and the criteria used by the Company's chief operating decision maker function to evaluate segment performance, develop strategy and allocate resources. The chief operating decision maker function consists of the Company's President and Co-Chief Executive Officer and the Company's Vice Chairman and Co-Chief Executive Officer.

The banking segment includes the operations of the Bank, the broker-dealer segment includes the operations of Securities Holdings, the mortgage origination segment is composed of PrimeLending, and the insurance segment is composed of NLC.

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, and management and administrative services to support the overall operations of the Company including, but not limited to, certain executive management, corporate relations, legal, finance and acquisition costs.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Balance sheet amounts not discussed previously and the elimination of intercompany transactions are included in “All Other and Eliminations.” The following tables present certain information about reportable business segment revenues, operating results, goodwill and assets (in thousands).

Three Months Ended June 30, 2017	Mortgage					All Other and Hilltop	
	Banking	Broker-Dealer Origination	Insurance	Corporate	Eliminations	Consolidated	
Net interest income (expense)	\$ 102,191	\$ 10,349	\$ 996	\$ 602	\$ (2,288)	\$ 4,126	\$ 115,976
Provision for loan losses	5,405	448	—	—	—	—	5,853
Noninterest income	25,499	92,810	179,637	38,413	12,608	(4,275)	344,692
Noninterest expense	62,511	86,901	161,369	49,416	6,298	(244)	366,251
Income (loss) before income taxes	\$ 59,774	\$ 15,810	\$ 19,264	\$ (10,401)	\$ 4,022	\$ 95	\$ 88,564

Six Months Ended June 30, 2017	Mortgage					All Other and Hilltop	
	Banking	Broker-Dealer Origination	Insurance	Corporate	Eliminations	Consolidated	
Net interest income (expense)	\$ 184,274	\$ 18,837	\$ (885)	\$ 1,119	\$ (4,823)	\$ 9,554	\$ 208,076
Provision for loan losses	7,241	316	—	—	—	1	7,558
Noninterest income	37,910	175,362	323,275	76,723	12,609	(9,748)	616,131
Noninterest expense	123,325	168,558	293,207	86,429	15,685	(461)	686,743
Income (loss)	\$ 91,618	\$ 25,325	\$ 29,183	\$ (8,587)	\$ (7,899)	\$ 266	\$ 129,906

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

before
income
taxes

Three Months Ended June 30, 2016	Mortgage					All Other and Hilltop	
	Banking	Broker-Dealer	Origination	Insurance	Corporate	Eliminations	Consolidated
Net interest income (expense)	\$ 92,029	\$ 7,440	\$ (2,299)	\$ 758	\$ (1,846)	\$ 4,315	\$ 100,397
Provision for loan losses	28,613	263	—	—	—	—	28,876
Noninterest income	13,346	102,900	192,881	41,392	1	(4,515)	346,005
Noninterest expense	55,132	91,780	162,488	51,717	6,483	(235)	367,365
Income (loss) before income taxes	\$ 21,630	\$ 18,297	\$ 28,094	\$ (9,567)	\$ (8,328)	\$ 35	\$ 50,161

Six Months Ended June 30, 2016	Mortgage					All Other and Hilltop	
	Banking	Broker-Dealer	Origination	Insurance	Corporate	Eliminations	Consolidated
Net interest income (expense)	\$ 178,133	\$ 14,491	\$ (4,865)	\$ 1,497	\$ (3,559)	\$ 8,540	\$ 194,237
Provision for loan losses	32,113	170	—	—	—	—	32,283
Noninterest income	26,301	183,782	339,219	83,196	2	(9,120)	623,380
Noninterest expense	119,480	176,041	297,160	88,091	12,332	(550)	692,554
Income (loss) before income taxes	\$ 52,841	\$ 22,062	\$ 37,194	\$ (3,398)	\$ (15,889)	\$ (30)	\$ 92,780

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidate
June 30, 2017							
Goodwill	\$ 207,741	\$ 7,008	\$ 13,071	\$ 23,988	\$ —	\$ —	\$ 251,808
Total assets	\$ 9,828,918	\$ 3,073,342	\$ 2,240,743	\$ 305,099	\$ 2,049,498	\$ (4,209,027)	\$ 13,288,57
December 31, 2016							
Goodwill	\$ 207,741	\$ 7,008	\$ 13,071	\$ 23,988	\$ —	\$ —	\$ 251,808
Total assets	\$ 9,527,518	\$ 2,777,849	\$ 2,042,458	\$ 347,252	\$ 2,032,749	\$ (3,989,764)	\$ 12,738,06

23. Earnings per Common Share

Nonvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of earnings per share pursuant to the two-class method prescribed by the Earnings Per Share Topic of the ASC. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Restricted Stock Awards are the only instruments issued by Hilltop which qualify as participating securities.

Net earnings, less any preferred dividends accumulated for the period (whether or not declared), is allocated between the common stock and participating securities pursuant to the two-class method. Basic earnings per common share is computed by dividing net earnings available to common stockholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

Diluted earnings per common share is computed in a similar manner, except that first the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares, excluding the participating securities, were issued using the treasury stock method. During the three and six months ended June 30, 2017, RSUs were the only potentially dilutive non-participating instruments issued by Hilltop, while during the three and six months ended June 30, 2016, stock options and RSUs were potentially dilutive non-

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

participating instruments. Next, the Company determines and includes in the diluted earnings per common share calculation the more dilutive effect of the participating securities using the treasury stock method or the two-class method. Undistributed losses are not allocated to the nonvested share-based payment awards (the participating securities) under the two-class method as the holders are not contractually obligated to share in the losses of the Company.

The following table presents the computation of basic and diluted earnings per common share (in thousands, except per share data).

	Three Months Ended		Six Months Ended June	
	June 30,	2016	30,	2016
	2017		2017	
Basic earnings per share:				
Income attributable to Hilltop	\$ 62,476	\$ 31,074	\$ 88,910	\$ 58,641
Less: income applicable to participating shares	(2)	(5)	(3)	(9)
Net earnings available to Hilltop common stockholders	\$ 62,474	\$ 31,069	\$ 88,907	\$ 58,632
Weighted average shares outstanding - basic	98,154	98,457	98,295	98,305
Basic earnings per common share	\$ 0.64	\$ 0.32	\$ 0.90	\$ 0.60
Diluted earnings per share:				
Income attributable to Hilltop	\$ 62,476	\$ 31,074	\$ 88,910	\$ 58,641
Weighted average shares outstanding - basic	98,154	98,457	98,295	98,305
Effect of potentially dilutive securities	260	129	281	314
Weighted average shares outstanding - diluted	98,414	98,586	98,576	98,619
Diluted earnings per common share	\$ 0.63	\$ 0.32	\$ 0.90	\$ 0.60

Table of Contents

SCHEDULE I – Insurance Incurred and Cumulative Paid Losses and Allocated Loss Adjustment Expenses,

Net of Reinsurance

(dollars in thousands)

Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance							June 30, 2017	
Six Months Ended June 30, 2017							Total of Incurred But Not Reported Reserves Plus Development On Reported Claims	Cumulative Number of Reported Claims
Accident Year	2012 Unaudited	2013 Unaudited	2014 Unaudited	2015 Unaudited	2016 Unaudited	2017 Unaudited		
2012	\$ 107,873	\$ 108,753	\$ 114,031	\$ 114,067	\$ 114,517	\$ 114,554	\$ 33	16,675
2013		107,793	108,951	111,006	111,011	111,074	53	15,736
2014			83,784	85,037	84,221	84,175	237	13,172
2015				89,646	88,477	88,082	1,842	14,968
2016					84,771	86,448	4,718	21,405
2017						49,997	7,283	10,546
						\$ 534,330		

Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance						
Six Months Ended June 30, 2017						
Accident Year	2012 Unaudited	2013 Unaudited	2014 Unaudited	2015 Unaudited	2016 Unaudited	2017 Unaudited
2012	\$ 89,603	\$ 101,968	\$ 107,126	\$ 110,782	\$ 112,062	\$ 112,723
2013		94,238	104,938	108,099	109,662	110,318
2014			70,831	79,713	81,684	82,620
2015				71,820	82,940	84,162
2016					71,543	79,433
2017						31,551
					Total	\$ 500,807
						85
						\$ 33,608

All outstanding reserves prior to 2012, net of reinsurance

Reserve for unpaid losses and allocated loss adjustment expenses, net of reinsurance

Table of Contents

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the consolidated historical financial statements and notes appearing elsewhere in this Quarterly Report on Form 10-Q (this “Quarterly Report”) and the financial information set forth in the tables herein.

Unless the context otherwise indicates, all references in this Management’s Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, to the “Company,” “we,” “us,” “our” or “ours” or similar words are to Hilltop Holdings Inc. and its direct and indirect wholly owned subsidiaries, references to “Hilltop” refer solely to Hilltop Holdings Inc., references to “PCC” refer to PlainsCapital Corporation (a wholly owned subsidiary of Hilltop), references to “Securities Holdings” refer to Hilltop Securities Holdings LLC (a wholly owned subsidiary of Hilltop), references to “Hilltop Securities” refer to Hilltop Securities Inc. (a wholly owned subsidiary of Securities Holdings that was formerly known as Southwest Securities, Inc.), references to “HTS Independent Network” refer to Hilltop Securities Independent Network Inc. (a wholly owned subsidiary of Securities Holdings that was formerly known as SWS Financial Services, Inc.), references to the “Bank” refer to PlainsCapital Bank (a wholly owned subsidiary of PCC), references to “FNB” refer to First National Bank, references to “SWS” refer to the former SWS Group, Inc., references to “FSC” refer to First Southwest Company, LLC (a former wholly owned subsidiary of First Southwest Holdings, LLC), references to “PrimeLending” refer to PrimeLending, a PlainsCapital Company (a wholly owned subsidiary of the Bank) and its subsidiaries as a whole, references to “NLC” refer to National Lloyds Corporation (a wholly owned subsidiary of Hilltop) and its subsidiaries as a whole, references to “NLIC” refer to National Lloyds Insurance Company (a wholly owned subsidiary of NLC) and references to “ASIC” refer to American Summit Insurance Company (a wholly owned subsidiary of NLC).

FORWARD-LOOKING STATEMENTS

This Quarterly Report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”), as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included in this Quarterly Report that address results or developments that we expect or anticipate will or may occur in the future, and statements that are preceded by, followed by or include, words such as “anticipates,” “believes,” “could,” “estimates,” “expects,” “forecasts,” “goal,” “intends,” “may,” “might,” “plan,” “probable,” “projects,” “seeks,” “should,” “would” or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our financial condition, our efforts to make strategic acquisitions, the costs of integration of the operations acquired in the SWS Merger (as defined below), our revenue, our liquidity and sources of funding, market trends, operations and business, capital levels, mortgage servicing rights (“MSR”) assets, stock repurchases, dividend payments, expectations concerning mortgage loan origination volume and interest rate compression, expected losses on covered loans and related reimbursements from the Federal Deposit Insurance Corporation (“FDIC”), anticipated amortization of the value of the receivable under our loss-share agreements with the FDIC (“FDIC Indemnification Asset”), expected levels of refinancing as a percentage of total loan origination volume, projected losses on mortgage loans originated, the effects of government regulation applicable to our operations, the appropriateness of our allowance for loan losses and provision for loan losses, anticipated investment yields, our expectations regarding accretion of discount on loans

in future periods, the collectability of loans and the outcome of litigation are forward-looking statements.

These forward-looking statements are based on our beliefs, assumptions and expectations of our future performance taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If an event occurs, our business, business plan, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Certain factors that could cause actual results to differ include, among others:

- the credit risks of lending activities, including our ability to estimate loan losses as well as the effects of changes in the level of, and trends in, loan delinquencies and write-offs;

- changes in general economic, market and business conditions in areas or markets where we compete, including changes in the price of crude oil;

- changes in the interest rate environment;

Table of Contents

- risks associated with concentration in real estate related loans;
- risks associated with merger and acquisition integration;

- severe catastrophic events in Texas and other areas of the southern United States;

- effectiveness of our data security controls in the face of cyber attacks;

- the effects of our indebtedness on our ability to manage our business successfully, including the restrictions imposed by the indenture governing our indebtedness;
- cost and availability of capital;
- changes in state and federal laws, regulations or policies affecting one or more of our business segments, including changes in regulatory fees, deposit insurance premiums, capital requirements and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”);

- changes in key management;

- competition in our banking, broker-dealer, mortgage origination and insurance segments from other banks and financial institutions as well as investment banking and financial advisory firms, mortgage bankers, asset-based non-bank lenders, government agencies and insurance companies;

- legal and regulatory proceedings;

- our obligations under loss-share agreements with the FDIC, including the possibility that we may be required to make a “true-up” payment to the FDIC;

- failure of our insurance segment reinsurers to pay obligations under reinsurance contracts; and

- our ability to use excess capital in an effective manner.

For a more detailed discussion of these and other factors that may affect our business and that could cause the actual results to differ materially from those anticipated in these forward-looking statements, see “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016 (“2016 Form 10-K”), which was filed with the Securities and Exchange Commission (the “SEC”) on February 16, 2017, this Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” Part II, Item 1A, “Risk Factors” herein and other filings we have made with the SEC. We caution that the foregoing list of factors is not exhaustive, and new factors may emerge, or changes to the foregoing factors may occur, that could impact our business. All subsequent written and oral forward-looking statements concerning our business attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements above. We do not undertake any obligation to update any forward-looking statement, whether written or oral, relating to the matters discussed in this Quarterly Report except to the extent required by federal securities laws.

OVERVIEW

We are a financial holding company registered under the Bank Holding Company Act of 1956. Our primary line of business is to provide business and consumer banking services from offices located throughout Texas through the Bank. We also provide an array of financial products and services through our broker-dealer, mortgage origination and insurance segments. The following includes additional details regarding the financial products and services provided by each of our primary business units.

PCC. PCC is a financial holding company headquartered in Dallas, Texas that provides, through its subsidiaries, traditional banking and wealth, investment management and treasury management services primarily in Texas and residential mortgage loans throughout the United States.

Securities Holdings. Securities Holdings is a holding company headquartered in Dallas, Texas that provides, through its subsidiaries, investment banking and other related financial services, including municipal advisory, sales, trading and underwriting of taxable and tax-exempt fixed income securities, equity trading, clearing, securities lending, structured finance and retail brokerage services throughout the United States.

Table of Contents

NLC. NLC is a property and casualty insurance holding company headquartered in Waco, Texas that provides, through its subsidiaries, fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the southern United States.

During the three and six months ended June 30, 2017, our net income to common stockholders was \$62.5 million, or \$0.63 per diluted share, and \$88.9 million, or \$0.90 per diluted share, respectively. We declared total common dividends of \$0.06 and \$0.12 per share during the three and six months ended June 30, 2017, respectively, which resulted in dividend payout ratios of 9.43% and 13.27%, respectively. Dividend payout ratio is defined as cash dividends declared per common share divided by basic earnings per common share. We also paid an aggregate of \$16.0 million to repurchase our common stock during the six months ended June 30, 2017.

We reported \$88.6 million and \$129.9 million of consolidated income before income taxes during the three and six months ended June 30, 2017, respectively, including the following contributions from our four reportable business segments.

- The banking segment contributed \$59.8 million and \$91.6 million of income before income taxes during the three and six months ended June 30, 2017, respectively;
- The broker-dealer segment contributed \$15.8 million and \$25.3 million of income before income taxes during the three and six months ended June 30, 2017, respectively;
- The mortgage origination segment contributed \$19.3 million and \$29.2 million of income before income taxes during the three and six months ended June 30, 2017, respectively; and
- The insurance segment incurred losses before income taxes of \$10.4 million and \$8.6 million during the three and six months ended June 30, 2017, respectively.

During the three months ended June 30, 2017, our consolidated income before taxes included the recognition within corporate of a pre-tax net increase to other noninterest income of \$11.6 million related to the resolution of the appraisal proceedings from the SWS Merger as discussed in detail in Note 12, Commitments and Contingencies.

During the three months ended June 30, 2016, the Bank discovered irregularities with respect to a non-covered loan that is currently in default, including the genuineness of certain underlying documents that supported the loan and the operations of the borrower's business. As a result of the payment default and other irregularities, the Bank increased its provision for loan losses and recorded a \$24.5 million charge-off, representing the entire outstanding principal balance of the loan. The banking segment's financial results for the three and six months ended June 30, 2016 reflect this charge-off. During the three months ended June 30, 2017, the Bank recorded an insurance receivable and related other noninterest income of \$15.0 million from coverage provided by an insurance policy for forgery. The Bank is actively pursuing legal remedies to recover losses arising from this isolated incident, including litigation against the borrower and guarantors. The Bank cannot currently estimate the amount of any future recoveries or additional expenses related to this charged-off loan.

At June 30, 2017, on a consolidated basis, we had total assets of \$13.3 billion, total deposits of \$7.6 billion, total loans, including loans held for sale, of \$8.3 billion and stockholders' equity of \$1.9 billion.

Segment Information

We have three primary business units, PCC (banking and mortgage origination), Securities Holdings (broker-dealer) and NLC (insurance). Under accounting principles generally accepted in the United States ("GAAP"), our business units are comprised of four reportable business segments organized primarily by the core products offered to the segments' respective customers: banking, broker-dealer, mortgage origination and insurance. Consistent with our historical segment operating results, we anticipate that future revenues will be driven primarily from the banking segment, with the remainder being generated by our broker-dealer, mortgage origination and insurance segments. Operating results for the mortgage origination segment have historically been more volatile than operating results for the banking, broker-dealer and insurance segments.

The banking segment includes the operations of the Bank, which primarily provides business and consumer banking services from offices located throughout Texas and generates revenue from its portfolio of earning assets. The Bank's

Table of Contents

results of operations are primarily dependent on net interest income, while also deriving revenue from other sources, including service charges on customer deposit accounts and trust fees.

The broker-dealer segment includes the operations of Securities Holdings. The broker-dealer segment generates a majority of its revenues from fees and commissions earned from investment advisory and securities brokerage services. Hilltop Securities is a broker-dealer registered with the Securities and Exchange Commission (the “SEC”) and FINRA and a member of the New York Stock Exchange (“NYSE”), HTS Independent Network is an introducing broker-dealer that is also registered with the SEC and FINRA, and First Southwest Asset Management, LLC, a wholly-owned subsidiary of Hilltop Securities, is a registered investment adviser under the Investment Advisers Act of 1940.

The mortgage origination segment includes the operations of PrimeLending, which offers a variety of loan products and generates revenue predominantly from fees charged on the origination of loans and from selling these loans in the secondary market.

The insurance segment includes the operations of NLC, which operates through its wholly owned subsidiaries, NLIC and ASIC, in Texas and other areas of the southern United States. Insurance segment income is primarily generated from revenue earned on net insurance premiums less loss and loss adjustment expenses (“LAE”) and policy acquisition and other underwriting expenses.

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, and management and administrative services to support the overall operations of the Company including, but not limited to, certain executive management, corporate relations, legal, finance, and acquisition costs.

The elimination of intercompany transactions are included in “All Other and Eliminations.” Additional information concerning our reportable segments is presented in Note 22, Segment and Related Information, in the notes to our consolidated financial statements. The following tables present certain information about the operating results of our reportable segments (in thousands).

Three Months Ended June 30, 2017	Mortgage				All Other and Hilltop		
	Banking	Broker-Dealer	Origination	Insurance	Corporate	Eliminations	Consolidated
	\$ 102,191	\$ 10,349	\$ 996	\$ 602	\$ (2,288)	\$ 4,126	\$ 115,976

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Net interest income (expense)							
Provision for loan losses	5,405	448	—	—	—	—	5,853
Noninterest income	25,499	92,810	179,637	38,413	12,608	(4,275)	344,692
Noninterest expense	62,511	86,901	161,369	49,416	6,298	(244)	366,251
Income (loss) before income taxes	\$ 59,774	\$ 15,810	\$ 19,264	\$ (10,401)	\$ 4,022	\$ 95	\$ 88,564

Six Months Ended June 30, 2017	Mortgage					All Other and Hilltop	
	Banking	Broker-Dealer	Origination	Insurance	Corporate	Eliminations	Consolidated
Net interest income (expense)	\$ 184,274	\$ 18,837	\$ (885)	\$ 1,119	\$ (4,823)	\$ 9,554	\$ 208,076
Provision for loan losses	7,241	316	—	—	—	1	7,558
Noninterest income	37,910	175,362	323,275	76,723	12,609	(9,748)	616,131
Noninterest expense	123,325	168,558	293,207	86,429	15,685	(461)	686,743
Income (loss) before income taxes	\$ 91,618	\$ 25,325	\$ 29,183	\$ (8,587)	\$ (7,899)	\$ 266	\$ 129,906

Three Months Ended June 30, 2016	Mortgage					All Other and Hilltop	
	Banking	Broker-Dealer	Origination	Insurance	Corporate	Eliminations	Consolidated
Net interest income (expense)	\$ 92,029	\$ 7,440	\$ (2,299)	\$ 758	\$ (1,846)	\$ 4,315	\$ 100,397
Provision for loan losses	28,613	263	—	—	—	—	28,876

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Noninterest income	13,346	102,900	192,881	41,392	1	(4,515)	346,005
Noninterest expense	55,132	91,780	162,488	51,717	6,483	(235)	367,365
Income (loss) before income taxes	\$ 21,630	\$ 18,297	\$ 28,094	\$ (9,567)	\$ (8,328)	\$ 35	\$ 50,161

Six Months Ended June 30, 2016	Mortgage					All Other and Hilltop	
	Banking	Broker-Dealer	Origination	Insurance	Corporate	Eliminations	Consolidated
Net interest income (expense)	\$ 178,133	\$ 14,491	\$ (4,865)	\$ 1,497	\$ (3,559)	\$ 8,540	\$ 194,237
Provision for loan losses	32,113	170	—	—	—	—	32,283
Noninterest income	26,301	183,782	339,219	83,196	2	(9,120)	623,380
Noninterest expense	119,480	176,041	297,160	88,091	12,332	(550)	692,554
Income (loss) before income taxes	\$ 52,841	\$ 22,062	\$ 37,194	\$ (3,398)	\$ (15,889)	\$ (30)	\$ 92,780

Table of Contents

How We Generate Revenue

We generate revenue from net interest income and from noninterest income. Net interest income represents the difference between the income earned on our assets, including our loans and investment securities, and our cost of funds, including the interest paid on the deposits and borrowings that are used to support our assets. Net interest income is a significant contributor to our operating results. Fluctuations in interest rates, as well as the amounts and types of interest-earning assets and interest-bearing liabilities we hold, affect net interest income. We generated \$208.1 million and \$194.2 million in net interest income during the six months ended June 30, 2017 and 2016, respectively. Changes in net interest income primarily included increases within our banking, broker-dealer and mortgage origination segments.

The other component of our revenue is noninterest income, which is primarily comprised of the following:

- (i) Income from broker-dealer operations. Through Securities Holdings, we provide investment banking and other related financial services. We generated \$124.6 million and \$131.9 million in securities commissions and fees and investment and securities advisory fees and commissions, and \$46.2 million and \$49.7 million in gains from derivative and trading portfolio activities (included within other noninterest income) during the six months ended June 30, 2017 and 2016, respectively.
- (ii) Income from mortgage operations. Through PrimeLending, we generate noninterest income by originating and selling mortgage loans. During the six months ended June 30, 2017 and 2016, we generated \$323.4 million and \$338.9 million, respectively, in net gains from the sale of loans, other mortgage production income (including income associated with retained mortgage servicing rights), and mortgage loan origination fees.
- (iii) Income from insurance operations. Through NLC, we provide fire and limited homeowners insurance for low value dwellings and manufactured homes. We generated \$72.2 million and \$78.5 million in net insurance premiums earned during the six months ended June 30, 2017 and 2016, respectively.

In the aggregate, we generated \$616.1 million and \$623.4 million in noninterest income during the six months ended June 30, 2017 and 2016, respectively. This year-over-year decrease in noninterest income was predominantly attributable to decreases in noninterest income in our mortgage origination, broker-dealer and insurance segments, partially offset by increases in noninterest income in our banking segment due to the previously mentioned increases in other noninterest income related to the insurance receivable of \$15.0 million within the banking segment and the \$11.6 million within corporate related to the resolution of the appraisal proceedings from the SWS Merger.

We also incur noninterest expenses in the operation of our businesses. Our businesses engage in labor intensive activities and, consequently, employees' compensation and benefits represent the majority of our noninterest expenses.

Consolidated Operating Results

Net income applicable to common stockholders during the three months ended June 30, 2017 was \$62.5 million, or \$0.63 per diluted share, compared with net income applicable to common stockholders of \$31.1 million, or \$0.32 per diluted share, during the three months ended June 30, 2016. Net income applicable to common stockholders during the six months ended June 30, 2017 was \$88.9 million, or \$0.90 per diluted share, compared with net income applicable to common stockholders of \$58.6 million, or \$0.60 per diluted share, during the six months ended June 30, 2016. The consolidated operating results during the three and six months ended June 30, 2017 included the previously mentioned insurance receivable and related increase to other noninterest income of \$15.0 million from coverage provided by an insurance policy for forgery related to a single, large loan charged off by the Bank and the pre-tax net increase to other noninterest income of \$11.6 million (or \$14.3 million after income tax benefit of \$2.6 million) related to the resolution of the appraisal proceedings from the SWS Merger. The consolidated operating results during the three and six months ended June 30, 2016 included the previously mentioned \$24.5 million charge-off of the single, large loan by the Bank.

Our consolidated operating results during the six months ended June 30, 2017 also included transaction costs related to the acquisition of SWS (the “SWS Merger”), while our consolidated operating results during the six months ended June 30, 2016 included both transaction costs and integration-related costs associated with employee expenses (such as severance and retention), professional fees (such as consulting and legal) and contractual costs (such as vendor contract termination and lease), incurred as a result of the integration of the operations and systems acquired in the SWS Merger.

Table of Contents

During the six months ended June 30, 2017, we incurred \$1.5 million in pre-tax transaction costs related to the SWS Merger. During the six months ended June 30, 2016, we incurred transaction costs and integration-related costs related to the SWS Merger totaling \$7.1 million resulting from \$2.3 million in pre-tax transaction costs and pre-tax integration-related costs associated with employee, professional fee and contractual expenses of \$2.1 million, \$2.6 million and \$0.1 million, respectively. Effective as of the close of business on January 22, 2016, we merged FSC and Hilltop Securities into a combined firm operating under the “Hilltop Securities” name. The integration is substantially complete and Hilltop Securities does not expect to incur any additional integration costs in relation to the SWS Merger.

Certain items included in net income for 2017 and 2016 resulted from purchase accounting associated with the merger of PlainsCapital Corporation with and into a wholly owned subsidiary of Hilltop on November 30, 2012 (the “PlainsCapital Merger”), the FDIC-assisted transaction (the “FNB Transaction”) whereby the Bank acquired certain assets and assumed certain liabilities of FNB, and the SWS Merger (collectively, the “Bank Transactions”). Income before taxes during the three months ended June 30, 2017 included net accretion of \$0.9 million, \$20.7 million and \$0.8 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of \$1.6 million, \$0.2 million and \$0.2 million, respectively. During the three months ended June 30, 2016, income before taxes included net accretion of \$2.7 million, \$12.6 million and \$1.1 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of \$2.0 million, \$0.2 million and \$0.3 million, respectively. Income before taxes during the six months ended June 30, 2017 included net accretion of \$1.9 million, \$30.4 million and \$1.8 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of \$3.2 million, \$0.3 million and \$0.4 million, respectively. During the six months ended June 30, 2016, income before taxes included net accretion of \$6.0 million, \$24.0 million and \$2.3 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of \$4.0 million, \$0.4 million and \$0.5 million, respectively.

In addition, the Bank recorded a “true-up” accrual related to the loss-share agreements with the FDIC and amortization of the FDIC Indemnification Asset, both related to the FNB Transaction, of \$5.3 million and \$9.9 million during the three and six months ended June 30, 2017, respectively, compared to \$1.9 million and \$3.9 million during the same periods in 2016.

We consider the ratios shown in the table below to be key indicators of our performance.

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
Performance Ratios:				
Return on average stockholder's equity	13.24 %	7.07 %	9.53 %	6.72 %
Return on average assets	1.94 %	1.05 %	1.43 %	1.01 %

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Net interest margin (1) (3) (4)	4.04	%	3.77	%	3.80	%	3.74	%
Net interest margin (taxable equivalent) (2) (3) (4)	4.05	%	3.80	%	3.81	%	3.76	%

- (1) Net interest margin is defined as net interest income divided by average interest-earning assets.
- (2) Net interest margin (taxable equivalent), a non-GAAP measure, is defined as taxable equivalent net interest income divided by average interest-earning assets. Annualized taxable equivalent adjustments are based on a 35% federal income tax rate. See footnote 2 to the following tables for the taxable equivalent adjustments to interest income.
- (3) The securities financing operations within our broker-dealer segment had the effect of lowering both the net interest margin and taxable equivalent net interest margin by 53 basis points and 65 basis points during the three months ended June 30, 2017 and 2016, respectively, and 51 basis points and 62 basis points during the six months ended June 30, 2017 and 2016, respectively.
- (4) Net interest margin and taxable equivalent net interest margin were 82 basis points and 72 basis points greater due to the impact of purchase accounting during the three months ended June 30, 2017 and 2016, respectively, and 67 basis points and 73 basis points greater due to the impact of purchase accounting during the six months ended June 30, 2017 and 2016, respectively.

We present net interest margin in the table above, and net interest margin and net interest income in the following discussion and tables below, on a taxable equivalent basis. The interest income earned on certain earning assets is completely or partially exempt from federal income tax. As such, these tax-exempt instruments typically yield lower returns than taxable investments. To provide more meaningful comparisons of net interest margins for all earning assets, we use net interest income on a taxable-equivalent basis in calculating net interest margin by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments.

Table of Contents

During the three months ended June 30, 2017, the consolidated taxable equivalent net interest margin of 4.05% was 82 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$1.7 million, \$20.7 million and \$0.8 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$0.7 million. The consolidated taxable equivalent net interest margin during the three months ended June 30, 2016 of 3.80% was 72 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$3.7 million, \$12.6 million and \$1.1 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$1.0 million.

During the six months ended June 30, 2017, the consolidated taxable equivalent net interest margin of 3.81% was 67 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$3.2 million, \$30.4 million and \$1.7 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$1.2 million. During the six months ended June 30, 2016, the consolidated taxable equivalent net interest margin of 3.76% was 73 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$7.8 million, \$24.0 million and \$2.2 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$1.7 million.

The FNB Transaction-related accretion of discount on loans of \$30.4 million and \$24.0 million during the six months ended June 30, 2017 and 2016, respectively, included accretion of approximately \$2 million and \$6 million, respectively, due to better-than-expected resolution of covered purchased credit impaired (“PCI”) loans during the respective periods. The performance of the covered PCI loan portfolio since 2014, which has exceeded our expectations at the time of acquisition, has led to higher yields calculated as a result of the Bank’s quarterly cash flow recast process. The recast process performed during the six months ended June 30, 2017 and 2016 resulted in the reclassification of \$23.0 million and \$18.4 million, respectively, from nonaccretable difference to accretable yield.

The tables below provide additional details regarding our consolidated net interest income (dollars in thousands).

	Three Months Ended June 30, 2017			2016			
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	
Assets							
Interest-earning assets							
Loans, gross (1)	\$ 7,794,300	\$ 113,794	5.81	% \$ 7,038,518	\$ 98,468	5.56	%
	1,399,402	9,516	2.72	% 1,080,097	6,813	2.53	%

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Investment securities - taxable								
Investment securities - non-taxable (2)	232,340	1,903	3.28	%	291,288	2,166	2.98	%
Federal funds sold and securities purchased under agreements to resell	147,179	27	0.07	%	144,820	36	0.10	%
Interest-bearing deposits in other financial institutions	381,100	885	0.93	%	388,520	484	0.50	%
Securities borrowed	1,512,222	9,597	2.51	%	1,702,286	6,327	1.49	%
Other	81,230	1,113	5.49	%	58,081	537	3.72	%
Interest-earning assets, gross (2)	11,547,773	136,835	4.72	%	10,703,610	114,831	4.27	%
Allowance for loan losses	(57,976)				(51,247)			
Interest-earning assets, net	11,489,797				10,652,363			
Noninterest-earning assets	1,529,020				1,523,095			
Total assets	\$ 13,018,817				\$ 12,175,458			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities								
Interest-bearing deposits	\$ 5,140,116	\$ 5,464	0.43	%	\$ 4,821,695	\$ 4,037	0.34	%
Securities loaned	1,388,897	7,481	2.16	%	1,626,021	4,916	1.22	%
Notes payable and other borrowings	1,708,241	7,386	1.72	%	1,096,007	4,852	1.78	%
Total interest-bearing liabilities	8,237,254	20,331	0.99	%	7,543,723	13,805	0.73	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,273,533				2,203,065			
Other liabilities	612,712				657,435			
Total liabilities	11,123,499				10,404,223			
Stockholders' equity	1,893,052				1,768,717			
Noncontrolling interest	2,266				2,518			
Total liabilities and stockholders' equity	\$ 13,018,817				\$ 12,175,458			

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Net interest income					
(2)	\$ 116,504			\$ 101,026	
Net interest spread					
(2)		3.73	%	3.53	%
Net interest margin					
(2)		4.05	%	3.80	%

Table of Contents

	Six Months Ended June 30, 2017				2016			
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate		Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	
Assets								
Interest-earning assets								
Loans, gross (1)	\$ 7,446,546	\$ 203,784	5.46	%	\$ 6,886,108	\$ 190,001	5.49	%
Investment securities - taxable	1,244,567	16,520	2.67	%	1,062,401	13,161	2.48	%
Investment securities - non-taxable (2)	225,904	3,654	3.24	%	276,472	4,490	3.25	%
Federal funds sold and securities purchased under agreements to resell	132,502	50	0.08	%	135,064	63	0.09	%
Interest-bearing deposits in other financial institutions	439,500	1,787	0.82	%	408,301	958	0.47	%
Securities borrowed	1,499,720	17,650	2.34	%	1,623,515	13,916	1.72	%
Other	86,236	2,137	4.97	%	61,910	1,085	3.53	%
Interest-earning assets, gross (2)	11,074,975	245,582	4.43	%	10,453,771	223,674	4.26	%
Allowance for loan losses	(56,809)				(50,049)			
Interest-earning assets, net	11,018,166				10,403,722			
Noninterest-earning assets	1,550,438				1,559,888			
Total assets	\$ 12,568,604				\$ 11,963,610			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities								
Interest-bearing deposits	\$ 5,039,067	\$ 10,154	0.41	%	\$ 4,802,849	\$ 7,876	0.33	%
Securities loaned	1,375,403	13,821	2.03	%	1,533,684	10,903	1.43	%
Notes payable and other borrowings	1,380,699	12,496	1.81	%	1,049,734	9,340	1.79	%
Total interest-bearing	7,795,169	36,471	0.94	%	7,386,267	28,119	0.76	%

liabilities					
Noninterest-bearing liabilities					
Noninterest-bearing deposits	2,254,268			2,178,378	
Other liabilities	634,661			641,335	
Total liabilities	10,684,098			10,205,980	
Stockholders' equity	1,881,809			1,755,963	
Noncontrolling interest	2,697			1,667	
Total liabilities and stockholders' equity	\$ 12,568,604			\$ 11,963,610	
Net interest income					
(2)		\$ 209,111			\$ 195,555
Net interest spread					
(2)		3.49	%		3.49 %
Net interest margin					
(2)		3.81	%		3.76 %

(1) Average balance includes non-accrual loans.

(2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on a 35% federal income tax rate. The adjustment to interest income was \$0.5 million and \$0.6 million for the three months ended June 30, 2017 and 2016, respectively, and \$1.0 million and \$1.3 million for the six months ended June 30, 2017 and 2016, respectively.

The banking segment's net interest margin exceeds our consolidated net interest margin shown above. Our consolidated net interest margin includes certain items that are not reflected in the calculation of our net interest margin within our banking segment and reduce our consolidated net interest margin, such as the borrowing costs of Hilltop and the yields and costs associated with certain items within interest-earning assets and interest-bearing liabilities in the broker-dealer segment, including items related to securities financing operations that particularly decrease net interest margin. In addition, yields and costs on certain interest-earning assets, such as warehouse lines of credit extended to subsidiaries by the banking segment, are eliminated from the consolidated financial statements.

On a consolidated basis, net interest income increased \$15.6 million and \$13.8 million during the three and six months ended June 30, 2017, respectively, compared with the same periods in 2016. Changes in net interest income were primarily related to increases in the net interest earned on mortgage-backed securities and improved stock loan spreads in our broker-dealer segment and net volume and yield changes on the loan portfolio within our banking segment as a result of the increase in year-over-year accretion of discount on loans.

The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The consolidated provision for loan losses, substantially all of which related to the banking segment, was \$5.9 million and \$28.9 million during the three months ended June 30, 2017 and 2016, respectively. During the three months ended June 30, 2017, the provision for loan

losses was comprised of charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$4.4 million and PCI loans of \$1.5 million, compared to charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$30.7 million, partially offset by the recapture of charges on PCI loans of \$1.8 million during the three months ended June 30, 2016. During the six months ended June 30, 2017 and 2016, the consolidated provision for loan losses, substantially all of which related to the banking segment, was \$7.6 million and \$32.3 million, respectively. The provision for loan losses during the six months ended June 30, 2017 was comprised of

63

Table of Contents

charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$6.1 million and PCI loans of \$1.5 million, compared to charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$33.2 million, partially offset by the recapture of charges on PCI loans of \$0.9 million during the six months ended June 30, 2016. In addition, as previously mentioned, the consolidated provision for loan losses during the three and six months ended June 30, 2016 included a \$24.5 million charge-off of a single large loan by the Bank.

Consolidated noninterest income increased \$1.3 million and \$7.2 million during the three and six months ended June 30, 2017, respectively, compared with the same periods in 2016. Consolidated noninterest income during the three and six months ended June 30, 2017 included the previously mentioned insurance receivable and related increase to other noninterest income of \$15.0 million in our banking segment and the pre-tax net increase to other noninterest income of \$11.6 million within corporate related to the resolution of the appraisal proceedings from the SWS Merger. The year-over-year changes in noninterest income, other than the previously mentioned non-recurring items, during the three and six months ended June 30, 2017, compared with the same periods in 2016, were primarily driven by decreases in noninterest income within each of our operating segments.

Consolidated noninterest expense decreased \$1.1 million and \$5.8 million during the three and six months ended June 30, 2017, respectively, compared with the same periods in 2016. The year-over-year decrease in noninterest expense during the three and six months ended June 30, 2017, compared with the same periods in 2016, primarily included decreases in noninterest expense within our broker-dealer, mortgage origination and insurance segments, partially offset by an increase within our banking segment primarily associated with covered assets. During the six months ended June 30, 2017, we incurred pre-tax transaction and integration costs related to the SWS Merger of \$1.5 million, compared with \$7.1 million during the same period in 2016.

Consolidated income tax expense during the three months ended June 30, 2017 and 2016 was \$25.8 million and \$18.4 million, respectively, reflecting effective tax rates of 29.1% and 36.8%, respectively. During the six months ended June 30, 2017 and 2016, consolidated income tax expense was \$40.8 million and \$32.9 million, respectively, reflecting effective tax rates of 31.4% and 35.4%, respectively. The effective tax rates during the three and six months ended June 30, 2017 were lower than the statutory rate primarily due to a nontaxable increase to other noninterest income recorded in the resolution of the SWS matter as previously discussed, as the SWS Merger was a tax-free reorganization under Section 368(a) of the Internal Revenue Code. The lower effective tax rates during the three and six months ended June 30, 2016 were primarily due to the recognition of excess tax benefits on share-based payment awards.

Segment Results

Banking Segment

Income before income taxes in our banking segment during the three months ended June 30, 2017 and 2016 was \$59.8 million and \$21.6 million, respectively, while income before income taxes in our banking segment during the six months ended June 30, 2017 and 2016 was \$91.6 million and \$52.8 million, respectively. The increases in income before income taxes during the three and six months ended June 30, 2017, compared with the same periods in 2016, were primarily due to the previously mentioned insurance receivable and related increase to other noninterest income of \$15.0 million during the 2017 periods and the \$24.5 million charge-off within the provision for loan losses during the 2016 periods. Income before income taxes during the three and six months ended June 30, 2017, compared with the same periods in 2016, also increased due to an increase in net interest income associated with net volume and yield changes as a result of both the increase in year-over-year accretion of discount on loans and the compression of interest rate margins.

Table of Contents

We consider the ratios shown in the table below to be key indicators of the performance of our banking segment.

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2017	2016	2017	2016
Performance Ratios:				
Efficiency ratio (1)	48.96 %	52.32 %	55.51 %	58.44 %
Return on average assets	1.63 %	0.66 %	1.30 %	0.82 %
Net interest margin (2) (4)	4.80 %	4.85 %	4.53 %	4.78 %
Net interest margin (taxable equivalent) (3) (4)	4.81 %	4.87 %	4.53 %	4.81 %

- (1) Efficiency ratio is defined as noninterest expenses divided by the sum of total noninterest income and net interest income for the period.
- (2) Net interest margin is defined as net interest income divided by average interest-earning assets.
- (3) Net interest margin (taxable equivalent), a non-GAAP measure, is defined as taxable equivalent net interest income divided by average interest-earning assets. Annualized taxable equivalent adjustments are based on a 35% federal income tax rate. See footnote 2 to the following tables for the taxable equivalent adjustments to interest income.
- (4) Net interest margin and taxable equivalent net interest margin were 112 basis points and 104 basis points greater due to the impact of purchase accounting during the three months ended June 30, 2017 and 2016, respectively, and 91 basis points and 104 basis points greater due to the impact of purchase accounting during the six months ended June 30, 2017 and 2016, respectively.

The banking segment presents net interest margin in the table above, and net interest margin and net interest income in the following discussion and tables below, on a taxable equivalent basis. The interest income earned on certain earning assets is completely or partially exempt from federal income tax. As such, these tax-exempt instruments typically yield lower returns than taxable investments. To provide more meaningful comparisons of net interest margins for all earning assets, we use net interest income on a taxable-equivalent basis in calculating net interest margin by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments.

During the three months ended June 30, 2017, the banking segment's taxable equivalent net interest margin of 4.81% was 112 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$1.7 million, \$20.7 million and \$0.8 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$0.7 million. The banking segment's taxable equivalent net interest margin during the three months ended June 30, 2016 of 4.87% was 104 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$3.7 million, \$12.6 million and \$1.1 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$0.9 million.

During the six months ended June 30, 2017, the banking segment's taxable equivalent net interest margin of 4.53% was 91 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$3.2 million, \$30.4 million and \$1.7 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$1.2 million. The banking segment's taxable equivalent net interest margin during the six months ended June 30, 2016 of 4.81% was 104 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$7.8 million, \$24.0 million and \$2.2 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$1.7 million.

The FNB Transaction-related accretion of discount on loans of \$30.4 million and \$24.0 million during the six months ended June 30, 2017 and 2016, respectively, included accretion of approximately \$2 million and \$6 million, respectively, due to better-than-expected resolution of covered PCI loans during the respective periods. The performance of the covered PCI loan portfolio since 2014, which has exceeded our expectations at the time of acquisition, has led to higher yields calculated as a result of the Bank's quarterly cash flow recast process. The recast process performed during the six months ended June 30, 2017 and 2016 resulted in the reclassification of \$23.0 million and \$18.4 million, respectively, from nonaccretable difference to accretable yield.

Table of Contents

The tables below provide additional details regarding our banking segment's net interest income (dollars in thousands).

	Three Months Ended June 30, 2017				2016			
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate		Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	
Assets								
Interest-earning assets								
Loans, gross (1)	\$ 5,640,067	\$ 90,471	6.37	%	\$ 5,264,002	\$ 81,306	6.13	%
Subsidiary warehouse lines of credit	1,545,376	14,655	3.75	%	1,150,015	11,282	3.88	%
Investment securities - taxable	883,414	4,162	1.88	%	733,539	3,735	2.04	%
Investment securities - non-taxable (2)	124,495	1,179	3.79	%	135,749	1,267	3.73	%
Federal funds sold and securities purchased under agreements to resell	10,794	27	1.00	%	27,114	36	0.54	%
Interest-bearing deposits in other financial institutions	284,862	773	1.09	%	302,485	426	0.57	%
Other	66,127	624	3.78	%	49,455	487	3.94	%
Interest-earning assets, gross (2)	8,555,135	111,891	5.20	%	7,662,359	98,539	5.11	%
Allowance for loan losses	(57,738)				(51,004)			
Interest-earning assets, net	8,497,397				7,611,355			
Noninterest-earning assets	943,310				1,040,375			
Total assets	\$ 9,440,707				\$ 8,651,730			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities								
Interest-bearing deposits	\$ 4,867,042	\$ 7,220	0.59	%	\$ 4,558,852	\$ 4,982	0.44	%
	914,994	2,073	0.90	%	515,004	727	0.56	%

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Notes payable and other borrowings								
Total interest-bearing liabilities (3)	5,782,036	9,293	0.64	%	5,073,856	5,709	0.44	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,239,680				2,225,626			
Other liabilities	54,498				59,844			
Total liabilities	8,076,214				7,359,326			
Stockholders' equity	1,364,493				1,292,404			
Total liabilities and stockholders' equity	\$ 9,440,707				\$ 8,651,730			
Net interest income (2)		\$ 102,598				\$ 92,830		
Net interest spread (2)			4.55	%			4.66	%
Net interest margin (2)			4.81	%			4.87	%

	Six Months Ended June 30, 2017				2016			
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate		Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	
Assets								
Interest-earning assets								
Loans, gross (1)	\$ 5,559,920	\$ 164,248	5.89	%	\$ 5,180,571	\$ 157,687	6.04	%
Subsidiary warehouse lines of credit	1,301,375	24,631	3.76	%	1,071,328	20,991	3.88	%
Investment securities - taxable	822,734	7,707	1.87	%	735,553	7,667	2.08	%
Investment securities - non-taxable (2)	125,036	2,370	3.79	%	139,068	2,568	3.69	%
Federal funds sold and securities purchased under agreements to resell	11,486	50	0.88	%	23,221	63	0.54	%
Interest-bearing deposits in other financial institutions	339,955	1,610	0.95	%	316,936	855	0.54	%

Edgar Filing: Hilltop Holdings Inc. - Form 10-Q

Other	71,112	1,159	3.26	%	51,504	998	3.87	%
Interest-earning assets, gross (2)	8,231,618	201,775	4.89	%	7,518,181	190,829	5.04	%
Allowance for loan losses	(56,642)				(49,821)			
Interest-earning assets, net	8,174,976				7,468,360			
Noninterest-earning assets	965,116				1,053,622			
Total assets	\$ 9,140,092				\$ 8,521,982			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities								
Interest-bearing deposits	\$ 4,765,219	\$ 13,657	0.58	%	\$ 4,494,259	\$ 9,689	0.43	%
Notes payable and other borrowings	735,228	3,024	0.82	%	512,534	1,400	0.54	%
Total interest-bearing liabilities (3)	5,500,447	16,681	0.61	%	5,006,793	11,089	0.44	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,227,775				2,190,428			
Other liabilities	55,112				47,401			
Total liabilities	7,783,334				7,244,622			
Stockholders' equity	1,356,758				1,277,360			
Total liabilities and stockholders' equity	\$ 9,140,092				\$ 8,521,982			
Net interest income (2)								
		\$ 185,094				\$ 179,740		
Net interest spread (2)								
			4.28	%			4.59	%
Net interest margin (2)								
			4.53	%			4.81	%

(1) Average balance includes non-accrual loans.

(2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on a 35% federal income tax rate. The adjustment to interest income was \$0.4 million and \$0.5 million for the three months ended June 30, 2017 and 2016, respectively, and \$0.8 million and \$0.9 million for the six months ended June 30, 2017 and 2016, respectively.

(3) Only considers debt of PlainsCapital without the allocation of interest expense on PCC debt of \$0.3 million and \$0.7 million for the three and six months ended June 30, 2016, respectively. Interest expense on PCC debt was not allocated to PlainsCapital beginning January 1, 2017.

Table of Contents

The banking segment's net interest margin exceeds our consolidated net interest margin. Our consolidated net interest margin includes certain items that are not reflected in the calculation of our net interest margin within our banking segment and reduce our consolidated net interest margin, such as the borrowing costs of Hilltop and the yields and costs associated with certain items within interest-earning assets and interest-bearing liabilities in the broker-dealer segment, including items related to securities financing operations that particularly decrease net interest margin. In addition, the banking segment's interest-earning assets include warehouse lines of credit extended to other subsidiaries, which are eliminated from the consolidated financial statements.

The following table summarizes the changes in the banking segment's net interest income for the periods indicated below, including the component changes in the volume of average interest-earning assets and interest-bearing liabilities and changes in the rates earned or paid on those items (in thousands).

	Three Months Ended June 30, 2017 vs. 2016			Six Months Ended June 30, 2017 vs. 2016		
	Change Due To (1)			Change Due To (1)		
	Volume	Yield/Rate	Change	Volume	Yield/Rate	Change
Interest income						
Loans, gross	\$ 5,750	\$ 3,415	\$ 9,165	\$ 11,367	\$ (4,806)	\$ 6,561
Subsidiary warehouse lines of credit	3,826	(453)	3,373	4,421	(781)	3,640
Investment securities - taxable	761	(334)	427	901	(861)	40
Investment securities - non-taxable (2)	(105)	17	(88)	(257)	59	(198)
Federal funds sold and securities purchased under agreements to resell	(22)	13	(9)	(32)	19	(13)
Interest-bearing deposits in other financial institutions	(25)	372	347	62	693	755
Other	164	(27)	137	377	(216)	161
Total interest income (2)	10,349	3,003	13,352	16,839	(5,893)	10,946
Interest expense						
Deposits	\$ 338	\$ 1,900	\$ 2,238	\$ 583	\$ 3,385	\$ 3,968
Notes payable and other borrowings	560	786	1,346	600	1,024	1,624
Total interest expense	898	2,686	3,584	1,183	4,409	5,592
Net interest income (2)	\$ 9,451	\$ 317	\$ 9,768	\$ 15,656	\$ (10,302)	\$ 5,354

(1) Changes attributable to both volume and yield/rate are included in yield/rate column.

(2) Annualized taxable equivalent.

Taxable equivalent net interest income increased \$9.8 million and \$5.4 million during the three and six months ended June 30, 2017, respectively, compared with the same periods in 2016. Changes in the yields earned on interest-earning assets increased taxable equivalent net interest income by \$3.0 million during the three months ended June 30, 2017, compared with the same period in 2016, primarily due to an increase in accretion of discount on loans of \$5.8 million, partially offset by a decrease in yield on a portion of the loan portfolio. Changes in yields earned on interest-earning assets decreased taxable equivalent net interest income by \$5.9 million during the six months ended June 30, 2017, compared with the same period in 2016, primarily due to lower yields on a portion of the loan portfolio, partially offset by an increase in accretion of discount on loans of \$1.3 million. These year-over-year increases in accretion of discount on loans were due to better-than-expected resolution of covered PCI loans. However, accretion of discount on loans is expected to decrease in future periods as loans acquired in the Bank Transactions are repaid, refinanced or renewed. We experienced interest rate margin compression during the three and six months ended June 30, 2017, which was driven by the rising interest rate environment and the rate floors in effect for a portion of the Bank's loan portfolio, thereby causing yields on our interest-earning assets to rise more slowly than increases in market interest rates. Absent a decline in interest rates, we believe this interest rate compression will continue until the rise in market interest rates is sufficient to allow our loan portfolio to reprice above applicable rate floors. Increases in the volume of interest-earning assets, primarily on the loan portfolio and additional amounts drawn on the subsidiary warehouse lines of credit, increased taxable equivalent net interest income by \$10.3 million and \$16.8 million during the three and six months ended June 30, 2017, respectively, compared with the same periods in 2016. Changes in rates paid on interest-bearing liabilities decreased taxable equivalent net interest income by \$2.7 million and \$4.4 million during the three and six months ended June 30, 2017, respectively, compared with the same periods in 2016, due to increases in market interest rates.

Table of Contents

The banking segment's noninterest income was \$25.5 million and \$13.3 million during the three months ended June 30, 2017 and 2016, respectively, and \$37.9 million and \$26.3 million during the six months ended June 30, 2017 and 2016, respectively. The increase in noninterest income during the three months ended June 30, 2017, compared to the same period in 2016, primarily included the previously mentioned insurance receivable and related increase in other noninterest income of \$15.0 million from coverage provided by an insurance policy for forgery related to a single, large loan previously charged off by the Bank. The changes in noninterest income, other than the previously mentioned insurance receivable, for the three and six months ended June 30, 2017 compared to the same periods in 2016, were primarily driven by year-over-year decreases in exchange fee income due to the impact of the Durbin amendment, which became applicable to the Bank on July 1, 2016, and intercompany financing charges.

The banking segment's noninterest expenses were \$62.5 million and \$55.1 million during the three months ended June 30, 2017 and 2016, respectively, and \$123.3 million and \$119.5 million during the six months ended June 30, 2017 and 2016, respectively. Noninterest expenses were primarily comprised of employees' compensation and benefits, and occupancy expenses. The change in noninterest expenses during the three months ended June 30, 2017, compared to the same period in 2016, included increases in net expenses associated with covered assets of \$3.4 million, repossession and foreclosure expenses of \$2.8 million, as well as legal expenses associated with its efforts to recover losses arising from the \$24.5 million loan that was charged off during the second quarter of 2016, partially offset by decreases in expenses associated with organizational changes. The change in noninterest expenses during the six months ended June 30, 2017, compared to the same period in 2016, included increases in employees' compensation and benefits of \$3.3 million primarily due to increased headcount and related benefit costs, net expenses associated with covered assets of \$6.0 million, repossession and foreclosure expenses of \$3.0 million, as well as legal expenses associated with the Bank's previously mentioned efforts, partially offset by a year-over-year decrease of \$7.9 million associated with a downward valuation adjustment on a significant covered OREO property recorded during the first quarter of 2016, as well as decreases in occupancy expenses associated with closed branches and expenses associated with organizational changes.

Broker-Dealer Segment

Income before income taxes in our broker-dealer segment was \$15.8 million and \$25.3 million during the three and six months ended June 30, 2017, respectively, and \$18.3 million and \$22.1 million during the three and six months ended June 30, 2016, respectively. The changes in income before income taxes during the three and six months ended June 30, 2017, compared with the same periods in 2016, were primarily the result of decreases in pre-tax integration-related costs of \$0.8 million and \$4.8 million, respectively, increases in the federal funds rate during the first and second quarters of 2017, which led to increases of \$2.5 million and \$5.1 million, respectively, in fees earned on money market and FDIC insured bank deposits, and decreases of \$4.5 million and \$6.3 million, respectively, in investment banking and advisory fees primarily earned on the underwriting of municipal bond transactions and the secondary trading of these and other municipal securities.

The broker-dealer segment is subject to interest rate risk as a consequence of maintaining inventory positions, trading in interest rate sensitive financial instruments and maintaining a matched stock loan book. Changes in interest rates are likely to have a meaningful impact on our overall financial performance. Our broker-dealer segment has historically earned a significant portion of its revenues from advisory fees paid to it by its clients, in large part upon the successful completion of the client's transaction. Rapid or significant changes in interest rates could adversely affect the broker-dealer segment's bond trading, sales, underwriting activities and other interest spread-sensitive activities described below. The broker-dealer segment also receives administrative fees for providing money market and FDIC investment alternatives to clients, which tend to be sensitive to short term interest rates. In addition, the profitability of the broker-dealer segment depends, to an extent, on the spread between revenues earned on customer loans and excess customer cash balances, and the interest expense paid on customer cash balances and other borrowings.

Table of Contents

The following table provides additional details regarding our broker-dealer operating results (in thousands).

	Three Months Ended June 30,			Six Months Ended June 30,		
	2017	2016	Variance 2017 vs 2016	2017	2016	Variance 2017 vs 2016
Net interest income:						
Securities lending	\$ 2,116	\$ 1,410	\$ 706	\$ 3,829	\$ 3,012	\$ 817
Other	8,233	6,030	2,203	15,008	11,479	3,529
Total net interest income	10,349	7,440	2,909	18,837	14,491	4,346
Noninterest income:						
Securities commissions and fees by business line (1):						
Capital markets	10,259	14,731	(4,472)	21,658	28,581	(6,923)
Retail	19,730	18,468	1,262	39,317	36,219	3,098
Clearing	8,595	7,238	1,357	17,110	13,753	3,357
Other	1,015	919	96	2,337	2,003	334
	39,599	41,356	(1,757)	80,422	80,556	(134)
Investment banking and advisory fees by business line:						
Public finance	19,816					