

Hilltop Holdings Inc.
Form 10-Q
April 28, 2016
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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 March 31, 2016

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

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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, or smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting 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)

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 April 28, 2016 was 98,498,077.

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HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2016

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	March 31, 2016	December 31, 2015
Assets		
Cash and due from banks	\$ 512,103	\$ 652,036
Federal funds sold	15,406	17,409
Securities purchased under agreements to resell	96,646	105,660
Assets segregated for regulatory purposes	120,714	158,613
Securities:		
Trading, at fair value	368,425	214,146
Available for sale, at fair value (amortized cost of \$655,989 and \$670,003, respectively)	666,328	673,706
Held to maturity, at amortized cost (fair value of \$313,553 and \$331,468, respectively)	310,478	332,022
	1,345,231	1,219,874
Loans held for sale	1,344,333	1,533,678
Non-covered loans, net of unearned income	5,366,065	5,220,040
Allowance for non-covered loan losses	(48,450)	(45,415)
Non-covered loans, net	5,317,615	5,174,625
Covered loans, net of allowance of \$1,217 and \$1,532, respectively	346,169	378,762
Broker-dealer and clearing organization receivables	1,370,622	1,362,499
Premises and equipment, net	198,414	200,618
FDIC indemnification asset	80,522	91,648
Covered other real estate owned	78,890	99,090
Other assets	601,181	565,813
Goodwill	251,808	251,808
Other intangible assets, net	52,274	54,868
Total assets	\$ 11,731,928	\$ 11,867,001
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	\$ 2,233,608	\$ 2,235,436
Interest-bearing	4,750,567	4,717,247
Total deposits	6,984,175	6,952,683

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Broker-dealer and clearing organization payables	1,284,016	1,338,305
Short-term borrowings	832,921	947,373
Securities sold, not yet purchased, at fair value	165,704	130,044
Notes payable	232,190	238,716
Junior subordinated debentures	67,012	67,012
Other liabilities	405,899	454,743
Total liabilities	9,971,917	10,128,876
Commitments and contingencies (see Notes 12 and 13)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, \$0.01 par value, 125,000,000 shares authorized; 98,584,947 and 98,896,184 shares issued and outstanding, respectively	986	989
Additional paid-in capital	1,567,150	1,577,270
Accumulated other comprehensive income	6,878	2,629
Retained earnings	183,042	155,475
Deferred compensation employee stock trust, net	1,020	1,034
Employee stock trust (21,453 and 22,196 shares, at cost, respectively)	(428)	(443)
Total Hilltop stockholders' equity	1,758,648	1,736,954
Noncontrolling interests	1,363	1,171
Total stockholders' equity	1,760,011	1,738,125
Total liabilities and stockholders' equity	\$ 11,731,928	\$ 11,867,001

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Interest income:		
Loans, including fees	\$ 91,551	\$ 87,388
Securities borrowed	7,589	10,018
Securities:		
Taxable	6,367	7,049
Tax-exempt	1,637	1,741
Other	1,009	1,473
Total interest income	108,153	107,669
Interest expense:		
Deposits	4,102	4,315
Securities loaned	5,987	7,506
Short-term borrowings	1,120	1,024
Notes payable	2,582	669
Junior subordinated debentures	645	585
Other	176	178
Total interest expense	14,612	14,277
Net interest income	93,541	93,392
Provision for loan losses	3,407	2,687
Net interest income after provision for loan losses	90,134	90,705
Noninterest income:		
Net realized gains on securities	46	4,403
Net gains from sale of loans and other mortgage production income	127,297	120,545
Mortgage loan origination fees	18,813	14,589
Net insurance premiums earned	39,733	39,567
Securities commissions and fees	38,752	42,918
Investment and securities advisory fees and commissions	23,819	24,922
Bargain purchase gain	—	81,289
Other	29,226	24,613
Total noninterest income	277,686	352,846
Noninterest expense:		
Employees' compensation and benefits	182,655	182,504

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Loss and loss adjustment expenses	21,959	18,860
Policy acquisition and other underwriting expenses	11,252	11,674
Occupancy and equipment, net	27,791	29,185
Other	81,544	72,253
Total noninterest expense	325,201	314,476
Income before income taxes	42,619	129,075
Income tax expense	14,423	15,420
Net income	28,196	113,655
Less: Net income attributable to noncontrolling interest	629	353
Income attributable to Hilltop	27,567	113,302
Dividends on preferred stock	—	1,426
Income applicable to Hilltop common stockholders	\$ 27,567	\$ 111,876
Earnings per common share:		
Basic	\$ 0.28	\$ 1.12
Diluted	\$ 0.28	\$ 1.11
Weighted average share information:		
Basic	98,153	99,741
Diluted	98,669	100,627

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Net income	\$ 28,196	\$ 113,655
Other comprehensive income:		
Net unrealized gains on securities available for sale, net of tax of \$2,390 and \$4,454, respectively	4,279	7,913
Reclassification adjustment for gains included in net income, net of tax of \$(16) and \$(1,589), respectively	(30)	(2,814)
Comprehensive income	32,445	118,754
Less: comprehensive income attributable to noncontrolling interest	629	353
Comprehensive income applicable to Hilltop	\$ 31,816	\$ 118,401

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

Stock	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings (Accumulated Deficit)	Deferred Compensation Employee Stock Trust, Net	Employee Stock Trust		Total Hilltop Stockholders' Equity	
	Shares	Amount					Shares	Amount		
\$	114,068	90,182	\$ 902	\$ 1,390,788	\$ 651	\$ (45,957)	\$ —	—	\$ —	\$ 1,460,452
—	—	—	—	—	113,302	—	—	—	—	113,302
—	—	—	—	5,099	—	—	—	—	—	5,099
—	10,113	101	199,932	—	—	—	—	—	—	200,033
—	—	—	1,814	—	—	—	—	—	—	1,814
—	2	—	51	—	—	—	—	—	—	51
—	(11)	—	—	—	—	—	—	—	—	—
—	—	—	—	—	(1,427)	—	—	—	—	(1,427)
—	—	—	—	—	—	1,189	30	(597)	—	592
—	—	—	—	—	—	—	—	—	—	—
\$	114,068	100,286	\$ 1,003	\$ 1,592,585	\$ 5,750	\$ 65,918	\$ 1,189	30	\$ (597)	\$ 1,779,916

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\$ —	98,896	\$ 989	\$ 1,577,270	\$ 2,629	\$ 155,475	\$ 1,034	22	\$ (443)	\$ 1,736,954
—	—	—	—	—	27,567	—	—	—	27,567
—	—	—	—	4,249	—	—	—	—	4,249
—	500	5	3,845	—	—	—	—	—	3,850
—	—	—	2,228	—	—	—	—	—	2,228
—	6	—	108	—	—	—	—	—	108
—	(1)	—	(33)	—	—	—	—	—	(33)
—	(816)	(8)	(16,268)	—	—	—	—	—	(16,276)
—	—	—	—	—	—	(14)	(1)	15	1
—	—	—	—	—	—	—	—	—	—
\$ —	98,585	\$ 986	\$ 1,567,150	\$ 6,878	\$ 183,042	\$ 1,020	21	\$ (428)	\$ 1,758,648

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Operating Activities		
Net income	\$ 28,196	\$ 113,655
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	3,407	2,687
Depreciation, amortization and accretion, net	(11,830)	(14,486)
Net realized gains on securities	(46)	(4,403)
Bargain purchase gain	—	(81,289)
Deferred income taxes	494	(2,545)
Other, net	8,320	(3,814)
Net change in securities purchased under agreements to resell	9,014	(22,486)
Net change in assets segregated for regulatory purposes	37,899	(20,657)
Net change in trading securities	(154,279)	11,632
Net change in broker-dealer and clearing organization receivables	130,858	(793,613)
Net change in FDIC Indemnification Asset	11,214	23,376
Net change in other assets	(14,890)	(34,554)
Net change in broker-dealer and clearing organization payables	(162,722)	690,552
Net change in other liabilities	(48,283)	(52,528)
Net gains from sales of loans	(127,297)	(120,545)
Loans originated for sale	(3,052,579)	(2,904,331)
Proceeds from loans sold	3,352,409	3,094,705
Net cash provided by (used in) operating activities	9,885	(118,644)
Investing Activities		
Proceeds from maturities and principal reductions of securities held to maturity	21,398	6,329
Proceeds from sales, maturities and principal reductions of securities available for sale	64,918	449,892
Purchases of securities available for sale	(51,531)	(2,623)
Net change in loans	(233,309)	(2,080)
Purchases of premises and equipment and other assets	(9,948)	(5,565)
Proceeds from sales of premises and equipment and other real estate owned	22,068	31,818
Net cash received for Federal Home Loan Bank and Federal Reserve Bank stock	12,311	4,044
Net cash from acquisitions	—	41,097

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Net cash provided by (used in) investing activities	(174,093)	522,912
Financing Activities		
Net change in deposits	139,925	(556,657)
Net change in short-term borrowings	(114,452)	72,540
Proceeds from notes payable	5,553	1,000
Payments on notes payable	(12,028)	(23,904)
Proceeds from issuance of common stock	3,850	—
Dividends paid on preferred stock	—	(1,426)
Net cash distributed to noncontrolling interest	(437)	(264)
Other, net	(139)	(99)
Net cash provided by (used in) financing activities	22,272	(508,810)
Net change in cash and cash equivalents	(141,936)	(104,542)
Cash and cash equivalents, beginning of period	669,445	813,075
Cash and cash equivalents, end of period	\$ 527,509	\$ 708,533
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	\$ 16,377	\$ 14,325
Cash paid for income taxes, net of refunds	\$ 831	\$ 45,981
Supplemental Schedule of Non-Cash Activities		
Conversion of loans to other real estate owned	\$ 4,726	\$ 26,211
Common stock issued in acquisition	\$ —	\$ 200,626
Additions to mortgage servicing rights	\$ 1,639	\$ 2,690

See accompanying notes.

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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 provides its products and services through three primary operating subsidiaries, PlainsCapital Corporation (“PlainsCapital”), Hilltop Securities Holdings LLC (“Securities Holdings”) and National Lloyds Corporation (“NLC”). PlainsCapital is a financial holding company, headquartered in Dallas, Texas, 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, 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. 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.

On January 1, 2015, Hilltop completed its acquisition of SWS Group, Inc. (“SWS”) in a stock and cash transaction (the “SWS Merger”), whereby SWS’s broker-dealer subsidiaries, Southwest Securities, Inc. and SWS Financial Services, Inc., became subsidiaries of Securities Holdings, and SWS’s banking subsidiary, Southwest Securities, FSB (“SWS FSB”), was merged into the Bank. On October 5, 2015, Southwest Securities, Inc. and SWS Financial Services, Inc. were renamed “Hilltop Securities Inc.” (“Hilltop Securities”) and “Hilltop Securities Independent Network Inc.” (“HTS Independent Network”), respectively.

On October 22, 2015, the Financial Industry Regulatory Authority (“FINRA”) granted approval to combine First Southwest Company, LLC (“FSC”) and Hilltop Securities, subject to customary conditions. FSC, Hilltop Securities and

HTS Independent Network operated as separate broker-dealers, under coordinated leadership from the date of the SWS Merger until January 22, 2016, when FSC was merged into Hilltop Securities to form a combined firm operating under the “Hilltop Securities” name. We use the term “Hilltop Broker-Dealers” to refer to FSC, Hilltop Securities and HTS Independent Network prior to January 22, 2016 and Hilltop Securities and HTS Independent Network after such date.

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, 2015 (“2015 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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 PlainsCapital. PlainsCapital 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”) and has a 100% membership interest in PlainsCapital Securities, LLC.

PrimeLending owns a 100% membership interest in PrimeLending Ventures Management, LLC, the controlling and sole managing member of PrimeLending Ventures, LLC (“Ventures”).

PlainsCapital 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 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, HTS Independent Network and First Southwest Holdings, LLC (“First Southwest”). Hilltop Securities is a broker-dealer registered with the SEC and the 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, a wholly-owned subsidiary of First Southwest, is a registered investment advisor under the Investment Advisors Act of 1940. As discussed above, prior to January 22, 2016, Securities Holdings’ subsidiaries also included FSC, First Southwest’s principal subsidiary and formerly a broker-dealer registered with the SEC and FINRA and a member of the NYSE.

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.

The operations acquired in the SWS Merger were included in the Company's operating results beginning January 1, 2015 and such operations included a preliminary bargain purchase gain of \$82.8 million as disclosed in the Company's Quarterly Report on Form 10-Q filed with the SEC on May 6, 2015. During 2015, certain adjustments were recorded that resulted in an aggregate decrease in the preliminary bargain purchase gain associated with the SWS Merger to \$81.3 million, which also decreased net income for the three months ended March 31, 2015 by \$1.5 million as compared with amounts previously reported in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2015. Accordingly, our results for the quarter ended March 31, 2015 and related disclosures have been revised to reflect these adjustments.

Certain reclassifications have been made to the prior period consolidated financial statements to conform with the current period presentation. Additionally, during the preparation of the condensed consolidated financial statements for the period ended September 30, 2015, the Company determined that its previously reported unaudited consolidated statements of cash flows contained in the previously filed Quarterly Reports on Form 10-Q filed with SEC on May 6, 2015 and July 29, 2015 contained a classification error related to how certain acquired balances related to its acquisition of SWS were reflected. Management has evaluated the quantitative and qualitative impact of the classification error to previously issued unaudited consolidated statements of cash flows and concluded that the previously issued condensed consolidated financial statements were not materially misstated. However, in order to correctly present the cash flow statements, management has elected to revise the unaudited consolidated statements of cash flows for each of the three

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

months ended March 31, 2015 included herein and the six months ended June 30, 2015 in its future filings. The correction had no impact on the Company's financial condition or results of operations for the periods presented.

The following table summarizes the revisions made to the Company's unaudited consolidated statements of cash flows for the noted periods (in thousands).

	Three Months Ended March 31, 2015	
	As Originally Reported	As Revised
Operating Activities		
Net change in broker-dealer and clearing organization receivables	\$ (1,062,969)	\$ (793,613)
Net change in broker-dealer and clearing organization payables	1,039,786	690,552
Net cash used in operating activities	(38,766)	(118,644)
Investing Activities		
Net change in loans	267,275	(2,080)
Net cash provided by investing activities	792,267	522,912
Financing Activities		
Net change in deposits	(905,890)	(556,657)
Net cash used in financing activities	(858,043)	(508,810)
Net change in cash and cash equivalents	(104,542)	(104,542)

2. Acquisition

SWS Merger

On January 1, 2015, Hilltop completed its acquisition of SWS in a stock and cash transaction, whereby each outstanding share of SWS common stock was converted into the right to receive 0.2496 shares of Hilltop common stock and \$1.94 in cash, equating to \$6.92 per share based on Hilltop's closing price on December 31, 2014 and resulting in an aggregate purchase price of \$349.1 million, consisting of 10.1 million shares of common stock, \$78.2 million in cash and \$70.3 million associated with Hilltop's existing investment in SWS common stock. The operations of SWS are included in the Company's operating results beginning January 1, 2015. Such operating results include a bargain purchase gain of \$81.3 million and are not necessarily indicative of future operating results. SWS's results of operations prior to the acquisition date are not included in the Company's consolidated operating results.

The SWS Merger was accounted for using the acquisition method of accounting, and accordingly, purchased assets, including identifiable intangible assets, and assumed liabilities were recorded at their respective acquisition date fair values. The components of the consideration paid are shown in the following table (in thousands).

Fair value of consideration paid:	
Common stock issued	\$ 200,626
Cash	78,217
Fair value of Hilltop's existing investment in SWS	70,282
Total consideration paid	\$ 349,125

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The resulting fair values of the identifiable assets acquired, and liabilities assumed, acquired in the SWS Merger at January 1, 2015 are summarized in the following table (in thousands).

Cash and due from banks	\$ 119,314
Federal funds sold and securities purchased under agreements to resell	44,741
Assets segregated for regulatory purposes	181,610
Securities	707,476
Non-covered loans, net	863,819
Broker-dealer and clearing organization receivables	1,221,793
Other assets	159,906
Total identifiable assets acquired	3,298,659
Deposits	(1,287,509)
Broker-dealer and clearing organization payables	(1,109,978)
Short-term borrowings	(164,240)
Securities sold, not yet purchased, at fair value	(140,409)
Notes payable	(76,643)
Other liabilities	(89,466)
Total liabilities assumed	(2,868,245)
Bargain purchase gain	(81,289)
	349,125
Less Hilltop existing investment in SWS	(70,282)
Net identifiable assets acquired	\$ 278,843

The bargain purchase gain represents the excess of the estimated fair value of the underlying net tangible assets and intangible assets over the merger consideration. The SWS Merger was a tax-free reorganization under Section 368(a) of the Internal Revenue Code, therefore no income taxes were recorded in connection with the bargain purchase gain. The Company used significant estimates and assumptions to value certain identifiable assets acquired and liabilities assumed. The bargain purchase gain was primarily driven by the Company's ability to realize acquired deferred tax assets through its consolidated core earnings and the decline in the price of the Company's common stock between the date the fixed conversion ratio was agreed upon and the closing date.

Included within the fair value of other assets in the table above are identifiable intangible assets recorded in connection with the SWS Merger. The allocation to intangible assets is as follows (in thousands).

	Estimated Useful Life (Years)	Gross Intangible Assets
Customer relationships	14	\$ 7,300
Core deposits	4	160
		\$ 7,460

In connection with the SWS Merger, Hilltop acquired loans both with and without evidence of credit quality deterioration since origination. The acquired loans were initially recorded at fair value with no carryover of any allowance for loan losses. Acquired loans were segregated between those considered to be purchased credit impaired (“PCI”) loans and those without credit impairment at acquisition.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following table presents details on acquired loans at the acquisition date (in thousands).

	Loans, excluding PCI Loans	PCI Loans	Total Loans
Commercial and industrial	\$ 178,603	\$ 9,850	\$ 188,453
Real estate	324,477	62,218	386,695
Construction and land development	14,708	1,391	16,099
Consumer	3,216	—	3,216
Broker-dealer (1)	269,356	—	269,356
Total	\$ 790,360	\$ 73,459	\$ 863,819

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

The following table presents information about the PCI loans at acquisition (in thousands).

Contractually required principal and interest payments	\$ 120,078
Nonaccretable difference	32,040
Cash flows expected to be collected	88,038
Accretable difference	14,579
Fair value of loans acquired with a deterioration of credit quality	\$ 73,459

The following table presents information about the acquired loans without credit impairment at acquisition (in thousands).

Contractually required principal and interest payments	\$ 901,672
Contractual cash flows not expected to be collected	39,721

Fair value at acquisition

790,360

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.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

- 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 March 31, 2016 and December 31, 2015, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was \$1.29 billion and \$1.46 billion, respectively, and the unpaid principal balance of those loans was \$1.23 billion and \$1.41 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.

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
March 31, 2016				
Trading securities	\$ 12,916	\$ 355,508	\$ 1	\$ 368,425
Available for sale securities	17,979	648,349	—	666,328
Loans held for sale	—	1,244,799	40,545	1,285,344

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Derivative assets	—	90,981	—	90,981
MSR asset	—	—	39,863	39,863
Securities sold, not yet purchased	60,149	105,555	—	165,704
Derivative liabilities	—	43,945	—	43,945

	Level 1	Level 2	Level 3	Total
December 31, 2015	Inputs	Inputs	Inputs	Fair Value
Trading securities	\$ 21,807	\$ 192,338	\$ 1	\$ 214,146
Available for sale securities	17,409	656,297	—	673,706
Loans held for sale	—	1,434,955	25,880	1,460,835
Derivative assets	—	35,676	—	35,676
MSR asset	—	—	52,285	52,285
Securities sold, not yet purchased	27,648	102,396	—	130,044
Derivative liabilities	—	5,426	—	5,426

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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)		Balance at End of Period
				Included in Net Income	Included in Other Comprehensive Income (Loss)	
Three months ended March 31, 2016						
Trading securities	\$ 1	\$ —	\$ —	\$ —	\$ —	\$ 1
Loans held for sale	25,880	23,236	(4,237)	(4,334)	—	40,545
MSR asset	52,285	1,639	—	(14,061)	—	39,863
Total	\$ 78,166	\$ 24,875	\$ (4,237)	\$ (18,395)	\$ —	\$ 80,409
Three months ended March 31, 2015						
Available for sale securities	\$ —	\$ 7,301	\$ —	\$ (1,369)	\$ —	\$ 5,932
Loans held for sale	9,017	11,136	(271)	(387)	—	19,495
MSR asset	36,155	2,690	—	(7,197)	—	31,648
Total	\$ 45,172	\$ 21,127	\$ (271)	\$ (8,953)	\$ —	\$ 57,075

All net realized and unrealized gains (losses) in the table above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at March 31, 2016.

For Level 3 financial instruments measured at fair value on a recurring basis at March 31, 2016, the significant unobservable inputs used in the fair value measurements were as follows.

Range

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Financial instrument	Valuation Technique	Unobservable Input	(Weighted-Average)
Trading securities	Discounted cash flow	Discount rate	8 - 17 % (10 %)
Loans held for sale	Discounted cash flow / Market comparable	Projected price	88 - 96 % (96 %)
MSR asset	Discounted cash flow	Constant prepayment rate	16.92 %
		Discount rate	10.79 %

Trading securities include corporate debt securities that are valued using a discounted cash flow model with observable market data; however, due to the distressed nature of these bonds, the Company has determined that these securities should be valued as a Level 3 financial instrument.

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, or unobservable, inputs. The fair value of such loans is 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.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following table presents the changes in fair value for instruments that are reported at fair value under the Fair Value Option (in thousands).

	Three Months Ended March 31, 2016			Three Months Ended March 31, 2015		
	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	\$ 447	\$ —	\$ 447	\$ (6,695)	\$ —	\$ (6,695)
MSR asset	(14,061)	—	(14,061)	(7,197)	—	(7,197)

The Company also determines the fair value of certain assets and liabilities on a non-recurring basis. In particular, the fair value of all of the assets acquired and liabilities assumed in the SWS Merger was determined at the acquisition date. 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. 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 PlainsCapital (the “PlainsCapital Merger”), the FDIC-assisted transaction (the “FNB Transaction”) whereby the Bank acquired certain assets and assumed certain liabilities of First National Bank (“FNB”) and the SWS Merger, 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 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 March 31, 2016, estimates for these significant unobservable inputs were as follows.

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	PCI Loans					
	PlainsCapital	FNB		SWS		
	Merger	Transaction		Merger		
Weighted average default rate	60	% 55	%	51	%	%
Weighted average loss severity rate	51	% 34	%	30	%	%
Weighted average prepayment speed	0	% 6	%	0	%	%

At March 31, 2016, the resulting weighted average expected loss on PCI loans associated with the PlainsCapital Merger, FNB Transaction and SWS Merger was 31%, 19% and 15%, 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 March 31, 2016, 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 March 31, 2016 and December 31, 2015, the estimated fair value of covered OREO was \$78.9 million and \$99.1 million, respectively, and

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

the underlying fair value measurements utilize Level 2 and Level 3 inputs. The fair value of non-covered OREO at March 31, 2016 and December 31, 2015 was \$0.5 million and \$0.4 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).

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value	Total Gains (Losses) for the Three Months Ended	
					March 31, 2016	2015
March 31, 2016						
Non-covered impaired loans	\$ —	\$ —	\$ 39,722	\$ 39,722	\$ (33)	\$ 349
Covered impaired loans	—	—	45,025	45,025	332	3,218
Non-covered other real estate owned	—	—	—	—	—	(28)
Covered other real estate owned	—	11,322	—	11,322	(9,765)	(950)

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. The methods for determining estimated fair value for financial assets and liabilities is described in detail in Note 3 to the consolidated financial statements included in the Company's 2015 Form 10-K.

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).

Carrying	Estimated Fair Value		Level 3
	Level 1	Level 2	

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March 31, 2016	Amount	Inputs	Inputs	Inputs	Total
Financial assets:					
Cash and cash equivalents	\$ 527,509	\$ 527,509	\$ —	\$ —	\$ 527,509
Securities purchased under agreements to resell	96,646	—	96,646	—	96,646
Assets segregated for regulatory purposes	120,714	120,714	—	—	120,714
Held to maturity securities	310,478	—	313,553	—	313,553
Loans held for sale	58,989	—	58,989	—	58,989
Non-covered loans, net	5,317,615	—	463,987	4,891,840	5,355,827
Covered loans, net	346,169	—	—	484,424	484,424
Broker-dealer and clearing organization receivables	1,370,622	—	1,370,622	—	1,370,622
FDIC indemnification asset	80,522	—	—	77,817	77,817
Other assets	60,468	—	54,412	6,056	60,468
Financial liabilities:					
Deposits	6,984,175	—	6,987,315	—	6,987,315
Broker-dealer and clearing organization payables	1,284,016	—	1,284,016	—	1,284,016
Short-term borrowings	832,921	—	832,921	—	832,921
Debt	299,202	—	292,817	—	292,817
Other liabilities	5,389	—	5,389	—	5,389

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2015	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Financial assets:					
Cash and cash equivalents	\$ 669,445	\$ 669,445	\$ —	\$ —	\$ 669,445
Securities purchased under agreements to resell	105,660	—	105,660	—	105,660
Assets segregated for regulatory purposes	158,613	158,613	—	—	158,613
Held to maturity securities	332,022	—	331,468	—	331,468
Loans held for sale	72,843	—	72,843	—	72,843
Non-covered loans, net	5,174,625	—	602,968	4,600,406	5,203,374
Covered loans, net	378,762	—	—	527,201	527,201
Broker-dealer and clearing organization receivables	1,362,499	—	1,362,499	—	1,362,499
FDIC indemnification asset	91,648	—	—	91,648	91,648
Other assets	68,786	—	53,214	15,572	68,786
Financial liabilities:					
Deposits	6,952,683	—	6,955,919	—	6,955,919
Broker-dealer and clearing organization payables	1,338,305	—	1,338,305	—	1,338,305
Short-term borrowings	947,373	—	947,373	—	947,373
Debt	305,728	—	299,257	—	299,257
Other liabilities	3,699	—	3,699	—	3,699

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

	March 31, 2016	December 31, 2015
U.S. Treasury securities	\$ 11,436	\$ 20,481
U.S. government agencies:		
Bonds	75,015	36,244
Residential mortgage-backed securities	55,526	12,505
Commercial mortgage-backed securities	21,717	19,280
Collateralized mortgage obligations	3,150	264
Corporate debt securities	53,277	34,735
States and political subdivisions	101,655	58,588
Unit investment trusts	37,897	18,400
Private-label securitized product	7,443	12,324
Other	1,309	1,325
Totals	\$ 368,425	\$ 214,146

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 obligation 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 sheet, had a value of \$165.7 million and \$130.0 million at March 31, 2016 and December 31, 2015, respectively.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

March 31, 2016	Available for Sale			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. Treasury securities	\$ 44,409	\$ 483	\$ (8)	\$ 44,884
U.S. government agencies:				
Bonds	301,690	1,703	(280)	303,113
Residential mortgage-backed securities	32,253	1,103	(14)	33,342
Commercial mortgage-backed securities	9,090	283	(2)	9,371
Collateralized mortgage obligations	49,082	81	(641)	48,522
Corporate debt securities	90,080	5,160	(17)	95,223
States and political subdivisions	110,515	2,863	(14)	113,364
Commercial mortgage-backed securities	499	31	—	530
Equity securities	18,371	666	(1,058)	17,979
Totals	\$ 655,989	\$ 12,373	\$ (2,034)	\$ 666,328

December 31, 2015	Available for Sale			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. Treasury securities	\$ 44,430	\$ 206	\$ (33)	\$ 44,603
U.S. government agencies:				
Bonds	297,448	1,135	(1,947)	296,636
Residential mortgage-backed securities	34,864	1,008	(19)	35,853
Commercial mortgage-backed securities	9,174	35	(2)	9,207
Collateralized mortgage obligations	54,297	48	(1,644)	52,701
Corporate debt securities	94,877	3,399	(326)	97,950
States and political subdivisions	116,246	2,581	(102)	118,725
Commercial mortgage-backed securities	498	33	—	531
Equity securities	18,169	574	(1,243)	17,500
Totals	\$ 670,003	\$ 9,019	\$ (5,316)	\$ 673,706

March 31, 2016	Held to Maturity			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. Treasury securities	\$ 25,073	\$ 1	\$ —	\$ 25,074
U.S. government agencies:				
Bonds	60,428	191	—	60,619
Residential mortgage-backed securities	23,099	634	—	23,733
Commercial mortgage-backed securities	18,577	543	(10)	19,110
Collateralized mortgage obligations	157,455	1,491	(2)	158,944
States and political subdivisions	25,846	235	(8)	26,073
Totals	\$ 310,478	\$ 3,095	\$ (20)	\$ 313,553

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2015	Held to Maturity			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. Treasury securities	\$ 25,146	\$ —	\$ (30)	\$ 25,116
U.S. government agencies:				
Bonds	69,379	145	(372)	69,152
Residential mortgage-backed securities	23,735	311	—	24,046
Commercial mortgage-backed securities	18,658	27	(92)	18,593
Collateralized mortgage obligations	167,541	302	(970)	166,873
States and political subdivisions	27,563	168	(43)	27,688
Totals	\$ 332,022	\$ 953	\$ (1,507)	\$ 331,468

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).

	March 31, 2016			December 31, 2015		
	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	3	\$ 4,304	\$ 5	8	\$ 33,791	\$ 33
Unrealized loss for twelve months or longer	2	2,457	3	—	—	—
	5	6,761	8	8	33,791	33
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	1	54,820	152	7	148,327	896
Unrealized loss for twelve months or longer	1	34,865	128	3	44,321	1,051
	2	89,685	280	10	192,648	1,947
Residential mortgage-backed securities:						
	1	1,311	1	3	3,407	5

Unrealized loss for less than twelve months						
Unrealized loss for twelve months or longer	1	976	13	1	982	14
	2	2,287	14	4	4,389	19
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	1	1,605	2	1	1,611	2
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	1	1,605	2	1	1,611	2
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	2	933	4	2	1,590	4
Unrealized loss for twelve months or longer	8	40,304	637	8	42,399	1,640
	10	41,237	641	10	43,989	1,644
Corporate debt securities:						
Unrealized loss for less than twelve months	2	2,820	17	16	16,635	277
Unrealized loss for twelve months or longer	—	—	—	1	1,949	49
	2	2,820	17	17	18,584	326
States and political subdivisions:						
Unrealized loss for less than twelve months	3	702	2	2	3,018	9
Unrealized loss for twelve months or longer	8	5,125	12	35	24,423	93
	11	5,827	14	37	27,441	102
Equity securities:						
Unrealized loss for less than twelve months	1	8,523	709	2	8,949	909
Unrealized loss for twelve months or longer	2	2,321	349	1	1,927	334
	3	10,844	1,058	3	10,876	1,243
Total available for sale:						
Unrealized loss for less than twelve months	14	75,018	892	41	217,328	2,135
Unrealized loss for twelve months or longer	22	86,048	1,142	49	116,001	3,181
	36	\$ 161,066	\$ 2,034	90	\$ 333,329	\$ 5,316

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	March 31, 2016			December 31, 2015		
	Number of	Fair Value	Unrealized	Number of	Fair Value	Unrealized
	Securities		Losses	Securities		Losses
Held to Maturity						
U.S. treasury securities:						
Unrealized loss for less than twelve months	—	\$ —	\$ —	1	\$ 25,115	\$ 30
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	1	25,115	30
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	—	—	—	6	46,607	372
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	6	46,607	372
Commercial						
mortgage-backed securities:						
Unrealized loss for less than twelve months	1	1,416	10	7	16,098	92
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	1	1,416	10	7	16,098	92
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	1	6,648	2	10	127,393	970
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	1	6,648	2	10	127,393	970
States and political subdivisions:						
Unrealized loss for less than twelve months	7	2,756	8	18	7,900	35
Unrealized loss for twelve months or longer	—	—	—	1	2,664	8
	7	2,756	8	19	10,564	43
Total held to maturity:	9	10,820	20	42	223,113	1,499

Unrealized loss for less than
twelve months

Unrealized loss for twelve
months or longer

—	—	—	1	2,664	8
9	\$ 10,820	\$ 20	43	\$ 225,777	\$ 1,507

During the three months ended March 31, 2016 and 2015, 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 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 OTTI of the securities. The Company does not intend, 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 March 31, 2016 are shown by contractual maturity below (in thousands).

	Available for Sale		Held to Maturity	
	Amortized		Amortized	
	Cost	Fair Value	Cost	Fair Value
Due in one year or less	\$ 105,633	\$ 105,938	\$ 26,360	\$ 26,364
Due after one year through five years	73,027	76,352	18,060	18,228
Due after five years through ten years	66,653	70,937	3,185	3,223
Due after ten years	301,381	303,357	63,742	63,951
	546,694	556,584	111,347	111,766
Residential mortgage-backed securities	32,253	33,342	23,099	23,733
Collateralized mortgage obligations	49,082	48,522	157,455	158,944
Commercial mortgage-backed securities	9,589	9,901	18,577	19,110
	\$ 637,618	\$ 648,349	\$ 310,478	\$ 313,553

The Company realized net gains of \$11.3 million and \$3.4 million from its trading securities portfolio during the three months ended March 31, 2016 and 2015, respectively, which are recorded as a component of other noninterest income within the consolidated statements of operations.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

Securities with a carrying amount of \$753.5 million and \$789.9 million (with a fair value of \$761.3 million and \$790.2 million, respectively) at March 31, 2016 and December 31, 2015, 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 March 31, 2016 and December 31, 2015.

Mortgage-backed securities and collateralized mortgage obligations consist principally 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 March 31, 2016 and December 31, 2015, NLC had investments on deposit in custody for various state insurance departments with carrying values of \$9.7 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).

	March 31, 2016	December 31, 2015
Commercial and industrial	\$ 1,619,567	\$ 1,552,805
Real estate	2,536,302	2,313,239
Construction and land development	701,358	705,356
Consumer	44,851	45,672

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Broker-dealer (1)	463,987	602,968
	5,366,065	5,220,040
Allowance for non-covered loan losses	(48,450)	(45,415)
Total non-covered loans, net of allowance	\$ 5,317,615	\$ 5,174,625

(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 the non-covered PCI loans (in thousands).

	March 31, 2016	December 31, 2015
Carrying amount	\$ 68,053	\$ 72,054
Outstanding balance	87,345	92,682

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	Three Months Ended	
	March 31,	
	2016	2015
Balance, beginning of period	\$ 17,744	\$ 12,814
Additions	—	14,579
Reclassifications from (to) nonaccretable difference, net(1)	2,343	281
Disposals of loans	—	(448)
Accretion	(3,919)	(2,749)
Balance, end of period	\$ 16,168	\$ 24,477

(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 nonaccrual and expected cash flows are no longer predictable and the accretable yield is eliminated.

The remaining nonaccretable difference for non-covered PCI loans was \$28.0 million and \$28.5 million at March 31, 2016 and December 31, 2015, respectively.

Impaired loans exhibit a clear indication that the borrower's cash flow may not be sufficient to meet principal and interest payments, which is generally 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 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	Recorded	Recorded	Total
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March 31, 2016	Contractual Principal Balance	Investment with No Allowance	Investment with Allowance	Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	\$ 28,379	\$ 4,085	\$ 9,032	\$ 13,117	\$ 1,027
Unsecured	2,559	—	—	—	—
Real estate:					
Secured by commercial properties	47,718	14,159	24,457	38,616	3,187
Secured by residential properties	15,516	8,888	2,806	11,694	175
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	6,914	3,115	983	4,098	138
Consumer	3,826	490	38	528	28
Broker-dealer	—	—	—	—	—
	104,912	30,737	37,316	68,053	4,555
Non-PCI					
Commercial and industrial:					
Secured	21,778	6,137	6,952	13,089	1,344
Unsecured	181	35	—	35	—
Real estate:					
Secured by commercial properties	668	607	—	607	—
Secured by residential properties	1,088	789	—	789	—
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	122	102	—	102	—
Consumer	2	1	—	1	—
Broker-dealer	—	—	—	—	—
	23,839	7,671	6,952	14,623	1,344
	\$ 128,751	\$ 38,408	\$ 44,268	\$ 82,676	\$ 5,899

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2015	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	\$ 32,597	\$ 5,520	\$ 7,830	\$ 13,350	\$ 1,341
Unsecured	2,572	—	—	—	—
Real estate:					
Secured by commercial properties	57,607	15,914	25,214	41,128	2,756
Secured by residential properties	15,278	8,957	2,690	11,647	175
Construction and land development:					
Residential construction loans	395	—	221	221	8
Commercial construction loans and land development	7,929	3,283	1,646	4,929	174
Consumer					