Hilltop Holdings Inc.
Form 10-Q
July 26, 2018
Table of Contents

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, 2018

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

2323 Victory Avenue, Suite 1400

Dallas, TX	75219
(Address of principal executive offices)	(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 (Do not check if a smaller reporting company)	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 26, 2018 was 94,576,828.

Table of Contents

HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2018

TABLE OF CONTENTS

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	June 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$ 353,432	$ 486,977
Federal funds sold	403	405
Securities purchased under agreements to resell	229,172	186,537
Assets segregated for regulatory purposes	128,417	186,578
Securities:		
Trading, at fair value	634,197	730,685
Available for sale, at fair value (amortized cost of $826,515 and $748,255, respectively)	811,218	744,319
Held to maturity, at amortized cost (fair value of $339,702 and $349,939, respectively)	353,192	355,849
Equity, at fair value	21,218	21,241
	1,819,825	1,852,094
Loans held for sale	1,953,562	1,715,357
Non-covered loans, net of unearned income	6,384,660	6,273,669
Allowance for non-covered loan losses	(59,996)	(60,957)
Non-covered loans, net	6,324,664	6,212,712
Covered loans, net of allowance of $1,974 and $2,729, respectively	158,996	179,400
Broker-dealer and clearing organization receivables	1,614,951	1,464,378
Premises and equipment, net	172,911	177,577
FDIC indemnification asset	23,525	29,340
Covered other real estate owned	34,895	36,744
Other assets	589,897	549,447
Goodwill	251,808	251,808
Other intangible assets, net	32,716	36,432
Total assets	$ 13,689,174	$ 13,365,786
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$ 2,468,332	$ 2,411,849
Interest-bearing	5,345,290	5,566,270
Total deposits	7,813,622	7,978,119

Broker-dealer and clearing organization payables	1,409,904	1,287,563
Short-term borrowings	1,610,735	1,206,424
Securities sold, not yet purchased, at fair value	251,581	232,821
Notes payable	227,736	208,809
Junior subordinated debentures	67,012	67,012
Other liabilities	392,171	470,231
Total liabilities	11,772,761	11,450,979
Commitments and contingencies (see Notes 12 and 13)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, $0.01 par value, 125,000,000 shares authorized; 94,570,757 and 95,982,184 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	946	960
Additional paid-in capital	1,502,105	1,526,369
Accumulated other comprehensive income (loss)	(11,846)	(394)
Retained earnings	419,683	384,545
Deferred compensation employee stock trust, net	857	848
Employee stock trust (11,217 and 11,672 shares, at cost, respectively)	(252)	(247)
Total Hilltop stockholders' equity	1,911,493	1,912,081
Noncontrolling interests	4,920	2,726
Total stockholders' equity	1,916,413	1,914,807
Total liabilities and stockholders' equity	$ 13,689,174	$ 13,365,786

See accompanying notes.

3

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,	
	2018	2017	2018	2017
Interest income:				
Loans, including fees	$ 103,924	$ 113,793	$ 203,868	$ 203,784
Securities borrowed	17,486	9,597	33,786	17,650
Securities:				
Taxable	12,516	8,833	23,469	15,433
Tax-exempt	1,697	1,375	3,469	2,619
Other	4,417	2,708	8,808	5,061
Total interest income	140,040	136,306	273,400	244,547
Interest expense:				
Deposits	10,136	5,464	18,811	10,154
Securities loaned	15,075	7,481	28,814	13,821
Short-term borrowings	6,466	3,648	10,509	5,066
Notes payable	2,437	2,826	4,934	5,640
Junior subordinated debentures	918	744	1,740	1,455
Other	160	167	324	335
Total interest expense	35,192	20,330	65,132	36,471
Net interest income	104,848	115,976	208,268	208,076
Provision (recovery) for loan losses	340	5,853	(1,467)	7,558
Net interest income after provision (recovery) for loan losses	104,508	110,123	209,735	200,518
Noninterest income:				
Net gains from sale of loans and other mortgage production income	132,478	153,688	238,245	277,838
Mortgage loan origination fees	29,318	25,976	49,944	45,532
Securities commissions and fees	38,320	37,804	77,037	76,861
Investment and securities advisory fees and commissions	21,965	25,537	40,319	47,739
Net insurance premiums earned	34,105	36,020	68,420	72,160
Other	23,248	65,667	40,612	96,001
Total noninterest income	279,434	344,692	514,577	616,131
Noninterest expense:				

Employees' compensation and benefits	200,632	214,719	383,232	401,605
Occupancy and equipment, net	27,893	27,919	55,723	55,212
Professional services	26,020	26,696	50,724	51,741
Loss and loss adjustment expenses	24,409	33,184	39,941	54,884
Other	59,563	63,733	117,099	123,301
Total noninterest expense	338,517	366,251	646,719	686,743
Income before income taxes	45,425	88,564	77,593	129,906
Income tax expense	11,034	25,754	18,522	40,789
Net income	34,391	62,810	59,071	89,117
Less: Net income attributable to noncontrolling interest	1,311	334	1,550	207
Income attributable to Hilltop	$ 33,080	$ 62,476	$ 57,521	$ 88,910
Earnings per common share:				
Basic	$ 0.35	$ 0.64	$ 0.60	$ 0.90
Diluted	$ 0.35	$ 0.63	$ 0.60	$ 0.90
Cash dividends declared per common share	$ 0.07	$ 0.06	$ 0.14	$ 0.12
Weighted average share information:				
Basic	95,270	98,154	95,625	98,295
Diluted	95,358	98,414	95,727	98,576

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$ 34,391	$ 62,810	$ 59,071	$ 89,117
Other comprehensive income:				
Net unrealized gains (losses) on securities available for sale, net of tax of $(602), $696, $(2,495) and $927, respectively	(2,148)	1,224	(8,851)	1,636
Reclassification adjustment for gains included in net income, net of tax of $0, $(5), $0 and $(5), respectively	—	(9)	—	(9)
Comprehensive income	32,243	64,025	50,220	90,744
Less: comprehensive income attributable to noncontrolling interest	1,311	334	1,550	207
Comprehensive income applicable to Hilltop	$ 30,932	$ 63,691	$ 48,670	$ 90,537

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Deferred Compensation Employee Stock Trust, Net	Employee Stock Trust Shares	Employee Stock Trust Amount	Total Hilltop Stockholders' Equity	Noncontrolli Interest
98,544	$ 985	$ 1,572,877	$ 485	$ 295,568	$ 903	15	$ (309)	$ 1,870,509	$ 4,011
—	—	—	—	88,910	—	—	—	88,910	207
—	—	—	1,627	—	—	—	—	1,627	—
—	—	5,687	—	—	—	—	—	5,687	—
7	—	212	—	—	—	—	—	212	—
244	3	(2,134)	—	—	—	—	—	(2,131)	—
(2,462)	(25)	(46,739)	—	(16,311)	—	—	—	(63,075)	—
—	—	—	—	(11,603)	—	—	—	(11,603)	—
—	—	—	—	—	(58)	(3)	61	3	—
—	—	—	—	—	—	—	—	—	(1,304)

	96,333	$ 963	$ 1,529,903	$ 2,112	$ 356,564	$ 845	12	$ (248)	$ 1,890,139	$ 2,914
	95,982	$ 960	$ 1,526,369	$ (394)	$ 384,545	$ 848	12	$ (247)	$ 1,912,081	$ 2,726
	—	—	—	—	57,521	—	—	—	57,521	1,550
e	—	—	—	(8,851)	—	—	—	—	(8,851)	—
	—	—	4,549	—	—	—	—	—	4,549	—
k d	10	—	248	—	—	—	—	—	248	—
	281	3	(1,732)	—	—	—	—	—	(1,729)	—
f	(1,702)	(17)	(27,329)	—	(11,531)	—	—	—	(38,877)	—
	—	—	—	—	(13,453)	—	—	—	(13,453)	—
	—	—	—	—	—	9	(1)	(5)	4	—
e	—	—	—	(2,601)	2,601	—	—	—	—	—
	—	—	—	—	—	—	—	—	—	644
	94,571	$ 946	$ 1,502,105	$ (11,846)	$ 419,683	$ 857	11	$ (252)	$ 1,911,493	$ 4,920

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2018	2017
Operating Activities		
Net income	$ 59,071	$ 89,117
Adjustments to reconcile net income to net cash used in operating activities:		
Provision (recovery) for loan losses	(1,467)	7,558
Depreciation, amortization and accretion, net	3,412	(14,436)
Net realized gains on securities	—	(14)
Net change in fair value of equity securities	512	—
Deferred income taxes	734	2,615
Other, net	4,926	5,264
Net change in securities purchased under agreements to resell	(42,635)	(35,758)
Net change in assets segregated for regulatory purposes	58,161	13,428
Net change in trading securities	96,488	(205,951)
Net change in broker-dealer and clearing organization receivables	(172,846)	(45,566)
Net change in FDIC indemnification asset	—	22,824
Net change in other assets	2,897	(48,794)
Net change in broker-dealer and clearing organization payables	52,574	75,004
Net change in other liabilities	(90,078)	(132,731)
Net change in securities sold, not yet purchased	18,760	(4,020)
Proceeds from sale of mortgage servicing rights asset	9,303	17,499
Net gains from sales of loans	(238,245)	(277,838)
Loans originated for sale	(7,308,972)	(7,151,419)
Proceeds from loans sold	7,286,188	7,221,859
Net cash used in operating activities	(261,217)	(461,359)
Investing Activities		
Proceeds from maturities and principal reductions of securities held to maturity	24,047	27,975
Proceeds from sales, maturities and principal reductions of securities available for sale	90,950	197,327
Proceeds from sales, maturities and principal reductions of equity securities	3	—
Purchases of securities held to maturity	(21,634)	(36,299)
Purchases of securities available for sale	(170,328)	(361,530)
Purchases of equity securities	(492)	—
Net change in loans	(49,003)	(195,832)
Purchases of premises and equipment and other assets	(12,252)	(13,771)

Proceeds from sales of premises and equipment and other real estate owned	8,172	18,071
Net cash received from Federal Home Loan Bank and Federal Reserve Bank stock	(16,626)	8,165
Net cash used in investing activities	(147,163)	(355,894)
Financing Activities		
Net change in deposits	(94,730)	483,993
Net change in short-term borrowings	404,311	97,780
Proceeds from notes payable	267,194	173,052
Payments on notes payable	(248,167)	(190,631)
Payments to repurchase common stock	(38,877)	(16,009)
Dividends paid on common stock	(13,453)	(11,603)
Net cash received from (distributed to) noncontrolling interest	644	(1,304)
Taxes paid on employee stock awards netting activity	(1,726)	(2,131)
Other, net	(363)	(332)
Net cash provided by financing activities	274,833	532,815
Net change in cash and cash equivalents	(133,547)	(284,438)
Cash and cash equivalents, beginning of period	487,382	690,764
Cash and cash equivalents, end of period	$ 353,835	$ 406,326
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	$ 65,349	$ 36,299
Cash paid for income taxes, net of refunds	$ 966	$ 26,703
Supplemental Schedule of Non-Cash Activities		
Conversion of loans to other real estate owned	$ 4,846	$ 5,644
Additions to mortgage servicing rights	$ 9,729	$ 2,490

See accompanying notes.

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.

On February 13, 2018, the Company entered into a definitive agreement to acquire privately-held, Houston-based The Bank of River Oaks (“BORO”) in an all-cash transaction. Under the terms of the definitive agreement, the Company has agreed to pay cash in the aggregate amount of $85 million to the shareholders and option holders of BORO. As of December 31, 2017, BORO had total assets, gross loans and deposits of $454.4 million, $343.6 million and $406.1 million, respectively. The acquisition was approved by BORO shareholders in May 2018 and was subsequently approved by regulators. The transaction is expected to close on or about August 1, 2018.

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, 2017 ("2017 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 Hilltop Opportunity Partners LLC, formerly known as PlainsCapital Equity, LLC, a merchant bank utilized to facilitate investments in companies engaged in non-financial activities. The Bank owns 100% of the outstanding stock of PrimeLending, a PlainsCapital Company ("PrimeLending").

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

PrimeLending owns a 100% membership interest in PrimeLending Ventures Management, LLC (“Ventures Management”), which holds an ownership interest in and is the managing member of certain affiliated business arrangements (“ABAs”).

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 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 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, including reclassifications due to the adoption of new accounting pronouncements. 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.

Significant accounting policies are detailed in Note 1 to the consolidated financial statements included in the Company’s 2017 Form 10-K. The Company has updated its accounting policies related to securities as a result of the adoption of Accounting Standards Update (“ASU”) 2016-01 as presented below.

Securities

Management classifies securities at the time of purchase and reassesses such designation at each balance sheet date. Securities held for resale to facilitate principal transactions with customers are classified as trading, and are carried at fair value, with changes in fair value reflected in the consolidated statements of operations. Hilltop reports interest income on trading securities as interest income on securities and other changes in fair value as other noninterest income.

Debt securities held but not intended to be held to maturity or on a long-term basis are classified as available for sale. Securities included in this category are those that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates, resultant prepayment risk, and other factors related to interest rate and resultant prepayment risk changes. Debt securities available for sale are carried at fair value. Unrealized holding gains and losses on debt securities available for sale, net of taxes, are reported in other comprehensive income (loss) until realized. Premiums and discounts are recognized in interest income using the effective interest method and consider any optionality that may be embedded in the security.

Equity securities are carried at fair value, with changes in fair value reflected in the consolidated statements of operations. Equity securities that do not have readily determinable fair values are initially recorded at cost and are remeasured when there is (i) an observable transaction involving the same investment, (ii) an observable transaction involving a similar investment from the same issuer or (iii) an impairment. These remeasurements are reflected in the consolidated statements of operations.

Purchases and sales (and related gain or loss) of securities are recorded on the trade date, based on specific identification. Declines in the fair value of available-for-sale debt securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the other-than-temporary impairment ("OTTI") is related to credit losses. The amount of the OTTI related to other factors is recognized in other comprehensive income (loss). In estimating OTTI, management considers in developing its best estimate of cash flows, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, (iii) the historic and implied volatility of the security, (iv) failure of the issuer to make scheduled interest payments and (v) changes to the rating of the security by a rating agency.

2. Recently Issued Accounting Standards

Adoption of New Accounting Standards

In February 2018, FASB issued ASU 2018-02 to help organizations address certain stranded income tax effects in accumulated other comprehensive income ("AOCI") resulting from the Tax Cuts and Jobs Act of 2017 ("Tax Legislation"). The amendment provides an option to reclassify stranded tax effects within AOCI to retained earnings in each period in which the effect of the changes in the U.S. federal corporate income tax rate in the Tax Legislation (or portion thereof) is recorded. The amendment also includes disclosure requirements regarding the issuer's accounting policy for releasing income tax effects from AOCI. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. As permitted within the amendment, the Company elected to early adopt and apply the provisions of this amendment as of January 1, 2018. The adoption of the amendment resulted in a reclassification of $0.1 million from AOCI to retained earnings, representing an increase to retained earnings. This reclassification is included within the adoption of accounting standards line item in the consolidated statements of stockholders' equity.

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. The Company adopted the amendments as of January 1, 2018, which did not have a significant 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. The Company adopted the amendment as of January 1, 2018 and will prospectively apply its provisions.

In November 2016, FASB issued ASU 2016-18 which requires that restricted cash be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. We have adopted the requirements of the new standard as of January 1, 2018. The adoption of this ASU had no impact on our consolidated statements of cash flows.

In October 2016, FASB issued ASU 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 amendment was effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15,

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

2017, using the modified retrospective transition method. The Company adopted the amendment as of January 1, 2018, which did not have a significant effect on the Company's consolidated financial statements.

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. The Company adopted the amendments as of January 1, 2018, which did not have a significant effect on the Company's consolidated financial statements.

In January 2016, FASB issued ASU 2016-01 related to financial instruments and subsequently issued technical corrections to the amendment in ASU 2018-03. The amendments require that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The amendments also impact financial liabilities under the Fair Value Option and the presentation and disclosure requirements for financial instruments and modify the required process used to evaluate deferred tax assets on available for sale securities. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Company adopted the amendments as of January 1, 2018, which resulted in $21.2 million of securities being reclassified from available for sale to equity within the consolidated balance sheets consistent with the provisions of the amendments, while certain other equity investments of $42.2 million are included in other assets within the consolidated balance sheets at June 30, 2018. The adoption of the amendments also resulted in $2.5 million being reclassified from accumulated other comprehensive income to retained earnings, representing an increase to retained earnings as of January 1, 2018. This reclassification is included within the adoption of accounting standards line item in the consolidated statement of stockholders' equity. All subsequent changes in fair value related to these equity investments will be recognized in net income. Additionally, the enhanced disclosures required by the amendments are included within the notes to the consolidated financial statements, including the disclosure of the fair value of the loan portfolio using an exit price method instead of the prior discounted cash flow method. These disclosure changes did not 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, all of which are codified in ASC 606, Revenue from Contracts with Customers. 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 have been adopted as of January 1, 2018 using the 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. Revenue from the Company’s mortgage origination and insurance segments are not in the scope of the new guidance, while certain revenue from contracts with customers within the broker-dealer and banking segments are subject to the new guidance. There were no material changes to the revenue recognition policies of the banking segment upon adoption.

The revenue recognition policies within the Company’s broker-dealer segment were affected upon adoption of ASC 606. Specifically, the new guidance required changes to the principal versus agent conclusion for certain advisory and underwriting revenues and expenses which, as of January 1, 2018, are recorded on a gross basis while legacy guidance required these revenues to be recognized net of the related expenses. Conversely, certain contract costs related to clearing and retail operations are now netted against the revenues while the legacy guidance required these revenues and expenses to be recognized on a gross basis. These changes did not have a material effect on the Company’s consolidated financial statements during the three and six months ended June 30, 2018. As the measurement and timing of revenue

Table of Contents

recognition was not affected for any of the Company's revenue streams, the implementation of the new guidance had no impact on opening retained earnings as of January 1, 2018.

The Company's broker-dealer segment has six primary lines of business: (i) public finance, (ii) capital markets, (iii) retail, (iv) structured finance, (v) clearing services and (vi) securities lending. Revenue from contracts with customers subject to the guidance in ASC 606 from the broker-dealer segment is included within the securities commissions and fees and investment and securities advisory fees and commissions line items within the consolidated statements of operations. Commissions and fees revenue is generally recognized at a point in time upon the delivery of contracted services based on a predefined contractual amount or on the trade date for trade execution services based on prevailing market prices and internal and regulatory guidelines.

The Company's banking segment has three primary lines of business: (i) business banking, (ii) personal banking and (iii) wealth and investment management. Revenue from contracts with customers subject to the guidance in ASC 606 from the banking segment (certain retail and trust fees) is included within the other noninterest income line item within the consolidated statements of operations. Retail and trust fees are generally recognized at the time the related transaction occurs or when services are completed. Fees are based on the dollar amount of the transaction or are otherwise predefined in contracts associated with each customer account depending on the type of account and services provided.

Accounting Standards Issued But Not Yet Adopted

In August 2017, FASB issued ASU 2017-12 which provides targeted improvements to accounting for hedging activities. The purpose of the amendment is to better align a company's risk management activities with its financial reporting for hedging relationships, to simplify the hedge accounting requirements and to improve the disclosures of hedging arrangements. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, and all transition requirements and elections should be applied to hedging relationships existing on the date of adoption. The Company has not historically applied hedge accounting to its derivative transactions. However, the Company is currently evaluating the provisions of the amendment and the impact, if any, on its future 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. The new standard, which is codified in ASC 326, Financial Instruments – Credit Losses, 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 new standard 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 new standard is 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. The Company does not intend to adopt the provisions of the new standard early. The Company's cross-functional team has begun the implementation of new credit forecasting models and a credit scoring system that will be utilized to estimate the likelihood of default and loss severity at the individual loan level as a part of its credit loss estimation methodology in accordance with the new standard. In addition, the Company continues to identify and assess key interpretive policy issues, as well as design and build new or modified policies and procedures that will be used to calculate its credit loss reserves. However, the magnitude of the change in allowance for loan losses upon adoption will depend on, among other things, 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 and subsequently issued technical corrections in ASU 2018-10. 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 new standard is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Adoption will require a modified retrospective transition where the lessees and lessors are required to recognize and measure leases at the date of adoption

Table of Contents

which is January 1, 2019 for calendar year-end entities. The Company's implementation efforts are ongoing, including the installation of an enhanced technology solution, which will aid in determining the magnitude of the increases in assets and liabilities and their impact on the consolidated financial statements. The Company expects to recognize lease liabilities and corresponding right-of-use assets (at their present value) related to predominantly all of the future minimum lease payments required under operating leases as disclosed in Note 18 to the consolidated financial statements in the 2017 Form 10-K. Upon implementation, the balance sheet effects of the new lease accounting standard will also impact regulatory capital ratios, performance ratios, and other measures which are dependent upon asset or liability balances. However, the population of contracts subject to balance sheet recognition, their initial measurement, and the expected impact to the aforementioned balances and measures remains under evaluation.

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 includes 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, 2018 and December 31, 2017, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was $1.81 billion and $1.58 billion, respectively, and the unpaid principal balance of those loans was $1.75 billion and $1.53 billion, respectively. The interest component of fair value is reported as interest income on loans in the accompanying consolidated statements of operations.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 fair value of loans held for sale is determined using an exit price method.

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

June 30, 2018	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	$ 1,051	$ 633,146	$ —	$ 634,197
Available for sale securities	—	811,218	—	811,218
Equity securities	21,218	—	—	21,218
Loans held for sale	—	1,773,333	40,781	1,814,114
Derivative assets	—	56,050	—	56,050
MSR asset	—	—	57,373	57,373
Securities sold, not yet purchased	183,714	67,867	—	251,581
Derivative liabilities	—	30,179	—	30,179

December 31, 2017	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	$ 3,329	$ 727,356	$ —	$ 730,685
Available for sale securities	—	744,319	—	744,319
Equity securities	21,241	—	—	21,241
Loans held for sale	—	1,544,631	36,972	1,581,603
Derivative assets	—	34,150	—	34,150
MSR asset	—	—	54,714	54,714
Securities sold, not yet purchased	156,586	76,235	—	232,821
Derivative liabilities	—	13,197	—	13,197

Table of Contents

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) Included in Net Income	Included in Other Comprehensive Income (Loss)	Balance at End of Period
Three months ended June 30, 2018						
Loans held for sale	$ 43,483	$ 8,071	$ (8,538)	$ (2,235)	$ —	$ 40,781
MSR asset	63,957	3,068	(9,303)	(349)	—	57,373
Total	$ 107,440	$ 11,139	$ (17,841)	$ (2,584)	$ —	$ 98,154
Six months ended June 30, 2018						
Loans held for sale	$ 36,972	$ 20,550	$ (12,513)	$ (4,228)	$ —	$ 40,781
MSR asset	54,714	9,729	(9,303)	2,233	—	57,373
Total	$ 91,686	$ 30,279	$ (21,816)	$ (1,995)	$ —	$ 98,154
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

All net realized and unrealized gains (losses) in the tables above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at June 30, 2018.

For Level 3 financial instruments measured at fair value on a recurring basis at June 30, 2018, 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	94 - 97 % (94 %)
MSR asset	Discounted cash flows	Constant prepayment rate	9.27 %
		Discount rate	11.09 %

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 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 reported at fair value using Level 3 inputs. The MSR asset 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.

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following table presents 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).

	Three Months Ended June 30, 2018			Three Months Ended June 30, 2017		
	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	$ 22,604	$ —	$ 22,604	$ 22,231	$ —	$ 22,231
MSR asset	(349)	—	(349)	(3,259)	—	(3,259)

	Six Months Ended June 30, 2018			Six Months Ended June 30, 2017		
	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	$ 7,724	$ —	$ 7,724	$ 31,093	$ —	$ 31,093
MSR asset	2,233	—	2,233	(3,379)	—	(3,379)

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 individually 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 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, 2018, estimates for these significant unobservable inputs were as follows.

	PCI Loans PlainsCapital Merger	FNB Transaction	SWS Merger
Weighted average default rate	81 %	38 %	69 %
Weighted average loss severity rate	66 %	15 %	29 %
Weighted average prepayment speed	0 %	6 %	0 %

At June 30, 2018, the resulting weighted average expected loss on PCI loans associated with the PlainsCapital Merger, FNB Transaction and SWS Merger was 54%, 6% and 20%, 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 inputs. 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, 2018 and December 31, 2017, the estimated fair value of covered OREO was $34.9 million and $36.7 million, respectively, and the underlying fair value measurements utilized Level 2 inputs. The fair value of non-covered OREO at

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

June 30, 2018 and December 31, 2017 was $2.9 million and $3.9 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, 2018	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value	Total Gains (Losses) for the Three Months Ended June 30, 2018	2017	Total Gains (Losses) for the Six Months Ended June 30, 2018	2017
Non-covered impaired loans	$ —	$ —	$ 19,465	$ 19,465	$ (1,446)	$ (274)	$ (1,471)	$ (470)
Covered impaired loans	—	—	72,953	72,953	844	(611)	746	(977)
Non-covered other real estate owned	—	225	—	225	(25)	(108)	(76)	(123)
Covered other real estate owned	—	15,996	—	15,996	(669)	(943)	(1,724)	(2,135)

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. In accordance with ASU 2016-01, effective January 1, 2018, the fair values of non-covered and covered loans are measured using an exit price method. There have been no other changes to the methods for determining estimated fair value for financial assets and liabilities as described in detail in Note 3 to the consolidated financial statements included in the Company’s 2017 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).

		Estimated Fair Value			
	Carrying	Level 1	Level 2	Level 3	
June 30, 2018	Amount	Inputs	Inputs	Inputs	Total
Financial assets:					
Cash and cash equivalents	$ 353,835	$ 353,835	$ —	$ —	$ 353,835
Securities purchased under agreements to resell	229,172	—	229,172	—	229,172
Assets segregated for regulatory purposes	128,417	128,417	—	—	128,417
Held to maturity securities	353,192	—	339,702	—	339,702
Loans held for sale	139,448	—	139,448	—	139,448
Non-covered loans, net	6,324,664	—	600,162	5,812,057	6,412,219
Covered loans, net	158,996	—	—	234,533	234,533
Broker-dealer and clearing organization receivables	1,614,951	—	1,614,951	—	1,614,951
FDIC indemnification asset	23,525	—	—	17,787	17,787
Other assets	66,245	—	65,951	294	66,245
Financial liabilities:					
Deposits	7,813,622	—	7,802,515	—	7,802,515
Broker-dealer and clearing organization payables	1,409,904	—	1,409,904	—	1,409,904
Short-term borrowings	1,610,735	—	1,610,735	—	1,610,735
Debt	294,748	—	292,494	—	292,494
Other liabilities	4,583	—	4,583	—	4,583

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

		Estimated Fair Value			
December 31, 2017	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Financial assets:					
Cash and cash equivalents	$ 487,382	$ 487,382	$ —	$ —	$ 487,382
Securities purchased under agreements to resell	186,537	—	186,537	—	186,537
Assets segregated for regulatory purposes	186,578	186,578	—	—	186,578
Held to maturity securities	355,849	—	349,939	—	349,939
Loans held for sale	133,754	—	133,754	—	133,754
Non-covered loans, net	6,212,712	—	577,889	5,828,868	6,406,757
Covered loans, net	179,400	—	—	269,386	269,386
Broker-dealer and clearing organization receivables	1,464,378	—	1,464,378	—	1,464,378
FDIC indemnification asset	29,340	—	—	20,122	20,122
Other assets	64,862	—	59,053	5,809	64,862
Financial liabilities:					
Deposits	7,978,119	—	7,973,101	—	7,973,101
Broker-dealer and clearing organization payables	1,287,563	—	1,287,563	—	1,287,563
Short-term borrowings	1,206,424	—	1,206,424	—	1,206,424
Debt	275,821	—	289,719	—	289,719
Other liabilities	4,795	—	4,795	—	4,795

The Company held equity investments other than securities of $42.2 million and $38.7 million at June 30, 2018 and December 31, 2017, respectively, which are included within other assets in the consolidated balance sheets. Of the $42.2 million held at June 30, 2018, $26.2 million do not have readily determinable fair values and are measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The following table presents the adjustments to the carrying value of these investments (in thousands).

	Three months ended, June 30, 2018	Six months ended, June 30, 2018
Balance, beginning of period	$ 21,906	$ 22,946
Impairments and downward adjustments	(2)	(1,314)
Additional investments and upward adjustments	4,247	4,519
Balance, end of period	$ 26,151	$ 26,151

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, 2018	December 31, 2017
U.S. Treasury securities	$ 1,033	$ —
U.S. government agencies:		
Bonds	57,996	52,078
Residential mortgage-backed securities	338,892	372,817
Commercial mortgage-backed securities	8,664	6,125
Collateralized mortgage obligations	1	5,122
Corporate debt securities	80,361	96,182
States and political subdivisions	112,646	170,413
Unit investment trusts	27,480	22,612
Private-label securitized product	3,684	1,631
Other	3,440	3,705
Totals	$ 634,197	$ 730,685

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 $251.6 million and $232.8 million at June 30, 2018 and December 31, 2017, respectively.

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

	Available for Sale			
June 30, 2018	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 34,671	$ —	$ (123)	$ 34,548
U.S. government agencies:				

Bonds	70,258	417	(736)	69,939
Residential mortgage-backed securities	311,305	232	(8,749)	302,788
Commercial mortgage-backed securities	11,817	11	(250)	11,578
Collateralized mortgage obligations	283,370	266	(6,594)	277,042
Corporate debt securities	57,162	331	(505)	56,988
States and political subdivisions	57,932	657	(254)	58,335
Totals	$ 826,515	$ 1,914	$ (17,211)	$ 811,218

	Available for Sale			
December 31, 2017	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 24,665	$ 107	$ (103)	$ 24,669
U.S. government agencies:				
Bonds	96,177	829	(366)	96,640
Residential mortgage-backed securities	246,707	538	(3,740)	243,505
Commercial mortgage-backed securities	11,966	105	(48)	12,023
Collateralized mortgage obligations	237,848	106	(4,142)	233,812
Corporate debt securities	66,868	1,819	(25)	68,662
States and political subdivisions	64,024	1,099	(115)	65,008
Totals	$ 748,255	$ 4,603	$ (8,539)	$ 744,319

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

June 30, 2018	Held to Maturity Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agencies:				
Bonds	$ 39,016	$ —	$ (2,007)	$ 37,009
Residential mortgage-backed securities	24,051	—	(483)	23,568
Commercial mortgage-backed securities	79,776	—	(2,509)	77,267
Collateralized mortgage obligations	157,000	—	(6,646)	150,354
States and political subdivisions	53,349	69	(1,914)	51,504
Totals	$ 353,192	$ 69	$ (13,559)	$ 339,702

December 31, 2017	Held to Maturity Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agencies:				
Bonds	$ 39,015	$ —	$ (1,188)	$ 37,827
Residential mortgage-backed securities	16,130	44	—	16,174
Commercial mortgage-backed securities	71,373	241	(735)	70,879
Collateralized mortgage obligations	173,928	19	(3,969)	169,978
States and political subdivisions	55,403	437	(759)	55,081
Totals	$ 355,849	$ 741	$ (6,651)	$ 349,939

Additionally, the Company had unrealized net gains of $1.0 million and $1.6 million from equity securities with fair values of $21.2 million held at both June 30, 2018 and December 31, 2017, respectively. The Company recognized net gains of $0.1 million during the three months ended June 30, 2018, and net losses of $0.5 million during the six months ended June 30, 2018, due to changes in the fair value of equity securities still held at the balance sheet date. During the three and six months ended June 30, 2018, net gains recognized from equity securities sold were nominal.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	June 30, 2018			December 31, 2017		
	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	8	$ 31,388	$ 103	6	$ 15,449	$ 69
Unrealized loss for twelve months or longer	3	3,159	20	1	4,150	34
	11	34,547	123	7	19,599	103
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	7	57,133	736	10	83,476	366
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	7	57,133	736	10	83,476	366
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	24	190,497	4,443	15	121,968	820
Unrealized loss for twelve months or longer	10	76,637	4,306	11	93,358	2,920
	34	267,134	8,749	26	215,326	3,740
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	2	8,654	250	1	5,048	48
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	2	8,654	250	1	5,048	48
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	22	111,616	2,003	16	90,886	819
Unrealized loss for twelve months or longer	19	90,124	4,591	17	80,492	3,323

	41	201,740	6,594	33	171,378	4,142
Corporate debt securities:						
Unrealized loss for less than twelve months	16	34,019	505	1	5,073	25
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	16	34,019	505	1	5,073	25
States and political subdivisions:						
Unrealized loss for less than twelve months	21	12,511	229	9	6,981	97
Unrealized loss for twelve months or longer	7	2,423	25	9	2,876	18
	28	14,934	254	18	9,857	115
Total available for sale:						
Unrealized loss for less than twelve months	100	445,818	8,269	58	328,881	2,244
Unrealized loss for twelve months or longer	39	172,343	8,942	38	180,876	6,295
	139	$ 618,161	$ 17,211	96	$ 509,757	$ 8,539

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	June 30, 2018			December 31, 2017		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Held to Maturity						
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	1	$ 5,714	$ 286	1	$ 5,950	$ 50
Unrealized loss for twelve months or longer	3	31,295	1,721	3	31,877	1,138
	4	37,009	2,007	4	37,827	1,188
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	4	23,568	483	—	—	—
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	4	23,568	483	—	—	—
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	15	58,293	1,737	7	39,396	271
Unrealized loss for twelve months or longer	2	12,188	773	2	12,659	464
	17	70,481	2,510	9	52,055	735
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	11	32,718	816	10	37,064	264
Unrealized loss for twelve months or longer	14	117,636	5,829	12	128,270	3,705
	25	150,354	6,645	22	165,334	3,969
States and political subdivisions:						
Unrealized loss for less than twelve months	58	25,086	398	22	11,079	71
Unrealized loss for twelve months or longer	46	17,749	1,516	46	18,598	688

	104	42,835	1,914	68	29,677	759
Total held to maturity:						
Unrealized loss for less than twelve months	89	145,379	3,720	40	93,489	656
Unrealized loss for twelve months or longer	65	178,868	9,839	63	191,404	5,995
	154	$ 324,247	$ 13,559	103	$ 284,893	$ 6,651
Equity						
Common and preferred stock:						
Unrealized loss for less than twelve months	—	—	—	1	944	13
Unrealized loss for twelve months or longer	—	—	—	1	6,800	103
	—	$ —	$ —	2	$ 7,744	$ 116

During the three and six months ended June 30, 2018 and 2017, the Company did not record any OTTI. 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 significant enough to warrant recording any OTTI of the securities. 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. 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.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 equity securities, at June 30, 2018 are shown by contractual maturity below (in thousands).

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 87,491	$ 87,501	$ 2,253	$ 2,252
Due after one year through five years	97,703	97,369	12,819	12,381
Due after five years through ten years	15,283	14,897	17,568	16,722
Due after ten years	19,546	20,043	59,725	57,158
	220,023	219,810	92,365	88,513
Residential mortgage-backed securities	311,305	302,788	24,051	23,568
Collateralized mortgage obligations	283,370	277,042	157,000	150,354
Commercial mortgage-backed securities	11,817	11,578	79,776	77,267
	$ 826,515	$ 811,218	$ 353,192	$ 339,702

The Company realized net gains of $6.8 million and $7.0 million from its trading portfolio during the three months ended June 30, 2018 and 2017, respectively, and $1.9 million and $12.9 million during the six months ended June 30, 2018 and 2017, respectively. In addition, the Hilltop Broker-Dealers realized net gains from structured product trading activities of $0.4 million and $10.5 million during the three months ended June 30, 2018 and 2017, respectively, and $17.4 million and $17.0 million during the six months ended June 30, 2018 and 2017, respectively. All such realized net gains and losses are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of $630.2 million and $738.5 million (with a fair value of $613.6 million and $730.1 million, respectively) at June 30, 2018 and December 31, 2017, 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, 2018 and December 31, 2017.

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 both June 30, 2018 and December 31, 2017, NLC had investments on deposit in custody for various state insurance departments with aggregate carrying values of $9.3 million.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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, 2018	December 31, 2017
Commercial and industrial	$ 1,655,431	$ 1,681,205
Real estate	3,142,496	3,011,524
Construction and land development	948,309	962,605
Consumer	38,262	40,446
Broker-dealer (1)	600,162	577,889
	6,384,660	6,273,669
Allowance for non-covered loan losses	(59,996)	(60,957)
Total non-covered loans, net of allowance	$ 6,324,664	$ 6,212,712

(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, 2018	December 31, 2017
Carrying amount	$ 26,665	$ 37,204
Outstanding balance	39,714	51,064

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Balance, beginning of period	$ 6,093	$ 11,442	$ 7,013	$ 13,116
Reclassifications from nonaccretable difference, net(1)	(92)	438	550	577
Disposals of loans	—	(61)	(98)	(61)
Accretion	(742)	(2,026)	(2,206)	(3,839)
Balance, end of period	$ 5,259	$ 9,793	$ 5,259	$ 9,793

(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 $19.1 million and $19.2 million at June 30, 2018 and December 31, 2017, 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).

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

June 30, 2018	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 15,315	$ 3,935	$ 1,120	$ 5,055	$ 58
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	24,947	8,610	8,152	16,762	969
Secured by residential properties	6,263	1,930	1,999	3,929	322
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	1,417	271	648	919	154
Consumer	2,083	—	—	—	—
Broker-dealer	—	—	—	—	—
	50,025	14,746	11,919	26,665	1,503
Non-PCI					
Commercial and industrial:					
Secured	25,451	13,406	5,430	18,836	2,501
Unsecured	656	425	—	425	—
Real estate:					
Secured by commercial properties	14,124	8,171	4,767	12,938	810
Secured by residential properties	1,241	803	—	803	—
Construction and land development:					
Residential construction loans	15	—	—	—	—
Commercial construction loans and land development	631	—	568	568	85
Consumer	155	49	—	49	—
Broker-dealer	—	—	—	—	—
	42,273	22,854	10,765	33,619	3,396
	$ 92,298	$ 37,600	$ 22,684	$ 60,284	$ 4,899

December 31, 2017	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 19,752	$ 3,610	$ 2,489	$ 6,099	$ 89
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	34,598	7,583	12,092	19,675	1,391
Secured by residential properties	12,600	5,307	4,558	9,865	325
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	2,001	428	1,010	1,438	215
Consumer	2,377	12	115	127	18
Broker-dealer	—	—	—	—	—
	71,328	16,940	20,264	37,204	2,038
Non-PCI					
Commercial and industrial:					
Secured	23,666	15,308	2,072	17,380	365
Unsecured	761	616	—	616	—
Real estate:					
Secured by commercial properties	15,504	10,934	3,686	14,620	932
Secured by residential properties	1,596	1,177	—	1,177	—
Construction and land development:					
Residential construction loans	15	—	—	—	—
Commercial construction loans and land development	653	—	611	611	93
Consumer	162	56	—	56	—
Broker-dealer	—	—	—	—	—
	42,357	28,091	6,369	34,460	1,390
	$ 113,685	$ 45,031	$ 26,633	$ 71,664	$ 3,428

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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,	
	2018	2017	2018	2017
Commercial and industrial:				
Secured	$ 23,581	$ 16,950	$ 23,685	$ 15,093
Unsecured	475	748	521	821
Real estate:				
Secured by commercial properties	30,245	37,189	31,998	37,362
Secured by residential properties	4,973	11,461	7,887	11,630
Construction and land development:				
Residential construction loans	—	—	—	14
Commercial construction loans and land development	1,673	3,170	1,768	3,580
Consumer	54	462	116	480
Broker-dealer	—	—	—	—
	$ 61,001	$ 69,980	$ 65,975	$ 68,980

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

	June 30, 2018	December 31, 2017
Commercial and industrial:		
Secured	$ 22,390	$ 20,262
Unsecured	425	616
Real estate:		
Secured by commercial properties	14,256	14,620
Secured by residential properties	1,217	1,614
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	569	611
Consumer	49	56
Broker-dealer	—	—

$ 38,906	$ 37,779

At June 30, 2018 and December 31, 2017, non-covered non-accrual loans included non-covered PCI loans of $5.3 million and $3.3 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, $3.1 million and $2.7 million of real estate loans secured by residential properties and classified as held for sale were in non-accrual status at June 30, 2018 and December 31, 2017, respectively.

Interest income, including recoveries and cash payments, recorded on non-covered impaired loans was $0.1 million during both the three months ended June 30, 2018 and 2017, and $0.1 million and $0.4 million during the six months ended June 30, 2018 and 2017, 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)

The Bank did not grant any TDRs during three or six months ended June 30, 2018. Information regarding TDRs granted during the three and six months ended June 30, 2017 is shown in the following tables (dollars in thousands). At June 30, 2018 and December 31, 2017, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

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

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

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 three and six months ended June 30, 2018 and 2017.

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, 2018 and 2017, respectively, for which a payment was at least 30 days past due (dollars in thousands).

	Twelve Months Preceding June 30, 2018			Twelve Months Preceding June 30, 2017		
	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	1	3,294	3,206	1	1,481	1,417
Secured by residential properties	—	—	—	—	—	—
Construction and land development:						
Residential construction loans	—	—	—	—	—	—
Commercial construction loans and land development	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Broker-dealer	—	—	—	—	—	—
	1	$ 3,294	$ 3,206	1	$ 1,481	$ 1,417

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

June 30, 2018	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing I (Non-PCI) Past Due 90 Days or
Commercial and industrial:								
Secured	$ 6,301	$ 1,394	$ 2,739	$ 10,434	$ 1,519,644	$ 5,055	$ 1,535,133	$ —
Unsecured	432	25	—	457	119,841	—	120,298	—
Real estate:								
	428	3,206	1,821	5,455	2,295,193	16,762	2,317,410	—

Secured by commercial properties								
Secured by residential properties	1,171	—	769	1,940	819,217	3,929	825,086	688
Construction and land development:								
Residential construction loans	1,054	—	—	1,054	208,601	—	209,655	—
Commercial construction loans and land development	51	400	—	451	737,284	919	738,654	—
Consumer	227	40	—	267	37,995	—	38,262	—
Broker-dealer	—	—	—	—	600,162	—	600,162	—
	$ 9,664	$ 5,065	$ 5,329	$ 20,058	$ 6,337,937	$ 26,665	$ 6,384,660	$ 688

28

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2017	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loa (Non-PCI) Past Due 90 Days or M
Commercial and industrial:								
Secured	$ 2,060	$ 312	$ 5,714	$ 8,086	$ 1,544,131	$ 6,099	$ 1,558,316	$ 640
Unsecured	642	—	—	642	122,247	—	122,889	—
Real estate:								
Secured by commercial properties	442	—	2,195	2,637	2,213,331	19,675	2,235,643	—
Secured by residential properties	1,490	1,290	418	3,198	762,818	9,865	775,881	—
Construction and land development:								
Residential construction loans	315	—	—	315	176,937	—	177,252	—
Commercial construction loans and land development	1,370	101	—	1,471	782,444	1,438	785,353	—
Consumer	194	20	—	214	40,105	127	40,446	—
Broker-dealer	—	—	—	—	577,889	—	577,889	—
	$ 6,513	$ 1,723	$ 8,327	$ 16,563	$ 6,219,902	$ 37,204	$ 6,273,669	$ 640

In addition to the non-covered loans shown in the tables above, PrimeLending had $73.4 million and $84.5 million of loans included in loans held for sale (with an aggregate unpaid principal balance of $74.0 million and $85.2 million, respectively) that were 90 days past due and accruing interest at June 30, 2018 and December 31, 2017, 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 state and local markets.

The Company utilizes a risk grading matrix to assign a risk grade to each of the loans in its portfolio with the exception of broker-dealer margin loans. 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 Company. 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 Company 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 Company 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 Company's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Company 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 Company 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, 2018	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 1,462,355	$ 6,600	$ 61,123	$ 5,055	$ 1,535,133
Unsecured	119,289	—	1,009	—	120,298
Real estate:					
Secured by commercial properties	2,233,481	4,740	62,427	16,762	2,317,410
Secured by residential properties	809,996	—	11,161	3,929	825,086
Construction and land development:					
Residential construction loans	209,655	—	—	—	209,655
Commercial construction loans and land development	737,143	—	592	919	738,654
Consumer	38,139	—	123	—	38,262
Broker-dealer	600,162	—	—	—	600,162
	$ 6,210,220	$ 11,340	$ 136,435	$ 26,665	$ 6,384,660

December 31, 2017	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 1,483,502	$ 17,354	$ 51,361	$ 6,099	$ 1,558,316
Unsecured	121,774	—	1,115	—	122,889
Real estate:					
Secured by commercial properties	2,154,595	7,647	53,726	19,675	2,235,643
Secured by residential properties	756,091	—	9,925	9,865	775,881
Construction and land development:					
Residential construction loans	177,252	—	—	—	177,252
Commercial construction loans and land development	780,905	2,259	751	1,438	785,353
Consumer	40,211	—	108	127	40,446
Broker-dealer	577,889	—	—	—	577,889
	$ 6,092,219	$ 27,260	$ 116,986	$ 37,204	$ 6,273,669

Allowance for Loan Losses

The allowance for loan losses is subject to regulatory examinations and determinations as to adequacy, 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 2017 Form 10-K.

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, 2018	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Balance, beginning of period	$ 23,269	$ 29,300	$ 7,449	$ 276	$ 77	$ 60,371
Provision (recovery) for loan losses	1,815	(767)	(178)	(75)	340	1,135
Loans charged off	(2,233)	(24)	—	(30)	—	(2,287)
Recoveries on charged off loans	666	75	—	36	—	777
Balance, end of period	$ 23,517	$ 28,584	$ 7,271	$ 207	$ 417	$ 59,996

Six Months Ended June 30, 2018	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Balance, beginning of period	$ 23,674	$ 28,775	$ 7,844	$ 311	$ 353	$ 60,957
Provision (recovery) for loan losses	119	(264)	(573)	(109)	64	(763)
Loans charged off	(3,416)	(30)	—	(43)	—	(3,489)
Recoveries on charged off loans	3,140	103	—	48	—	3,291
Balance, end of period	$ 23,517	$ 28,584	$ 7,271	$ 207	$ 417	$ 59,996

Three Months Ended June 30, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Balance, beginning of period	$ 21,679	$ 26,112	$ 6,879	$ 464	$ 23	$ 55,157
Provision for loan losses	735	2,779	766	165	448	4,893
Loans charged off	(1,200)	(218)	—	(127)	—	(1,545)
	620	61	—	22	—	703

Recoveries on charged off loans						
Balance, end of period	$ 21,834	$ 28,734	$ 7,645	$ 524	$ 471	$ 59,208

Six Months Ended June 30, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Balance, beginning of period	$ 21,369	$ 25,236	$ 7,002	$ 424	$ 155	$ 54,186
Provision for loan losses	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

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

June 30, 2018	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	$ 18,653	$ 12,679	$ 569	$ —	$ —	$ 31,901
Loans collectively evaluated for impairment	1,631,723	3,109,126	946,821	38,262	600,162	6,326,094
PCI Loans	5,055	20,691	919	—	—	26,665
	$ 1,655,431	$ 3,142,496	$ 948,309	$ 38,262	$ 600,162	$ 6,384,660

December 31, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	$ 16,819	$ 13,782	$ 611	$ —	$ —	$ 31,212

Loans collectively evaluated for impairment	1,658,287	2,968,202	960,556	40,319	577,889	6,205,253
PCI Loans	6,099	29,540	1,438	127	—	37,204
	$ 1,681,205	$ 3,011,524	$ 962,605	$ 40,446	$ 577,889	$ 6,273,669

31

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, 2018	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	$ 2,501	$ 810	$ 85	$ —	$ —	$ 3,396
Loans collectively evaluated for impairment	20,958	26,483	7,032	207	417	55,097
PCI Loans	58	1,291	154	—	—	1,503
	$ 23,517	$ 28,584	$ 7,271	$ 207	$ 417	$ 59,996

December 31, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	$ 365	$ 932	$ 93	$ —	$ —	$ 1,390
Loans collectively evaluated for impairment	23,220	26,127	7,536	293	353	57,529
PCI Loans	89	1,716	215	18	—	2,038
	$ 23,674	$ 28,775	$ 7,844	$ 311	$ 353	$ 60,957

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, 2018, the Bank has recorded a related “true-up” payment accrual of $16.6 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 similar 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, 2018	December 31, 2017
Commercial and industrial	$ 938	$ 1,055
Real estate	158,672	179,359
Construction and land development	1,360	1,715
	160,970	182,129
Allowance for covered loans	(1,974)	(2,729)
Total covered loans, net of allowance	$ 158,996	$ 179,400

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

	June 30, 2018	December 31, 2017
Carrying amount	$ 75,473	$ 87,113
Outstanding balance	151,529	179,019

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Balance, beginning of period	$ 87,593	$ 142,466	$ 91,833	$ 143,731
Reclassifications from nonaccretable difference, net (1)	3,228	11,618	9,715	23,024
Transfer of loans to covered OREO (2)	(656)	(662)	(847)	(780)
Accretion	(8,772)	(25,115)	(19,308)	(37,668)
Balance, end of period	$ 81,393	$ 128,307	$ 81,393	$ 128,307

(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 $57.2 million and $72.7 million at June 30, 2018 and December 31, 2017, respectively. During the three and six months ended June 30, 2018 and 2017, 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, 2018	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 3,372	$ —	$ 147	$ 147	$ 15
Unsecured	5,443	—	—	—	—
Real estate:					
Secured by commercial properties	62,824	5,326	12,057	17,383	889
Secured by residential properties	115,541	248	57,695	57,943	1,047
Construction and land development:					
Residential construction loans	645	—	—	—	—
Commercial construction loans and land development	10,467	—	—	—	—
	198,292	5,574	69,899	75,473	1,951
Non-PCI					
Commercial and industrial:					
Secured	44	—	—	—	—
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	—	—	—	—	—
Secured by residential properties	6,610	5,550	—	5,550	—
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	9	5	—	5	—

	6,663	5,555	—	5,555	—
	$ 204,955	$ 11,129	$ 69,899	$ 81,028	$ 1,951

December 31, 2017	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 3,783	$ —	$ 194	$ 194	$ 19
Unsecured	5,732	—	—	—	—
Real estate:					
Secured by commercial properties	80,223	2,388	21,171	23,559	1,817
Secured by residential properties	125,361	249	63,107	63,356	861
Construction and land development:					
Residential construction loans	672	—	—	—	—
Commercial construction loans and land development	11,118	4	—	4	—
	226,889	2,641	84,472	87,113	2,697
Non-PCI					
Commercial and industrial:					
Secured	44	—	—	—	—
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	—	—	—	—	—
Secured by residential properties	6,279	5,370	—	5,370	—
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	18	12	—	12	—
	6,341	5,382	—	5,382	—
	$ 233,230	$ 8,023	$ 84,472	$ 92,495	$ 2,697

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,	
	2018	2017	2018	2017
Commercial and industrial:				
Secured	$ 144	$ 644	$ 171	$ 887
Unsecured	—	171	—	234
Real estate:				
Secured by commercial properties	17,547	37,752	20,471	41,734
Secured by residential properties	65,772	71,734	66,110	73,689
Construction and land development:				
Residential construction loans	—	—	—	—
Commercial construction loans and land development	8	2,537	11	3,846
	$ 83,471	$ 112,838	$ 86,763	$ 120,390

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

	June 30, 2018	December 31, 2017
Commercial and industrial:		
Secured	$ —	$ —
Unsecured	—	—
Real estate:		
Secured by commercial properties	—	—
Secured by residential properties	5,271	5,087
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	6	17
	$ 5,277	$ 5,104

At both June 30, 2018 and December 31, 2017, there were no covered non-accrual loans included in covered PCI loans for which discount accretion had been suspended because the extent and timing of cash flows from these covered PCI loans could no longer be reasonably estimated.

Interest income, including recoveries and cash payments, recorded on covered impaired loans was $0.2 million during both the three months ended June 30, 2018 and 2017, while interest income recorded on covered impaired loans during both the six months ended June 30, 2018 and 2017 was $0.3 million. 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, 2018 and 2017. Pooled Loans are not in the scope of the disclosure requirements for TDRs. At June 30, 2018 and December 31, 2017, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

There were no TDRs granted during the twelve months preceding June 30, 2018 or 2017 for which payment was at least 30 days past due.

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

June 30, 2018	Loans Past Due 30 59 Days	Loans Past Due 60 89 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	$ —	$ —	$ —	$ —	$ 791	$ 147	$ 938	$ —
Unsecured	—	—	—	—	—	—	—	—
Real estate:								
Secured by commercial properties	66	—	—	66	9,902	17,383	27,351	—
Secured by residential properties	2,397	1,535	1,776	5,708	67,670	57,943	131,321	—
Construction and land development:								
Residential construction loans	—	—	—	—	—	—	—	—
Commercial construction loans and land development	—	—	—	—	1,360	—	1,360	—
	$ 2,463	$ 1,535	$ 1,776	$ 5,774	$ 79,723	$ 75,473	$ 160,970	$ —

December 31, 2017	Loans Past Due 30 59 Days	Loans Past Due 60 89 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	$ —	$ —	$ —	$ —	$ 861	$ 194	$ 1,055	$ —
Unsecured	—	—	—	—	—	—	—	—
Real estate:								
Secured by commercial properties	209	113	—	322	11,472	23,559	35,353	—
Secured by residential properties	5,624	1,211	3,226	10,061	70,589	63,356	144,006	283
Construction and land development:								
Residential construction loans	—	—	—	—	—	—	—	—
Commercial construction loans and land development	38	—	—	38	1,673	4	1,715	—
	$ 5,871	$ 1,324	$ 3,226	$ 10,421	$ 84,595	$ 87,113	$ 182,129	$ 283

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, 2018	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 392	$ —	$ 399	$ 147	$ 938
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	9,208	—	760	17,383	27,351
Secured by residential properties	57,048	343	15,987	57,943	131,321
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	1,342	—	18	—	1,360
	$ 67,990	$ 343	$ 17,164	$ 75,473	$ 160,970

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2017	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 429	$ —	$ 432	$ 194	$ 1,055
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	10,961	—	833	23,559	35,353
Secured by residential properties	68,544	356	11,750	63,356	144,006
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	1,649	—	62	4	1,715
	$ 81,583	$ 356	$ 13,077	$ 87,113	$ 182,129

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 2017 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, 2018	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Balance, beginning of period	$ 45	$ 2,776	$ 2	$ 2,823
Provision (recovery) for loan losses	(26)	(764)	(5)	(795)
Loans charged off	—	(57)	—	(57)
Recoveries on charged off loans	—	—	3	3
Balance, end of period	$ 19	$ 1,955	$ —	$ 1,974

Six months ended June 30, 2018	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Balance, beginning of period	$ 24	$ 2,702	$ 3	$ 2,729
Provision (recovery) for loan losses	(5)	(690)	(9)	(704)
Loans charged off	—	(57)	—	(57)
Recoveries on charged off loans	—	—	6	6

Balance, end of period	$ 19	$ 1,955	$ —	$ 1,974

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 for loan losses	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 for loan losses	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

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, 2018	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	791	83,346	1,360	85,497
PCI Loans	147	75,326	—	75,473
	$ 938	$ 158,672	$ 1,360	$ 160,970

December 31, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	861	92,444	1,711	95,016
PCI Loans	194	86,915	4	87,113
	$ 1,055	$ 179,359	$ 1,715	$ 182,129

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

June 30, 2018	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	4	19	—	23
PCI Loans	15	1,936	—	1,951
	$ 19	$ 1,955	$ —	$ 1,974

December 31, 2017	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	5	24	3	32
PCI Loans	19	2,678	—	2,697
	$ 24	$ 2,702	$ 3	$ 2,729

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,	
	2018	2017	2018	2017
Balance, beginning of period	$ 35,777	$ 45,374	$ 36,744	$ 51,642
Additions to covered OREO	2,351	3,404	4,846	5,127
Dispositions of covered OREO	(2,565)	(5,531)	(4,972)	(12,330)
Valuation adjustments in the period	(668)	(943)	(1,723)	(2,135)
Balance, end of period	$ 34,895	$ 42,304	$ 34,895	$ 42,304

During the three and six months ended June 30, 2018 and 2017, 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. The downward valuations recorded during the three and six months ended June 30, 2018 and 2017 were related to covered assets subject to the loss-share agreements with the FDIC.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 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 June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Balance, beginning of period	$ 25,458	$ 47,940	$ 29,340	$ 71,313
FDIC Indemnification Asset accretion (amortization)	(1,933)	(4,236)	(5,815)	(8,185)
Transfers to due from FDIC and other	—	(3,400)	—	(22,824)
Balance, end of period	$ 23,525	$ 40,304	$ 23,525	$ 40,304

As of June 30, 2018, the Bank had billed $147.8 million to and collected $145.8 million from the FDIC, which represented reimbursable covered losses and expenses through September 30, 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,	
	2018	2017	2018	2017
Balance, beginning of period	$ 63,957	$ 45,573	$ 54,714	$ 61,968
Additions	3,068	1,266	9,729	2,490
Sales	(9,303)	—	(9,303)	(17,499)
Changes in fair value:				
Due to changes in model inputs or assumptions (1)	1,032	(2,064)	4,673	(1,207)
Due to customer payoffs	(1,381)	(1,195)	(2,440)	(2,172)
Balance, end of period	$ 57,373	$ 43,580	$ 57,373	$ 43,580

	June 30, 2018	December 31, 2017
Mortgage loans serviced for others	$ 4,394,219	$ 4,762,042
MSR asset as a percentage of serviced mortgage loans	1.31 %	1.15 %

(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, 2018	December 31, 2017
Weighted average constant prepayment rate	9.27 %	10.93 %
Weighted average discount rate	11.09 %	11.03 %
Weighted average life (in years)	7.6	6.9

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, 2018	December 31, 2017
Constant prepayment rate:		
Impact of 10% adverse change	$ (1,704)	$ (1,948)
Impact of 20% adverse change	(3,473)	(3,839)
Discount rate:		
Impact of 10% adverse change	(2,401)	(2,135)
Impact of 20% adverse change	(4,604)	(4,103)

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 $6.1 million and $5.0 million during the three months ended June 30, 2018 and 2017, respectively, and $11.8 million and $11.5 million during the six months ended June 30, 2018 and 2017, respectively, were included in net gains from sale of loans and other mortgage production income within the consolidated statements of operations.

8. Deposits

Deposits are summarized as follows (in thousands).

	June 30, 2018	December 31, 2017

Noninterest-bearing demand	$ 2,468,332	$ 2,411,849
Interest-bearing:		
NOW accounts	1,272,098	1,202,752
Money market	2,209,780	2,222,555
Brokered - money market	9,911	101,624
Demand	354,232	411,771
Savings	200,643	218,812
Time	1,298,626	1,313,482
Brokered - time	—	95,274
	$ 7,813,622	$ 7,978,119

9. Short-term Borrowings

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

	June 30, 2018	December 31, 2017
Federal funds purchased	$ 78,350	$ 101,775
Securities sold under agreements to repurchase	502,885	539,149
Federal Home Loan Bank	675,000	250,000
Short-term bank loans	354,500	315,500
	$ 1,610,735	$ 1,206,424

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, 2018		2017	
Average balance during the period	$ 721,167		$ 500,830	
Average interest rate during the period	1.63	%	0.86	%

	June 30, 2018		December 31, 2017	
Average interest rate at end of period	1.74	%	1.21	%
Securities underlying the agreements at end of period:				
Carrying value	$ 514,378		$ 581,636	
Estimated fair value	$ 531,130		$ 598,300	

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, 2018		2017	
Average balance during the period	$ 117,956		$ 355,249	
Average interest rate during the period	1.91	%	0.92	%

	June 30, 2018		December 31, 2017	
Average interest rate at end of period	2.07	%	1.30	%

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, 2018 and December 31, 2017 was 2.82% and 2.27%, respectively.

10. Notes Payable

Notes payable consisted of the following (in thousands).

	June 30, 2018	December 31, 2017
Senior Notes due April 2025, net of discount of $1,469 and $1,545, respectively	$ 148,531	$ 148,455
FHLB notes, net of premium of $261 and $436, respectively, with maturities ranging from September 2020 to June 2030	4,603	19,402
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, 2018	—	1,000
Ventures Management lines of credit due January 2019	47,102	12,452
	$ 227,736	$ 208,809

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 rates were 24.3% and 29.1% during the three months ended June 30, 2018 and 2017, respectively, and 23.9% and 31.4% during the six months ended June 30, 2018 and 2017, respectively. The 2018 effective tax rates approximated the applicable statutory rates. 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 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) the Internal Revenue Code. The decreases in the Company's effective tax rates from periods in 2017 to periods in 2018 were primarily driven by the reduction in the corporate tax rate from 35% to 21% pursuant to the enactment of the Tax Legislation. Certain deferred tax asset amounts recorded in December 2017 following enactment of the Tax Legislation are considered reasonable estimates as of June 30, 2018 and could be adjusted during the measurement period, which will end in December 2018, as a result of further refinement of calculations, changes in interpretations and assumptions made, guidance that may be issued and actions the Company may take as a result of the Tax Legislation.

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. When it is practicable, the Company estimates loss contingencies for possible litigation and claims, whether or not there is accrued probable loss. When the Company is able to estimate such probably losses, and when it estimates that it is reasonably possible it could incur losses in excess of amounts accrued, the Company is required to make a disclosure of the aggregate estimation. As available information changes, however, the matters for which the Company is able to estimate, as well as the estimate themselves, will be adjusted accordingly.

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

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 included in the Company’s 2017 Form 10-K. Certain Petitioners filed an appeal to the Court’s Memorandum Opinion. On February 23, 2018, the Delaware Supreme Court affirmed the decision of the lower Court.

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.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 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, 2018 and December 31, 2017, the mortgage origination segment's indemnification liability reserve totaled $23.9 million and $23.5 million, respectively. The provision for indemnification losses was $1.0 million and $1.1 million during the three months ended June 30, 2018 and 2017, respectively, and $1.7 million and $2.0 million during the six months ended June 30, 2018 and 2017, 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,	
	2018	2017	2018	2017
Balance, beginning of period	$ 32,321	$ 39,245	$ 33,702	$ 40,669
Claims made	5,361	8,650	12,350	17,029
Claims resolved with no payment	(5,892)	(9,991)	(11,753)	(18,088)
Repurchases	(1,245)	(226)	(3,334)	(1,688)
Indemnification payments	—	(5,124)	(420)	(5,368)

Balance, end of period	$ 30,545	$ 32,554	$ 30,545	$ 32,554

	Indemnification Liability Reserve Activity			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Balance, beginning of period	$ 23,332	$ 18,952	$ 23,472	$ 18,239
Additions for new sales	1,014	1,145	1,743	1,992
Repurchases	(85)	(23)	(245)	(125)
Early payment defaults	(41)	(60)	(188)	(129)
Indemnification payments	(4)	(671)	(121)	(713)
Change in reserves for loans sold in prior years	(306)	3,024	(751)	3,103
Balance, end of period	$ 23,910	$ 22,367	$ 23,910	$ 22,367

	June 30, 2018	December 31, 2017
Reserve for Indemnification Liability:		
Specific claims	$ 999	$ 646
Incurred but not reported claims	22,911	22,826
Total	$ 23,910	$ 23,472

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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: (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 $16.6 million at June 30, 2018 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, 2018, 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, 2018, the Bank had billed $184.7 million of covered net losses to the FDIC, of which 80%, or $147.8 million, were reimbursable under the loss-share agreements. As of June 30, 2018, the Bank had received aggregate reimbursements of $145.8 million from the FDIC, which represented reimbursable covered losses and expenses through September 30, 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, 2018 and outstanding financial and performance standby letters of credit of $25.1 million at June 30, 2018.

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 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, 2018, 1,267,430 shares of common stock remained available for issuance pursuant to awards granted under the 2012 Plan, excluding shares that may be delivered pursuant to outstanding awards. Compensation expense related to the 2012 Plan was $2.5 million and $3.2 million during the three months ended June 30, 2018 and 2017, respectively, and $4.8 million and $5.9 million during the six months ended June 30, 2018 and 2017, respectively.

During the six months ended June 30, 2018 and 2017, Hilltop granted 10,024 and 7,513 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 Units

The following table summarizes information about nonvested RSU activity for the six months ended June 30, 2018 (shares in thousands).

	RSUs	
	Outstanding	Weighted Average Grant Date Fair Value
Balance, December 31, 2017	1,318	$ 20.89
Granted	457	$ 23.37
Vested/Released	(355)	$ 19.79
Forfeited	(100)	$ 19.78
Balance, June 30, 2018	1,320	$ 22.13

Vested/Released RSUs include an aggregate of 73,661 shares withheld to satisfy employee statutory tax obligations during the six months ended June 30, 2018. Pursuant to certain RSU award agreements, an aggregate of 17,481 vested RSUs at June 30, 2018 require deferral of the settlement in shares and statutory tax obligations to a future date.

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

During the six months ended June 30, 2018, the Compensation Committee of the board of directors of the Company awarded certain executives and key employees an aggregate of 433,268 RSUs pursuant to the 2012 Plan. At June 30, 2018, 335,560 of these outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 84,626 of these outstanding RSUs will cliff vest based upon the achievement of certain performance goals over a three-year period.

At June 30, 2018, in the aggregate, 1,061,629 of the outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 258,773 outstanding RSUs cliff vest based upon the achievement of certain performance goals over a three-year period. At June 30, 2018, unrecognized compensation expense related to outstanding RSUs of $17.9 million is expected to be recognized over a weighted average period of 1.65 years.

15. Regulatory Matters

Banking and Hilltop

PlainsCapital, which includes the Bank and PrimeLending, 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 PlainsCapital. Based on the actual ratios as shown in the table below, Hilltop and PlainsCapital exceed each of the capital conservation buffer requirements in effect as of June 30, 2018, as well as the fully phased-in requirements through 2019.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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, 2018 and December 31, 2017, 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.

			Minimum Capital Requirements Including Conservation Buffer		
	Actual Amount	Ratio	In Effect at End of Period Ratio	Fully Phased In Ratio	To Be Well Capitalized Ratio
June 30, 2018					
Tier 1 capital (to average assets):					
PlainsCapital	$ 1,174,264	12.80 %	4.0 %	4.0 %	5.0 %
Hilltop	1,689,009	12.90 %	4.0 %	4.0 %	N/A
Common equity Tier 1 capital (to risk-weighted assets):					
PlainsCapital	1,174,264	14.59 %	6.375 %	7.0 %	6.5 %
Hilltop	1,643,623	17.61 %	6.375 %	7.0 %	N/A
Tier 1 capital (to risk-weighted assets):					
PlainsCapital	1,174,264	14.59 %	7.875 %	8.5 %	8.0 %
Hilltop	1,689,009	18.10 %	7.875 %	8.5 %	N/A
Total capital (to risk-weighted assets):					
PlainsCapital	1,237,812	15.38 %	9.875 %	10.5 %	10.0 %
Hilltop	1,733,360	18.58 %	9.875 %	10.5 %	N/A

			Minimum Capital Requirements Including Conservation Buffer		
	Actual Amount	Ratio	In Effect at End of Period Ratio	Fully Phased In Ratio	To Be Well Capitalized Ratio
December 31, 2017					
Tier 1 capital (to average assets):					

PlainsCapital	$ 1,147,527	12.32 %	4.0 %	4.0 %	5.0 %
Hilltop	1,688,358	12.94 %	4.0 %	4.0 %	N/A
Common equity Tier 1 capital (to risk-weighted assets):					
PlainsCapital	1,147,527	14.47 %	5.75 %	7.0 %	6.5 %
Hilltop	1,639,009	17.71 %	5.75 %	7.0 %	N/A
Tier 1 capital (to risk-weighted assets):					
PlainsCapital	1,147,527	14.47 %	7.25 %	8.5 %	8.0 %
Hilltop	1,688,358	18.24 %	7.25 %	8.5 %	N/A
Total capital (to risk-weighted assets):					
PlainsCapital	1,212,793	15.29 %	9.25 %	10.5 %	10.0 %
Hilltop	1,738,325	18.78 %	9.25 %	10.5 %	N/A

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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, 2018, the net capital position of each of the Hilltop Broker-Dealers was as follows (in thousands).

	Hilltop Securities	HTS Independent Network
Net capital	$ 205,730	$ 3,362
Less: required net capital	11,427	250
Excess net capital	$ 194,303	$ 3,112
Net capital as a percentage of aggregate debit items	36.0 %	
Net capital in excess of 5% aggregate debit items	$ 177,161	

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, 2018 and December 31, 2017, the Hilltop Broker-Dealers held cash of $128.4 million and $186.6 million, respectively, segregated in special reserve bank accounts for the benefit of customers. The Hilltop Broker-Dealers were not required to segregate cash and securities in special reserve accounts for the benefit of proprietary accounts of introducing broker-dealers at June 30, 2018 or December 31, 2017.

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 minimum net worth and liquidity requirements. As of June 30, 2018, 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.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	June 30, 2018	December 31, 2017
Capital and surplus:		
National Lloyds Insurance Company	$ 93,578	$ 93,812
American Summit Insurance Company	23,910	22,778

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Statutory net income (loss):				
National Lloyds Insurance Company	$ (2,633)	$ (7,152)	$ 1,134	$ (6,516)
American Summit Insurance Company	394	(309)	1,283	523

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, 2018, 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, 2018, the Company's insurance subsidiaries' RBC ratio exceeded the level at which regulatory action would be required.

16. Stockholders’ Equity

Dividends

On July 26, 2018, the Company announced that its board of directors declared a quarterly cash dividend of $0.07 per common share, payable on August 31, 2018, to all common stockholders of record as of the close of business on August 15, 2018.

Stock Repurchase Program

In January 2018, the Hilltop board of directors authorized a new stock repurchase program through January 2019 pursuant to which the Company was originally authorized to repurchase, in the aggregate, up to $50.0 million of its outstanding common stock. In July 2018, the Hilltop board of directors authorized an increase to the aggregate amount of common stock the Company may repurchase under this program to $100.0 million, which is inclusive of repurchases to offset dilution related to grants of stock-based compensation.

During the six months ended June 30, 2018, the Company paid $38.8 million to repurchase an aggregate of 1,702,696 shares of common stock at an average price of $22.81 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 stock repurchase program and related accounting policy are discussed in detail in Note 1 and Note 22 to the consolidated financial statements included in the Company’s 2017 Form 10-K.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 decreased $3.1 million and increased $8.8 million during the three months ended June 30, 2018 and 2017, respectively, and increased $6.9 million and $9.5 million during the six months ended June 30, 2018 and 2017, 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 $3.0 million and $9.9 million during the three months ended June 30, 2018 and 2017, respectively, while the fair values of the Bank's derivatives increased nominally during the three months ended June 30, 2018 and 2017, respectively. The fair values of the Hilltop Broker-Dealers' derivatives decreased $2.2 million and increased $16.2 million during the six months ended June 30, 2018 and 2017, respectively, while the fair values of the Bank's derivatives increased $0.2 million and $0.1 million during the six months ended June 30, 2018 and 2017, respectively.

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

	June 30, 2018		December 31, 2017	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Derivative instruments:				
IRLCs	$ 1,390,728	$ 31,475	$ 850,850	$ 18,851
Customer-based written options	30,889	(109)	21,637	38
Customer-based purchased options	30,889	109	21,637	(38)
Commitments to purchase MBSs	3,153,297	7,297	2,831,635	(921)
Commitments to sell MBSs	5,753,361	(13,112)	4,963,498	2,972
Interest rate swaps	24,102	211	25,971	51
U.S. Treasury bond futures and options (1)	198,000	—	214,500	—

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

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

PrimeLending had cash collateral advances totaling $8.2 million and $0.8 million to offset net liability derivative positions on its commitments to sell MBSs at June 30, 2018 and December 31, 2017, respectively. In addition, PrimeLending advanced cash collateral totaling $3.2 million on its U.S. Treasury bond futures and options at both June 30, 2018 and December 31, 2017. 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).

				Gross Amounts Not Offset in the Balance Sheet		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet	Financial Instruments	Cash Collateral Pledged	Net Amount
June 30, 2018						
Securities borrowed:						
Institutional counterparties	$ 1,491,182	$ —	$ 1,491,182	$ (1,424,434)	$ —	$ 66,748
Interest rate options:						
Customer counterparties	109	—	109	—	—	109
Interest rate swaps:						
Institutional counterparties	211	—	211	(909)	—	(698)
Reverse repurchase agreements:						
Institutional counterparties	229,172	—	229,172	(228,049)	—	1,123

Forward MBS derivatives:						
Institutional counterparties	7,297	—	7,297	(7,297)	—	—
	$ 1,727,971	$ —	$ 1,727,971	$ (1,660,689)	$ —	$ 67,282
December 31, 2017						
Securities borrowed:						
Institutional counterparties	$ 1,386,821	$ —	$ 1,386,821	$ (1,327,536)	$ —	$ 59,285
Interest rate options:						
Customer counterparties	38	—	38	—	—	38
Reverse repurchase agreements:						
Institutional counterparties	186,537	—	186,537	(186,026)	—	511
Forward MBS derivatives:						
Institutional counterparties	3,576	—	3,576	(3,576)	—	—
	$ 1,576,972	$ —	$ 1,576,972	$ (1,517,138)	$ —	$ 59,834

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, 2018						
Securities loaned:						
Institutional counterparties	$ 1,316,128	$ —	$ 1,316,128	$ (1,254,389)	$ —	$ 61,739
Interest rate options:						
Institutional counterparties	109	—	109	—	—	109
Repurchase agreements:						
Institutional counterparties	418,566	—	418,566	(418,566)	—	—
Customer counterparties	84,319	—	84,319	(84,319)	—	—
Forward MBS derivatives:						
Institutional counterparties	14,050	(938)	13,112	(7,123)	—	5,989
	$ 1,833,172	$ (938)	$ 1,832,234	$ (1,764,397)	$ —	$ 67,837
December 31, 2017						
Securities loaned:						
Institutional counterparties	$ 1,215,093	$ —	$ 1,215,093	$ (1,157,198)	$ —	$ 57,895
Interest rate options:						
Institutional counterparties	38	—	38	—	—	38
Interest rate swaps:						
	35	(86)	(51)	(1,059)	—	(1,110)

Institutional counterparties						
Repurchase agreements:						
Institutional counterparties	409,058	—	409,058	(409,058)	—	—
Customer counterparties	130,091	—	130,091	(130,091)	—	—
Forward MBS derivatives:						
Institutional counterparties	2,696	(1,171)	1,525	(1,295)	—	230
	$ 1,757,011	$ (1,257)	$ 1,755,754	$ (1,698,701)	$ —	$ 57,053

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 one to thirty days from the transaction date or involve arrangements with no definite termination 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, 2018 and December 31, 2017.

	Remaining Contractual Maturities				
June 30, 2018	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
Repurchase agreement transactions:					
U.S. Treasury and agency securities	$ 145,005	$ —	$ —	$ —	$ 145,005
Asset-backed securities	357,880	—	—	—	357,880
Securities lending transactions:					
Corporate securities	1,266	—	—	—	1,266
Equity securities	1,314,862	—	—	—	1,314,862
Total	$ 1,819,013	$ —	$ —	$ —	$ 1,819,013
Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above					$ 1,819,013
Amount related to agreements not included in offsetting disclosure above					$ —

	Remaining Contractual Maturities				
December 31, 2017	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
Repurchase agreement transactions:					
U.S. Treasury and agency securities	$ 181,915	$ —	$ —	$ —	$ 181,915
Asset-backed securities	357,234	—	—	—	357,234
Securities lending transactions:					
Corporate securities	11,499	—	—	—	11,499
Equity securities	1,203,594	—	—	—	1,203,594
Total	$ 1,754,242	$ —	$ —	$ —	$ 1,754,242

Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above	$ 1,754,242
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, 2018	December 31, 2017
Receivables:		
Securities borrowed	$ 1,491,182	$ 1,386,821
Securities failed to deliver	58,522	25,491
Trades in process of settlement	47,174	29,412
Other	18,073	22,654
	$ 1,614,951	$ 1,464,378
Payables:		
Securities loaned	$ 1,316,128	$ 1,215,093
Correspondents	26,537	30,160
Securities failed to receive	60,041	37,864
Other	7,198	4,446
	$ 1,409,904	$ 1,287,563

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, 2018	December 31, 2017
Reserve for unpaid losses and allocated LAE balance, net	$ 21,004	$ 17,470
Reinsurance recoverables on unpaid losses	6,091	11,495
Unallocated LAE	1,148	1,248
Reserve for unpaid losses and LAE balance, gross	$ 28,243	$ 30,213

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

Accident	Six Months Ended June 30, 2018		June 30, 2018	
Year	Paid	Incurred	Total of IBNR Reserves Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
2014	83,640	84,050	87	13,150
2015	86,175	87,205	410	15,121
2016	82,671	84,614	1,490	21,451
2017	85,089	89,107	2,659	21,308
2018	23,338	36,431	5,669	5,779
Total	360,913	$ 381,407		
	510	All outstanding reserves prior to 2014, net of reinsurance		
	$ 21,004			

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, 2018, total reinsurance recoverables and receivables had a carrying value of $8.8 million, which is included in other assets within the consolidated balance sheets. There was no allowance for uncollectible accounts at June 30, 2018, 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,			
	2018		2017		2018		2017	
	Written	Earned	Written	Earned	Written	Earned	Written	Earned
Premiums from direct business	$ 35,801	$ 33,372	$ 37,792	$ 36,753	$ 68,886	$ 66,740	$ 73,588	$ 73,952
Reinsurance assumed	3,567	3,111	3,358	2,910	6,609	6,111	6,227	5,728
Reinsurance ceded	(2,335)	(2,378)	(2,974)	(3,643)	(4,345)	(4,431)	(6,187)	(7,520)
Net premiums	$ 37,033	$ 34,105	$ 38,176	$ 36,020	$ 71,150	$ 68,420	$ 73,628	$ 72,160

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Losses and LAE incurred	$ 23,869	$ 33,352	$ 37,321	$ 55,654
Reinsurance recoverables	540	(168)	2,620	(770)
Net loss and LAE incurred	$ 24,409	$ 33,184	$ 39,941	$ 54,884

Catastrophic coverage

At June 30, 2018, 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 of reinsurance coverage in excess of its $1.5 million retention to bridge to the primary program. The reinsurance for NLIC and ASIC in excess of $8 million is comprised of three layers of protection: $17 million in excess of $8 million retention and/or loss; $30 million in excess of $25 million loss; and $50 million in excess of $55 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, 2018, total retention for any one catastrophe that affects both NLIC and ASIC was limited to $8 million in the aggregate.

Effective January 1, 2018, NLC renewed its underlying excess of loss contract that provides $10 million aggregate coverage in excess of NLC's per event retention of $1.0 million and aggregate retention of $17.5 million for sub-catastrophic events. As of January 1, 2018, NLC retains 17.5% participation in this coverage, up from no participation during 2017.

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, merchant banking investment opportunities 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, 2018	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 87,958	$ 12,890	$ 704	$ 793	$ (2,482)	$ 4,985	$ 104,848
Provision for loan losses	—	340	—	—	—	—	340
Noninterest income	10,644	73,589	162,759	36,546	1,436	(5,540)	279,434
Noninterest expense	65,542	77,967	150,026	39,712	5,340	(70)	338,517
Income (loss) before income taxes	$ 33,060	$ 8,172	$ 13,437	$ (2,373)	$ (6,386)	$ (485)	$ 45,425

Six Months Ended June 30, 2018	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 174,596	$ 25,441	$ 1,645	$ 1,580	$ (4,573)	$ 9,579	$ 208,268
Provision (recovery) for loan losses	(1,531)	64	—	—	—	—	(1,467)
Noninterest income	20,823	142,135	289,862	71,564	724	(10,531)	514,577
Noninterest expense	124,913	155,743	280,729	70,725	14,743	(134)	646,719

Income (loss) before income taxes	$ 72,037	$ 11,769	$ 10,778	$ 2,419	$ (18,592)	$ (818)	$ 77,593

Three Months Ended June 30, 2017	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop 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	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop 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

	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidate
June 30, 2018							
Goodwill	$ 207,741	$ 7,008	$ 13,071	$ 23,988	$ —	$ —	$ 251,808
Total assets	$ 9,778,476	$ 3,445,391	$ 2,171,149	$ 292,186	$ 2,078,735	$ (4,076,763)	$ 13,689,17
December 31, 2017							
Goodwill	$ 207,741	$ 7,008	$ 13,071	$ 23,988	$ —	$ —	$ 251,808
Total assets	$ 9,558,718	$ 3,394,911	$ 1,937,327	$ 291,639	$ 2,106,978	$ (3,923,787)	$ 13,365,78

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 were the only instruments issued by Hilltop which previously qualified as participating securities through August 2017 when these awards vested.

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

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

shares, excluding the participating securities, were issued using the treasury stock method. During the three months ended June 30, 2018, RSUs were the only potentially dilutive non-participating instruments issued by Hilltop. 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 June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Basic earnings per share:				
Income attributable to Hilltop	$ 33,080	$ 62,476	$ 57,521	$ 88,910
Less: income applicable to participating shares	—	(2)	—	(3)
Net earnings available to Hilltop common stockholders	$ 33,080	$ 62,474	$ 57,521	$ 88,907
Weighted average shares outstanding - basic	95,270	98,154	95,625	98,295
Basic earnings per common share	$ 0.35	$ 0.64	$ 0.60	$ 0.90
Diluted earnings per share:				
Income attributable to Hilltop	$ 33,080	$ 62,476	$ 57,521	$ 88,910
Weighted average shares outstanding - basic	95,270	98,154	95,625	98,295
Effect of potentially dilutive securities	88	260	102	281
Weighted average shares outstanding - diluted	95,358	98,414	95,727	98,576
Diluted earnings per common share	$ 0.35	$ 0.63	$ 0.60	$ 0.90

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, 2018	
	June 30, 2018					Total of Incurred But Not Reported Reserves Plus Development On Reported Claims	Cumulative Number of Reported Claims
Accident Year	2014 Unaudited	2015 Unaudited	2016 Unaudited	2017 Unaudited	2018 Unaudited		
2014	$ 83,784	$ 85,037	$ 84,221	$ 84,074	$ 84,050	$ 87	13,150
2015		89,646	88,477	87,262	87,205	410	15,121
2016			84,771	85,189	84,614	1,490	21,451
2017				87,899	89,107	2,659	21,308
2018					36,431	5,669	5,779
					$ 381,407		

	Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance				
	June 30, 2018				
Accident Year	2014 Unaudited	2015 Unaudited	2016 Unaudited	2017 Unaudited	2018 Unaudited
2014	$ 70,831	$ 79,713	$ 81,684	$ 83,346	$ 83,640
2015		71,820	82,940	85,507	86,175
2016			71,543	81,682	82,671
2017				77,675	85,089
2018					23,338
Total					$ 360,913
All outstanding reserves prior to 2014, net of reinsurance					510
Reserve for unpaid losses and allocated loss adjustment expenses, net of reinsurance					$ 21,004

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 “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,” “shoul “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, and the timing of, strategic acquisitions, the costs of integration of the operations of acquired businesses, our revenue, our liquidity and sources of funding, market trends, operations and business, taxes, information technology expenses, 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 or to 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, loss estimates related to natural disasters, the effects of government regulation applicable to our operations, the appropriateness of, and changes in, 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, cybersecurity incidents 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, 2017 ("2017 Form 10-K"), which was filed with the Securities and Exchange Commission (the "SEC") on February 15, 2018, 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.

Table of Contents

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 that provides, through its subsidiaries, traditional banking and wealth, investment and treasury management services primarily in Texas and residential mortgage loans throughout the United States.

Securities Holdings. 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. 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.

During the three and six months ended June 30, 2018, our net income to common stockholders was $33.1 million, or $0.35 per diluted share, and $57.5 million, or $0.60 per diluted share, respectively. We declared total common dividends of $0.07 and $0.14 per share during the three and six months ended June 30, 2018, respectively, which resulted in a dividend payout ratios of 20.16% and 23.28%, 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 $38.8 million to repurchase our common stock during the six months ended June 30, 2018.

We reported $45.4 million and $77.6 million of consolidated income before income taxes during the three and six months ended June 30, 2018, respectively, including the following contributions from our four reportable business segments.

- The banking segment contributed $33.1 million and $72.0 million of income before income taxes during the three and six months ended June 30, 2018, respectively;
-

The broker-dealer segment contributed $8.2 million and $11.8 million of income before income taxes during the three and six months ended June 30, 2018, respectively;

- The mortgage origination segment $13.4 million and $10.8 million of income before income taxes during the three and six months ended June 30, 2018, respectively; and
- The insurance segment incurred losses before income taxes of $2.4 million and contributed income before income taxes of $2.4 million during the three and six months ended June 30, 2018, respectively.

At June 30, 2018, on a consolidated basis, we had total assets of $13.7 billion, total deposits of $7.8 billion, total loans, including loans held for sale, of $8.4 billion and stockholders' equity of $1.9 billion.

On February 13, 2018, we entered into a definitive agreement to acquire privately-held, Houston-based The Bank of River Oaks ("BORO") in an all-cash transaction. Under the terms of the definitive agreement, we have agreed to pay cash in the aggregate amount of $85 million to the shareholders and option holders of BORO. As of December 31, 2017, BORO had total assets, gross loans and deposits of $454.4 million, $343.6 million and $406.1 million, respectively. The acquisition was approved by BORO shareholders in May 2018 and was subsequently approved by regulators. The transaction is expected to close on or about August 1, 2018. Once completed, BORO will be merged into the Bank, and all customer accounts are expected to be converted to the PlainsCapital Bank platform by December 31, 2018.

During the three and six 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 our acquisition of SWS (the "SWS Merger") as discussed in detail in Note 12, Commitments

Table of Contents

and Contingencies, in addition to the recognition within the Bank of an insurance receivable and related other noninterest income of $15.0 million from coverage provided by an insurance policy for forgery.

Technology Enhancements and Corporate Initiatives

In furtherance of our goal of building a premier, diversified financial services company, we regularly evaluate strategic opportunities to invest in our business and technology platforms. Such investments are intended to support long-term technological competitiveness and improved operational efficiencies throughout our organization. During 2018, we have started making significant investment in new technological solutions, substantial core system upgrades and other technology enhancements, and are working on preliminary plans for additional investments in such solutions, upgrades and enhancements. In combination with these technology enhancements, we have begun the consolidation of common back office functions. We believe that costs incurred related to these technology investments and corporate initiatives will begin to represent an increasingly significant portion of our noninterest expenses in the near term, but are making such investments with the expectation that they will result in cost savings over the long term.

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 results of operations are primarily dependent on net interest income. The Bank also derives 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 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 Securities Holdings, 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, merchant banking investment opportunities, 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

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, 2018	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 87,958	$ 12,890	$ 704	$ 793	$ (2,482)	$ 4,985	$ 104,848
Provision for loan losses	—	340	—	—	—	—	340
Noninterest income	10,644	73,589	162,759	36,546	1,436	(5,540)	279,434
Noninterest expense	65,542	77,967	150,026	39,712	5,340	(70)	338,517
Income (loss) before income taxes	$ 33,060	$ 8,172	$ 13,437	$ (2,373)	$ (6,386)	$ (485)	$ 45,425

Six Months Ended June 30, 2018	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 174,596	$ 25,441	$ 1,645	$ 1,580	$ (4,573)	$ 9,579	$ 208,268
Provision (recovery) for loan losses	(1,531)	64	—	—	—	—	(1,467)
Noninterest income	20,823	142,135	289,862	71,564	724	(10,531)	514,577
Noninterest expense	124,913	155,743	280,729	70,725	14,743	(134)	646,719
Income (loss) before income taxes	$ 72,037	$ 11,769	$ 10,778	$ 2,419	$ (18,592)	$ (818)	$ 77,593

Three Months Ended June 30, 2017	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop 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	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop 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

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 $208.3 million and $208.1 million in net interest income during the six months ended June 30, 2018 and 2017, respectively. Changes in net interest income during the six months ended June 30, 2018, compared with the six months ended June 30, 2017, primarily included a decrease within our banking segment and increases within our 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 $117.3 million and $124.6 million in securities commissions and fees and investment and securities advisory fees and commissions, and $17.2 million and $46.2 million in gains from derivative and trading portfolio activities (included within other noninterest income) during the six months ended June 30, 2018 and 2017, 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, 2018 and 2017, we generated $288.2 million and $323.4 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.

Table of Contents

(iii) Income from insurance operations. Through NLC, we provide fire and limited homeowners insurance for low value dwellings and manufactured homes. We generated $68.4 million and $72.2 million in net insurance premiums earned during the six months ended June 30, 2018 and 2017, respectively.

In the aggregate, we generated $514.6 million and $616.1 million in noninterest income during the six months ended June 30, 2018 and 2017, respectively. This year-over-year decrease in noninterest income was predominantly attributable to decreases of $39.6 million in net gains from sale of loans and other mortgage production income, $7.4 million in investment and securities advisory fees and commissions and $29.0 million in gains from derivative and trading portfolio activities. Additionally, the three and six months ended June 30, 2017 reflect a $15.0 million receivable and related noninterest income within the banking segment related to coverage provided by an insurance policy for forgery, and $11.6 million within corporate related to the resolution of the appraisal proceedings from the SWS Merger, both of which were nonrecurring.

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, 2018 was $33.1 million, or $0.35 per diluted share, compared with net income applicable to common stockholders of $62.5 million, or $0.63 per diluted share, during the three months ended June 30, 2017. Net income applicable to common stockholders during the six months ended June 30, 2018 was $57.5 million, or $0.60 per diluted share, compared with net income applicable to common stockholders of $88.9 million, or $0.90 per diluted share, during the six months ended June 30, 2017.

Certain items included in net income for 2018 and 2017 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") and 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, 2018 included net accretion of $0.4 million, $6.9 million and $0.7 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of $1.4 million, $0.1 million and $0.2 million, respectively. During the three months ended June 30, 2017, income before taxes 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. Income before taxes during the six months ended June 30, 2018 included net accretion of $0.9 million, $15.3 million and $1.2 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of $2.9 million, $0.2 million and $0.4 million, respectively. During the six months ended June 30, 2017, income before taxes 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.

In addition, the Bank recorded “true-up” accruals with respect to the FNB Transaction loss-share agreements with the FDIC of $0.1 million and $0.3 million during the three and six months ended June 30, 2018, respectively, compared to $1.1 million and $1.7 million during the three and six months ended June 30, 2017, respectively. The total true-up accrual at June 30, 2018 was $16.6 million. This true-up accrual is based on a formula within the loss-share agreements, pursuant to which we agreed to reimburse the FDIC if the actual losses incurred and billed to the FDIC through loss sharing are below a stated threshold. During the three and six months ended June 30, 2018, the Bank also recorded $1.9 million and $5.8 million, respectively, of amortization of the FDIC Indemnification Asset due to lower projected collections from the FDIC than were originally estimated at the acquisition date.

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Performance Ratios:				
Return on average stockholder's equity	6.95 %	13.24 %	6.07 %	9.53 %
Return on average assets	1.03 %	1.94 %	0.90 %	1.43 %
Net interest margin (1) (2) (4) (5)	3.46 %	3.98 %	3.49 %	3.74 %
Net interest margin (taxable equivalent) (2) (3) (4) (5)	3.47 %	3.99 %	3.50 %	3.75 %

(1) Net interest margin is defined as net interest income divided by average interest-earning assets.
(2) Noted measures during the three and six months ended June 30, 2017 reflect certain asset category reclassifications within the detailed calculations to conform with the current period presentation.
(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 the applicable corporate federal income tax rates of 21% and 35% for the periods presented in 2018 and 2017, respectively. See footnote 2 to the following tables for the taxable equivalent adjustments to interest income.
(4) 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 41 basis points and 53 basis points during the three months ended June 30, 2018 and 2017, respectively, and 42 basis points and 51 basis points during the six months ended June 30, 2018 and 2017, respectively.
(5) During the three months ended June 30, 2018 and 2017, purchase accounting contributed 29 basis points and 82 basis points, respectively, to both net interest margin and taxable equivalent net interest margin. During the six months ended June 30, 2018 and 2017, purchase accounting contributed 33 basis points and 67 basis points, respectively, to both net interest margin and taxable equivalent net interest margin.

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.

During the three months ended June 30, 2018, purchase accounting contributed 29 basis points to our consolidated taxable equivalent net interest margin of 3.47% and primarily related to accretion of discount on loans of $0.8 million, $6.9 million and $0.7 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $0.3 million. During the three months ended June 30, 2017, purchase accounting contributed 82 basis points to our consolidated taxable equivalent net interest margin of 3.99% 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.

During the six months ended June 30, 2018, purchase accounting contributed 33 basis points to our consolidated taxable equivalent net interest margin of 3.50% and primarily related to accretion of discount on loans of $1.7 million, $15.3 million and $1.2 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $0.8 million. During the six months ended June 30, 2017, purchase accounting contributed 67 basis points to our consolidated taxable equivalent net interest margin of 3.75% 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.

Table of Contents

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

	Three Months Ended June 30, 2018			2017		
	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 held for sale	$ 1,589,149	$ 18,241	4.59 %	$ 1,672,968	$ 18,021	4.31 %
Loans held for investment, gross (1)	6,374,873	85,683	5.34 %	6,121,332	95,772	6.22 %
Investment securities - taxable	1,663,257	12,486	3.00 %	1,399,402	8,811	2.52 %
Investment securities - non-taxable (2)	252,591	1,912	3.03 %	232,340	1,903	3.28 %
Federal funds sold and securities purchased under agreements to resell	228,786	859	1.51 %	147,179	242	0.66 %
Interest-bearing deposits in other financial institutions	419,006	1,890	1.81 %	550,716	1,375	1.00 %
Securities borrowed	1,544,235	17,486	4.48 %	1,512,222	9,597	2.51 %
Other	69,297	1,691	9.77 %	81,230	1,113	5.49 %
Interest-earning assets, gross (2)	12,141,194	140,248	4.59 %	11,717,389	136,834	4.65 %
Allowance for loan losses	(63,944)			(57,976)		
Interest-earning assets, net	12,077,250			11,659,413		
Noninterest-earning assets	1,286,608			1,359,404		
Total assets	$ 13,363,858			$ 13,018,817		
Liabilities and Stockholders' Equity						

Interest-bearing liabilities												
Interest-bearing deposits	$	5,366,535	$	10,136	0.76	%	$	5,140,116	$	5,464	0.43	%
Securities loaned		1,382,984		15,075	4.37	%		1,388,897		7,481	2.16	%
Notes payable and other borrowings		1,588,132		9,981	2.51	%		1,708,241		7,385	1.72	%
Total interest-bearing liabilities		8,337,651		35,192	1.69	%		8,237,254		20,330	0.99	%
Noninterest-bearing liabilities												
Noninterest-bearing deposits		2,492,253						2,273,533				
Other liabilities		620,900						612,712				
Total liabilities		11,450,804						11,123,499				
Stockholders' equity		1,910,316						1,893,052				
Noncontrolling interest		2,738						2,266				
Total liabilities and stockholders' equity	$	13,363,858					$	13,018,817				
Net interest income (2)			$	105,056					$	116,504		
Net interest spread (2)					2.90	%					3.66	%
Net interest margin (2)					3.47	%					3.99	%

67

Table of Contents

	Six Months Ended June 30, 2018				2017			
	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 held for sale	$ 1,442,512	$ 32,854	4.56	%	$ 1,411,964	$ 29,743	4.21	%
Loans held for investment, gross (1)	6,341,997	171,014	5.38	%	6,034,582	174,041	5.75	%
Investment securities - taxable	1,638,570	23,414	2.86	%	1,244,567	15,389	2.47	%
Investment securities - non-taxable (2)	255,644	3,942	3.08	%	225,904	3,654	3.23	%
Federal funds sold and securities purchased under agreements to resell	209,312	1,340	1.29	%	132,502	320	0.49	%
Interest-bearing deposits in other financial institutions	525,276	4,368	1.68	%	612,556	2,648	0.87	%
Securities borrowed	1,540,790	33,786	4.36	%	1,499,720	17,650	2.34	%
Other	70,071	3,143	9.02	%	86,236	2,137	4.97	%
Interest-earning assets, gross (2)	12,024,172	273,861	4.55	%	11,248,031	245,582	4.36	%
Allowance for loan losses	(64,569)				(56,809)			
Interest-earning assets, net	11,959,603				11,191,222			
Noninterest-earning assets	1,257,495				1,377,382			
Total assets	$ 13,217,098				$ 12,568,604			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities								
Interest-bearing deposits	$ 5,430,242	$ 18,811	0.70	%	$ 5,039,067	$ 10,154	0.41	%
Securities loaned	1,374,082	28,814	4.23	%	1,375,403	13,821	2.03	%
	1,393,146	17,507	2.52	%	1,380,699	12,496	1.81	%

Notes payable and other borrowings								
Total interest-bearing liabilities	8,197,470	65,132	1.60	%	7,795,169	36,471	0.94	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,456,189				2,254,268			
Other liabilities	650,557				634,661			
Total liabilities	11,304,216				10,684,098			
Stockholders’ equity	1,910,736				1,881,809			
Noncontrolling interest	2,146				2,697			
Total liabilities and stockholders' equity	$ 13,217,098				$ 12,568,604			
Net interest income (2)		$ 208,729				$ 209,111		
Net interest spread (2)			2.95	%			3.42	%
Net interest margin (2)			3.50	%			3.75	%

(1) Average balance includes non-accrual loans.

(2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on the applicable corporate federal income tax rates of 21% and 35% for the periods presented in 2018 and 2017, respectively. The adjustment to interest income was $0.2 million and $0.5 million for the three months ended June 30, 2018 and 2017, respectively, and $0.5 million and $1.0 million for the six months ended June 30, 2018 and 2017.

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 decreased $11.1 million and increased $0.2 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017. The decrease in net interest income during the three months ended June 30, 2018, compared to the same period in 2017, was primarily related to a decrease in accretion of discount on loans within our banking segment, partially offset by improved spreads within our broker-dealer segment. The increase in net interest income during the six months ended June 30, 2018, compared to the same period in 2017, was primarily related to improved spreads within our broker-dealer segment, offset by a decrease in accretion of discount on loans and changes attributable to both volumes and yields within our banking segment.

The provision (recovery) for loan losses is determined by management as the amount to be added to (recovered from) 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 $0.3 million and $5.9 million during the three months ended June 30, 2018 and 2017, respectively. During the three months ended June 30, 2018, the provision for loan losses was comprised of charges relating to newly originated loans and acquired loans without credit impairment at acquisition of $1.3 million and the recovery of charges on PCI loans of $1.0 million, compared to 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 during the three months ended June 30, 2017. During the six months ended June 30, 2018 and

2017, the consolidated provision (recovery) for loan losses, substantially all of which related to the banking segment, was ($1.5) million and $7.6 million, respectively. During the six months ended June 30, 2018, the provision (recovery) for loan losses was comprised of the recovery of charges relating to newly originated loans and acquired loans without credit impairment at acquisition of $0.2 million and the recovery of charges on PCI loans of $1.3 million, compared to 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 during the six months ended June 30, 2017.

Consolidated noninterest income decreased $65.3 million and $101.6 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017. 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, 2018, compared with the same periods in 2017, were primarily driven by decreases in noninterest income within our broker-dealer and mortgage origination segments.

Consolidated noninterest expense decreased $27.7 million and $40.0 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017. The year-over-year decreases in noninterest expense during the three and six months ended June 30, 2018, compared with the same periods in 2017, were primarily driven by decreases in noninterest expense within our broker-dealer, mortgage origination and insurance segments, partially offset by a wire fraud loss incurred within the banking segment during the three months ended June 30, 2018 as discussed in more detail in the banking segment discussion below.

Consolidated income tax expense during the three months ended June 30, 2018 and 2017 was $11.0 million and $25.8 million, respectively, reflecting effective tax rates of 24.3% and 29.1%, respectively. Consolidated income tax expense during the six months ended June 30, 2018 and 2017 was $18.5 million and $40.8 million, respectively, reflecting effective tax rates of 23.9% and 31.4%, respectively. The 2018 effective tax rates approximated the applicable statutory tax rates. The effective tax rates during the three and six months ended June 30, 2017 were lower than the then applicable statutory rate due to the 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 decreases in our effective tax rates from periods in 2017 to 2018 were driven by the reduction in the corporate tax rate from 35% to 21% pursuant to the enactment of the Tax Cuts and Jobs Act of 2017 (“Tax Legislation”). As a result of the Tax Legislation, we expect income tax expense during reporting periods in 2018 to be lower than the corresponding periods in 2017. Certain deferred tax asset amounts recorded in December 2017 following enactment of the Tax Legislation are considered reasonable estimates as of June 30, 2018 and could be adjusted during the measurement period, which will end in December 2018, as a result of further refinement of our calculations, changes in interpretations and assumptions made, guidance that may be issued and actions we may take as a result of the Tax Legislation.

Segment Results

Banking Segment

Income before income taxes in our banking segment during the three months ended June 30, 2018 and 2017 was $33.1 million and $59.8 million, respectively, while income before income taxes in our banking segment during the six months ended June 30, 2018 and 2017 was $72.0 million and $91.6 million, respectively. In addition to the previously mentioned $15.0 million insurance receivable and related noninterest income recognized during the three months ended June 30, 2017, the decreases in income before income taxes during the three and six months ended June 30, 2018, compared with the same periods in 2017, were primarily due to a decline in accretion, increases in deposit rates and a $4.3 million wire fraud loss and related expenses, partially offset by an increase in interest income associated with increases in both rate and volume on the loan portfolio. The wire fraud loss was a result of an unauthorized third party gaining remote access to a single employee’s email account through “spear phishing” and did not involve unauthorized access to other systems or accounts, or to our network. We discovered and blocked the unauthorized access on May 14, 2018. Through such email account, we believe the unauthorized third party also obtained access to personally identifiable information of some customers, including names, account numbers, and, in certain cases, social security numbers. During the second quarter of 2018, in addition to the $4.0 million wire fraud loss, we incurred approximately $0.3 million in costs to investigate the incident, provide identity protection services, including credit monitoring, to customers who may have been impacted and other legal and professional services, all of which were expensed as

Table of Contents

incurred within the banking segment. We also may incur expenses, including legal and professional services expenses, and claims for damages related to this incident in the future. We have not recorded an accrual for future claims as we have not concluded that such a loss is probable. We have notified our insurance carriers of this incident, and we expect available insurance coverage will reduce our overall financial exposure. In addition, we continue to seek recovery of the wire fraud loss arising from this incident. Given the preliminary nature of such actions, we cannot currently estimate the amount of any future legal or insurance recoveries related to this loss.

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
Performance Ratios:								
Efficiency ratio (1)	66.47	%	48.96	%	63.92	%	55.51	%
Return on average assets	1.09	%	1.63	%	1.20	%	1.30	%
Net interest margin (2) (4)	4.11	%	4.80	%	4.13	%	4.53	%
Net interest margin (taxable equivalent) (3) (4)	4.12	%	4.81	%	4.14	%	4.53	%

(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 the applicable corporate federal income tax rates of 21% and 35% for the periods presented in 2018 and 2017, respectively. See footnote 2 to the following tables for the taxable equivalent adjustments to interest income.
(4) During the three months ended June 30, 2018 and 2017, purchase accounting contributed 42 basis points and 112 basis points, respectively, to net interest margin and taxable equivalent net interest margin. During the six months ended June 30, 2018 and 2017, purchase accounting contributed 47 basis points and 91 basis points to net interest margin and taxable equivalent net interest margin.

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, 2018, purchase accounting contributed 42 basis points to the banking segment’s taxable equivalent net interest margin of 4.12% and primarily related to accretion of discount on loans of \$0.8 million, \$6.9 million and \$0.7 million associated with the PlainsCapital Merger, FNB Transaction and SWS

Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $0.3 million. During the three months ended June 30, 2017, purchase accounting contributed 112 basis points to the banking segment's taxable equivalent net interest margin of 4.81% 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.

During the six months ended June 30, 2018, purchase accounting contributed 47 basis points to the banking segment's taxable equivalent net interest margin of 4.14% and primarily related to accretion of discount on loans of $1.7 million, $15.3 million and $1.2 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $0.8 million. During the six months ended June 30, 2017, purchase accounting contributed 91 basis points to the banking segment's taxable equivalent net interest margin of 4.53% 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.

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, 2018 Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	2017 Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
Assets						
Interest-earning assets						
Loans, gross (1)	$ 5,822,978	$ 79,173	5.40 %	$ 5,640,067	$ 90,471	6.37 %
Subsidiary warehouse lines of credit	1,462,319	15,444	4.18 %	1,545,376	14,655	3.75 %
Investment securities - taxable	943,411	5,333	2.26 %	883,414	4,162	1.88 %
Investment securities - non-taxable (2)	112,148	945	3.37 %	124,495	1,179	3.79 %
Federal funds sold and securities purchased under agreements to resell	585	1	0.73 %	10,794	27	1.00 %
Interest-bearing deposits in other financial institutions	190,984	851	1.79 %	284,862	773	1.09 %
Other	45,529	542	4.76 %	66,127	624	3.78 %
Interest-earning assets, gross (2)	8,577,954	102,289	4.73 %	8,555,135	111,891	5.20 %
Allowance for loan losses	(63,044)			(57,738)		
Interest-earning assets, net	8,514,910			8,497,397		
Noninterest-earning assets	881,822			943,310		
Total assets	$ 9,396,732			$ 9,440,707		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities						
Interest-bearing deposits	$ 5,029,042	$ 12,479	1.00 %	$ 4,867,042	$ 7,220	0.59 %
	455,002	1,660	1.45 %	914,994	2,073	0.90 %

Notes payable and other borrowings								
Total interest-bearing liabilities	5,484,044	14,139	1.03	%	5,782,036	9,293	0.64	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,459,643				2,239,680			
Other liabilities	45,262				54,498			
Total liabilities	7,988,949				8,076,214			
Stockholders' equity	1,407,783				1,364,493			
Total liabilities and stockholders' equity	$ 9,396,732				$ 9,440,707			
Net interest income (2)		$ 88,150				$ 102,598		
Net interest spread (2)			3.70	%			4.55	%
Net interest margin (2)			4.12	%			4.81	%

	Six Months Ended June 30, 2018				2017			
	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)	$ 5,808,832	$ 158,364	5.43	%	$ 5,559,920	$ 164,248	5.89	%
Subsidiary warehouse lines of credit	1,338,227	27,143	4.03	%	1,301,375	24,631	3.76	%
Investment securities - taxable	924,125	10,159	2.20	%	822,734	7,707	1.87	%
Investment securities - non-taxable (2)	114,839	1,925	3.35	%	125,036	2,370	3.79	%
Federal funds sold and securities purchased under agreements to resell	540	2	0.57	%	11,486	50	0.88	%
Interest-bearing deposits in other financial institutions	286,140	2,325	1.64	%	339,955	1,610	0.95	%
Other	45,981	1,048	4.56	%	71,112	1,159	3.26	%
	8,518,684	200,966	4.70	%	8,231,618	201,775	4.89	%

Interest-earning assets, gross (2)								
Allowance for loan losses	(63,938)				(56,642)			
Interest-earning assets, net	8,454,746				8,174,976			
Noninterest-earning assets	886,028				965,116			
Total assets	$ 9,340,774				$ 9,140,092			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities								
Interest-bearing deposits	$ 5,088,835	$ 23,655	0.94	%	$ 4,765,219	$ 13,657	0.58	%
Notes payable and other borrowings	368,932	2,322	1.25	%	735,228	3,024	0.82	%
Total interest-bearing liabilities (3)	5,457,767	25,977	0.96	%	5,500,447	16,681	0.61	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,436,115				2,227,775			
Other liabilities	47,580				55,112			
Total liabilities	7,941,462				7,783,334			
Stockholders' equity	1,399,312				1,356,758			
Total liabilities and stockholders' equity	$ 9,340,774				$ 9,140,092			
Net interest income (2)		$ 174,989				$ 185,094		
Net interest spread (2)			3.74	%			4.28	%
Net interest margin (2)			4.14	%			4.53	%

(1) Average balance includes non-accrual loans.
(2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on the applicable corporate federal income tax rates of 21% and 35% for the periods presented in 2018 and 2017, respectively. The adjustment to interest income was $0.2 million and $0.4 million for the three months ended June 30, 2018 and 2017, respectively, and $0.4 million and $0.8 million for the six months ended June 30, 2018 and 2017.

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, 2018 vs. 2017 Change Due To (1)			Six Months Ended June 30, 2018 vs. 2017 Change Due To (1)		
	Volume	Yield/Rate	Change	Volume	Yield/Rate	Change
Interest income						
Loans, gross	$ 2,907	$ (14,205)	$ (11,298)	$ 7,269	$ (13,153)	$ (5,884)
Subsidiary warehouse lines of credit	(777)	1,566	789	688	1,824	2,512
Investment securities - taxable	282	889	1,171	942	1,510	2,452
Investment securities - non-taxable (2)	(117)	(117)	(234)	(192)	(253)	(445)
Federal funds sold and securities purchased under agreements to resell	(25)	(1)	(26)	(48)	—	(48)
Interest-bearing deposits in other financial institutions	(255)	333	78	(255)	970	715
Other	(194)	112	(82)	(406)	295	(111)
Total interest income (2)	1,821	(11,423)	(9,602)	7,998	(8,807)	(809)
Interest expense						
Deposits	$ 240	$ 5,019	$ 5,259	$ 927	$ 9,071	$ 9,998
Notes payable and other borrowings	(1,029)	616	(413)	(1,489)	787	(702)
Total interest expense	(789)	5,635	4,846	(562)	9,858	9,296

Net interest income (2)	$ 2,610	$ (17,058)	$ (14,448)	$ 8,560	$ (18,665)	$ (10,105)

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

Taxable equivalent net interest income decreased $14.4 million and $10.1 million during the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017. Changes in the yields earned on interest-earning assets decreased taxable equivalent net interest income by $11.4 million and $8.8 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017, primarily as a result of decreases in accretion of discount on loans of $14.8 million and $17.1 million, respectively, partially offset by higher loan yields due to increased market rates. Accretion of discount on loans is expected to continue to decrease in future periods as loans acquired in the Bank Transactions are repaid, refinanced or renewed. While we are seeing an increase in loan yields as a result of the rising interest rate environment, a portion of our loan portfolio remains at applicable rate floors, thereby causing yields on our interest-earning assets to rise more slowly than increases in market interest rates, which have also increased our borrowing costs. Absent a decline in interest rates, we believe this trend will continue until contractual rate resets allow our entire loan portfolio to reprice above applicable rate floors. Changes in the volume of interest-earning assets, primarily due to an increase in the loan portfolio, increased taxable equivalent net interest income by $1.8 million and $8.0 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017. Changes in rates paid on interest-bearing liabilities decreased taxable equivalent net interest income by $5.6 million and $9.9 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017, due to increases in market interest rates. Short-term interest rates have risen faster than medium and longer term rates, which has reduced the favorable impact of our asset-sensitive position on net interest income. Any changes in interest rates across the term structure will continue to impact net interest income and net interest margin. The impact of rate movements will change with the shape of the yield curve, including any changes in steepness or flatness and inversions at any points on the yield curve.

The banking segment's noninterest income was $10.6 million and $25.5 million during the three months ended June 30, 2018 and 2017, respectively, and $20.8 million and $37.9 million during the six months ended June 30, 2018 and 2017, respectively. The decreases in noninterest income during the three and six months ended June 30, 2018 and 2017, compared to the same periods in 2017, were primarily driven by the previously mentioned insurance receivable and related increase in other noninterest income of $15.0 million recorded during the three months ended June 30, 2017 from coverage provided by an insurance policy for forgery related to a single, large loan previously charged off by the Bank. The decreases in noninterest income, other than the previously mentioned insurance receivable, for the six months ended June 30, 2018, compared to the same period in 2017, were primarily driven by a decrease in intercompany financing charges.

The banking segment's noninterest expenses were $65.5 million and $62.5 million during the three months ended June 30, 2018 and 2017, respectively, and $124.9 million and $123.3 million during the six months ended June 30, 2018 and 2017, respectively. The increases in noninterest expenses during the three and six months ended June 30, 2018, compared to the same periods in 2017, were primarily due to the wire fraud loss and related expenses of $4.3 million previously discussed, partially offset by net decreases in expenses related to other real estate owned ("OREO"), employees' compensation and benefits and other operating expenses.

Broker-Dealer Segment

Income before income taxes in our broker-dealer segment was $8.2 million and $15.8 million during the three months ended June 30, 2018 and 2017, respectively, and $11.8 million and $25.3 million during the six months ended June 30, 2018 and 2017. The decreases in income before income taxes during the three and six months ended June 30, 2018, compared with the same periods in 2017, were primarily the result of decreases of $17.2 million and $29.0 million, respectively, in trading gains earned from our derivative and trading portfolio activities, most notably in our structured finance business. These decreases during the three and six months ended June 30, 2018, compared to the same periods in 2017, were primarily due to market volatility, competitive pricing pressures, decreases of 26% and 31%, respectively, in the business line's to-be-announced ("TBA") mortgage-backed securities volume and decreases of $3.6 million and $7.4 million, respectively, in investment and securities advisory fees and commissions primarily earned on the underwriting of municipal bond transactions within our public finance business line. The decreases were partially offset by an 85-basis point increase in the federal funds rate during the twelve months preceding June 30, 2018, which led to increases of $1.3 million and $3.3 million, respectively, in fees earned on money market and FDIC insured bank deposits during the three and six months ended June 30, 2018, compared with the same periods in 2017, increases in the net interest income earned from stock lending and margin lending and decreases in variable compensation of $10.5 million and $16.7 million, respectively, during the three and six months ended June 30, 2018, compared with the same periods in 2017, based on less robust financial results.

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 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, as well as the interest revenue earned on trading securities, net of financing costs.

Table of Contents

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

	Three Months Ended June 30,		Variance 2018 vs	Six Months Ended June 30,		Variance 2018 vs
	2018	2017	2017	2018	2017	2017
Net interest income:						
Securities lending	$ 2,411	$ 2,116	$ 295	$ 4,972	$ 3,829	$ 1,143
Structured finance	3,324	2,307	1,017	5,232	3,443	1,789
Clearing (1)	3,107	2,605	502	6,168	4,753	1,415
Other (1)	4,048	3,321	727	9,069	6,812	2,257
Total net interest income	12,890	10,349	2,541	25,441	18,837	6,604
Noninterest income:						
Securities commissions and fees by business line (2):						
Capital markets	10,892	10,259	633	21,029	21,658	(629)
Retail	20,084	19,730	354	41,028	39,317	1,711
Clearing	8,854	8,595	259	17,859	17,110	749
Other	1,261	1,015	246	2,654	2,337	317
	41,091	39,599	1,492	82,570	80,422	2,148
Investment and securities advisory fees and commissions by business line:						
Public finance	15,088	19,816	(4,728)	27,144	36,688	(9,544)
Capital markets	800	207	593	1,750	507	1,243
Retail	4,688	4,102	586	9,050	7,847	1,203
Structured finance	1,059	1,119	(60)	1,714	2,142	(428)
Clearing	285	291	(6)	577	552	25
Other	45	2	43	84	3	81
	21,965	25,537	(3,572)	40,319	47,739	(7,420)
Other:						
Structured finance	5,336	20,701	(15,365)	9,900	34,466	(24,566)
Capital markets	4,863	6,625	(1,762)	7,324	11,697	(4,373)
Other	334	348	(14)	2,022	1,038	984
	10,533	27,674	(17,141)	19,246	47,201	(27,955)
Total noninterest income	73,589	92,810	(19,221)	142,135	175,362	(33,227)
Net revenue (3)	86,479	103,159	(16,680)	167,576	194,199	(26,623)
Noninterest expense (4):						
Employees' compensation and benefits	52,418	62,840	(10,422)	104,683	120,080	(15,397)
Other	25,889	24,509	1,380	51,124	48,794	2,330
	78,307	87,349	(9,042)	155,807	168,874	(13,067)

Total noninterest expense						
Income before income taxes	$ 8,172	$ 15,810	$ (7,638)	$ 11,769	$ 25,325	$ (13,556)

(1) Noted balances during the three and six months ended June 30, 2017 include certain reclassifications to conform with current period presentation.
(2) Securities commissions and fees includes income of $2.8 million and $1.8 million during the three months ended June 30, 2018 and 2017, respectively, and $5.6 million and $3.6 million during the six months ended June 30, 2018 and 2017, respectively, that is eliminated in consolidation.
(3) Net revenue is defined as the sum of total net interest income and total noninterest income
(4) Noninterest expense includes provision for loan losses associated with the broker-dealer segment within other noninterest expenses.

The broker-dealer segment had net interest income of $12.9 million and $10.3 million during the three months ended June 30, 2018 and 2017, respectively, and $25.4 million and $18.8 million during the six months ended June 30, 2018 and 2017, respectively. In the broker-dealer segment, interest is earned from securities lending activities, interest charged on customer margin loan balances and interest earned on investment securities used to support sales, underwriting and other customer activities. The increases between the three and six months ended June 30, 2018 and the comparable periods in 2017 were primarily due to improved spreads on customer balances, improved spreads on stock loan balances and an increase in net interest earned on trading securities.

Noninterest income was $73.6 million and $92.8 million during the three months ended June 30, 2018 and 2017, respectively, and $142.1 million and $175.4 million during the six months ended June 30, 2018 and 2017, respectively. The decreases in noninterest income between the three and six months ended June 30, 2018 and the comparable periods in 2017 were primarily due to decreases of $17.1 million and $28.0 million, respectively, in other noninterest income and $3.6 million and $7.4 million, respectively, in investment and securities advisory fees and commissions, which were partially offset by increases of $1.5 million and $2.1 million, respectively, in securities commissions and fees.

Securities commissions and fees increased $1.5 million and $2.1 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017. The increases were primarily attributable to fees earned on money market accounts and FDIC insured bank deposits by the clearing and retail businesses resulting from the 85-basis point increase in the federal funds rate during the twelve months preceding June 30, 2018.

Table of Contents

Investment and securities advisory fees and commissions decreased $3.6 million and $7.4 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017, primarily due to reductions in the number and the aggregate dollar amount of municipal bond transactions as a number of national municipal issuers elected to accelerate certain capital raising initiatives in the fourth quarter of 2017 before the enactment of the Tax Legislation. As a result, we have experienced lower municipal issuance volume in 2018 compared to 2017 and expect this trend to continue for the remainder of 2018.

The decreases in other noninterest income during the three and six months ended June 30, 2018, compared with the same periods in 2017, were primarily the result of $17.2 million and $29.0 million respective decreases in trading gains earned from our derivative and trading portfolio activities, most notably in our structured finance business primarily due to market volatility, competitive pricing pressures and decreases of 26% and 31%, respectively, in the business line's TBA mortgage-backed securities volume.

Noninterest expenses were $78.3 million and $87.3 million during the three months ended June 30, 2018 and 2017, respectively, and $155.8 million and $168.9 million during the six months ended June 30, 2018 and 2017, respectively. The decreases in noninterest expenses of $9.0 million and $13.1 million during the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017, were primarily due to decreases in the variable compensation and benefits expense components that are based on performance.

Selected information concerning the broker-dealer segment follows (dollars in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Compensation as a % of net revenue	60.6 %	60.9 %	62.5 %	61.8 %
FDIC insured program balances at the Bank (end of period)			$ 1,278,694	$ 1,301,043
Other FDIC insured program balances (end of period)			$ 896,739	$ 1,099,965
Customer margin balances (end of period)			$ 355,561	$ 338,514
Customer funds on deposit, including short credits (end of period)			$ 354,277	$ 394,335
Public finance:				
Number of issues	368	460	604	792
Aggregate amount of offerings	$ 15,066,403	$ 19,299,334	$ 25,715,524	$ 39,837,764
Capital markets:				
Total volumes	$ 20,505,462	$ 20,573,899	$ 36,376,727	$ 34,441,862
Net inventory (end of period)			$ 376,388	$ 311,395

Retail:				
Retail employee representatives (end of period)			124	123
Independent registered representatives (end of period)			218	224
Structured finance:				
Lock production/TBA volume	$ 1,318,084	$ 1,790,385	$ 2,379,596	$ 3,460,487
Clearing:				
Total tickets	373,385	315,646	779,516	664,785
Correspondents (end of period)			153	170
Securities lending:				
Interest-earning assets - stock borrowed (end of period)			$ 1,491,182	$ 1,459,990
Interest-bearing liabilities - stock loaned (end of period)			$ 1,316,128	$ 1,312,985

Table of Contents

Mortgage Origination Segment

Income before income taxes in our mortgage origination segment was $13.4 million and $19.3 million during the three months ended June 30, 2018 and 2017, respectively, and $10.8 million and $29.2 million during the six months ended June 30, 2018 and 2017, respectively. The decreases in income before income taxes during both the three and six months ended June 30, 2018, compared to the same periods in 2017, were primarily due to decreases in noninterest income, partially offset by decreases in noninterest expense.

The mortgage lending business is subject to variables that can impact loan origination volume, including seasonal and interest rate fluctuations. Historically, the mortgage origination segment has typically experienced increased loan origination volume from purchases of homes during the spring and summer, when more people tend to move and buy or sell homes. An increase in mortgage interest rates tends to result in decreased loan origination volume from refinancings, while a decrease in mortgage interest rates tends to result in increased loan origination volume from refinancings. While mortgage interest rates have increased since the beginning of 2017, refinancing volume has remained between 12% and 16% of total loan origination volume during both the three and six months ended June 30, 2018 and 2017. We do not anticipate that any additional increases in mortgage interest rates will significantly impact home purchases volume during the remainder of 2018, as changes in mortgage interest rates have historically had a lesser impact on home purchases volume than on refinancing volume.

The mortgage origination segment primarily originates its mortgage loans through a retail channel, with limited lending through its affiliated business arrangements (“ABAs”). For the six months ended June 30, 2018, funded volume through ABAs was approximately 6% of the mortgage origination segment’s total loan volume. Currently, PrimeLending owns a 51% membership interest in five ABAs. We expect production within the ABA channel to remain at approximately 6% of the total loan volume during 2018, a slight increase from 2017.

The following table provides certain details regarding our mortgage loan originations and selected information for the periods indicated below (dollars in thousands).

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
ortgage an iginations - its	17,007		17,594		29,318		29,986	
	$ 4,107,375		$ 4,058,084		$ 7,067,172		$ 6,882,415	

ortgage an iginations - lume																
ortgage an iginations:																
nventional	$	2,529,836	61.59	%	$	2,442,701	60.19	%	$	4,289,069	60.69	%	$	4,165,784	60.53	
overnment		998,786	24.32	%		1,001,799	24.69	%		1,754,865	24.83	%		1,676,450	24.36	
mbo		354,275	8.63	%		378,454	9.33	%		629,884	8.91	%		654,088	9.50	
her		224,478	5.46	%		235,130	5.79	%		393,354	5.57	%		386,093	5.61	
	$	4,107,375	100.00	%	$	4,058,084	100.00	%	$	7,067,172	100.00	%	$	6,882,415	100.00	
ome rchases	$	3,615,991	88.04	%	$	3,502,128	86.30	%	$	5,974,683	84.54	%	$	5,771,266	83.86	
financings		491,384	11.96	%		555,956	13.70	%		1,092,489	15.46	%		1,111,149	16.14	
	$	4,107,375	100.00	%	$	4,058,084	100.00	%	$	7,067,172	100.00	%	$	6,882,415	100.00	
xas	$	764,337	18.61	%	$	889,017	21.91	%	$	1,328,961	18.80	%	$	1,511,576	21.96	
lifornia		449,994	10.96	%		482,466	11.89	%		836,232	11.83	%		843,550	12.26	
orida		309,413	7.53	%		239,769	5.91	%		526,721	7.45	%		414,947	6.03	
io		184,169	4.48	%		196,187	4.83	%		300,960	4.26	%		311,212	4.52	
izona		164,240	4.00	%		156,183	3.85	%		291,449	4.12	%		272,682	3.96	
ashington		155,215	3.78	%		119,411	2.94	%		261,855	3.71	%		204,808	2.98	
uth rolina		138,012	3.36	%		126,815	3.12	%		233,635	3.31	%		226,829	3.30	
ssouri		137,557	3.35	%		141,237	3.48	%		228,145	3.23	%		217,544	3.16	
rth rolina		128,157	3.12	%		137,481	3.39	%		222,105	3.14	%		225,275	3.27	
aryland		121,339	2.95	%		126,549	3.12	%		210,538	2.98	%		209,569	3.04	
l other tes		1,554,942	37.86	%		1,442,969	35.56	%		2,626,571	37.17	%		2,444,423	35.52	
	$	4,107,375	100.00	%	$	4,058,084	100.00	%	$	7,067,172	100.00	%	$	6,882,415	100.00	
ortgage an Sales - lume	$	3,526,603			$	3,385,260			$	6,712,041			$	6,660,427		

Table of Contents

Refinancing volume decreased to $491.4 million during the three months ended June 30, 2018 from $556.0 million during the three months ended June 30, 2017 (representing 12.0% and 13.7%, respectively, of total loan origination volume), while refinancing volume was relatively unchanged at approximately $1.1 billion during both the six months ended June 30, 2018 and 2017 (representing 15.5% and 16.1%, respectively, of total loan origination volume). Home purchases volume increased 3.3% to $3.6 billion during the three months ended June 30, 2018 from $3.5 billion during the three months ended June 30, 2017, while home purchases volume increased 3.5% to $6.0 billion during the six months ended June 30, 2018, from $5.8 billion during the six months ended June 30, 2017.

The mortgage origination segment's total loan origination volume during the three and six months ended June 30, 2018 increased 1.2% and 2.7%, respectively, compared to the same periods in 2017, while income before income taxes during the three and six months ended June 30, 2018 decreased 30.2% and 63.1%, respectively, compared to the same periods in 2017. The decreases in income before taxes during the three and six months ended June 30, 2018, compared to the same periods in 2017, were primarily due to decreases in net gains from sale of loans, in addition to decreases in the change in net fair value and related derivative activity of interest rate lock commitments ("IRLCs") and loans held for sale. These changes were partially offset by decreases in net interest expense and segment operating costs.

Net interest income (expense) of $0.7 million and $1.0 million during the three months ended June 30, 2018 and 2017, respectively, and $1.6 million and ($0.9) million during the six months ended June 30, 2018 and 2017, respectively, was primarily comprised of interest incurred on a warehouse line of credit held with the Bank as well as related intercompany financing costs, partially offset by interest income earned on loans held for sale. The year-over-year improvement in net interest income for the six months ended June 30, 2018 included the effects of slightly increased average hold periods and net yields on mortgage loans held for sale.

Noninterest income was $162.8 million and $179.6 million during the three months ended June 30, 2018 and 2017, respectively, and $289.9 million and $323.3 million during the six months ended June 30, 2018 and 2017, respectively, and was comprised of the following (in thousands).

	Three Months Ended June 30,		Variance 2018 vs 2017	Six Months Ended June 30,		Variance 2018 vs 2017
	2018	2017		2018	2017	
Net gains from sale of loans	$ 111,719	$ 122,484	$ (10,765)	$ 217,824	$ 242,123	$ (24,299)
Mortgage loan origination fees and other related income	29,618	25,976	3,642	50,544	45,532	5,012
Other mortgage production income:						
Change in net fair value and related derivative activity:						
Interest rate lock commitments and loans held	17,032	27,979	(10,947)	12,494	24,529	(12,035)

for sale						
Mortgage servicing rights asset	(1,688)	(1,785)	97	(2,830)	(428)	(2,402)
Servicing fees	6,078	4,983	1,095	11,830	11,519	311
	$ 162,759	$ 179,637	$ (16,878)	$ 289,862	$ 323,275	$ (33,413)

Net gains from sale of loans decreased 8.8% and 10.0% during the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017. Mortgage loan origination fees increased 14.0% and 11.0% during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017. The decreases in net gains from sale of loans during the three and six months ended June 30, 2018, compared with the same periods in 2017, were primarily a result of decreases in average loan sales margin, partially offset by slight increases in total loan sales volume of 4.2% and 0.8% during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017. The decreases in average loan sales margin were primarily attributable to competitive pricing pressure resulting from home inventory shortages and a reduction in national refinancing volume. The increases in mortgage loan origination fees were primarily the result of increases in average mortgage loan origination fees, in addition to a slight increase in total loan origination volume, during three and six months ended June 30, 2018, compared with the same periods in 2017.

Noninterest income included increases of $17.0 million and $12.5 million during the three and six months ended June 30, 2018, respectively, compared with increases of $28.0 million and $24.5 million during the three and six months ended June 30, 2017, respectively, in the net fair value of the mortgage origination segment's IRLCs and loans held for sale and the related activity associated with forward commitments used by the mortgage origination segment to mitigate interest rate risk associated with its IRLCs and mortgage loans held for sale. The increase during the three months ended June 30, 2018 was primarily the result of an increase in the volume of IRLCs and mortgage loans, in addition to an increase in the average value of individual IRLCs and mortgage loans. The increase during the six months ended June

Table of Contents

30, 2018 was primarily the result of an increase in the volume of IRLCs and mortgage loans, partially offset by a decrease in the average value of individual IRLCs and mortgage loans.

The mortgage origination segment sells substantially all mortgage loans it originates to various investors in the secondary market, the majority servicing released. During the three months ended June 30, 2018, the mortgage origination segment retained servicing on approximately 7% of loans sold, compared to 5% during the same period in 2017. During the six months ended June 30, 2018, the mortgage origination segment retained servicing on approximately 12% of loans sold, compared to 4% during the same period in 2017. The mortgage origination segment’s determination of whether to retain or release servicing on mortgage loans it sells is impacted by, among other things, changes in mortgage interest rates, and refinancing and market activity. The related MSR asset was valued at $58.9 million on $4.5 billion of serviced loan volume at June 30, 2018, compared with a value of $55.8 million on $4.9 billion of serviced loan volume at December 31, 2017. The mortgage origination segment may, from time to time, manage its MSR asset through different strategies, including varying the percentage of mortgage loans sold servicing released and opportunistically selling MSR assets. The mortgage origination segment has also retained servicing on certain loans sold to the banking segment. Gains and losses associated with such sales to the banking segment and the related MSR asset are eliminated in consolidation. The mortgage origination segment uses derivative financial instruments, including U.S. Treasury bond futures and options, as a means to mitigate interest rate risk associated with its MSR asset. Changes in the net fair value of the MSR asset and the related derivatives associated with normal customer payments, changes in discount rates, prepayment speed assumptions and customer payoffs resulted in net losses of $1.7 million and $2.8 million during the three and six months ended June 30, 2018, respectively, compared to net losses of $1.8 million and $0.4 million during the three and six months ended June 30, 2017. Additionally, net servicing income was $2.9 million and $5.4 million during the three and six months ended June 30, 2018, respectively, compared with $1.6 million and $4.8 million during the same periods in 2017. In May 2018 and March 2017, the mortgage origination segment sold MSR assets of $9.3 million and $17.5 million, respectively, which represented $834.3 million and $1.7 billion of its serviced loan volume at the time.

Noninterest expenses were $150.0 million and $161.4 million during the three months ended June 30, 2018 and 2017, respectively, and $280.7 million and $293.2 million during the six months ended June 30, 2018 and 2017, respectively. Noninterest expenses were comprised of the items set forth in the table below (in thousands). Reclassifications of $2.4 million and $4.5 million from variable compensation to segment operating costs were made to the amounts presented below for the three and six months ended June 30, 2017, respectively, to conform with the current period presentation.

	Three Months Ended June 30,		Variance	Six Months Ended June 30,		Variance
	2018	2017	2018 vs 2017	2018	2017	2018 vs 2017
Variable compensation	$ 66,531	$ 69,445	$ (2,914)	$ 112,823	$ 114,286	$ (1,463)
Segment operating costs	74,189	81,056	(6,867)	150,654	159,744	(9,090)
Lender paid closing costs	6,134	7,521	(1,387)	10,826	12,500	(1,674)
Servicing expense	3,172	3,347	(175)	6,426	6,677	(251)
	$ 150,026	$ 161,369	$ (11,343)	$ 280,729	$ 293,207	$ (12,478)

Employees’ compensation and benefits accounted for the majority of noninterest expenses incurred during all periods presented. Variable compensation decreased $2.9 million and $1.5 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017, and comprised 59.6% and 60.3% of total employees’ compensation and benefits expenses during the three months ended June 30, 2018 and 2017, respectively, and 55.6% and 55.7% of total employees’ compensation and benefits expenses during the six months ended June 30, 2018 and 2017, respectively. Variable compensation, which is primarily driven by loan origination volume, tends to fluctuate to a greater degree than loan origination volume because mortgage loan originator and fulfillment staff incentive compensation plans are structured to pay at increasing rates as higher monthly volume tiers are achieved. However, certain other incentive compensation plans driven by non-mortgage production criteria may alter this trend. A decrease in the average incentive rate paid and the impact of incentive plans driven by non-mortgage production criteria were both responsible for variable compensation decreasing while origination volume increased during both the three and six months ended June 30, 2018, compared to the same periods in 2017.

While total loan origination volume increased 1.2% and 2.7% for the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017, the mortgage origination segment’s operating costs decreased 8.5% and 5.7%, respectively. The decrease in segment operating costs during the three months ended June 30, 2018, compared to the same period in 2017, was primarily due to a decrease in indemnification liability reserve expense, in addition to decreases in legal, administrative, loan delivery, and business development costs, partially offset by an increase in professional fees associated with software development projects. The decrease in segment operating costs during the six months ended June 30, 2018, compared to the same period in 2017, was primarily due to a decrease in indemnification liability reserve expense, in addition to decreases in administrative, loan origination, loan delivery, and health insurance costs, partially offset by an increase in professional fees associated with software development projects. Historically, segment operating costs tend to fluctuate with, but at a lesser magnitude than, loan origination volume, as these costs are comprised of salaries, benefits, occupancy and administrative costs, which are not normally highly sensitive to changes in loan origination volume.

In exchange for a higher interest rate, customers may opt to have PrimeLending pay certain costs associated with the origination of their mortgage loans (“lender paid closing costs”). Fluctuations in lender paid closing costs are not always aligned with fluctuations in loan origination volume. Other loan pricing conditions, including the mortgage loan interest rate, loan origination fees paid by the customer, and a customer’s willingness to pay closing costs, may influence fluctuations in lender paid closing costs.

Between January 1, 2009 and June 30, 2018, the mortgage origination segment sold mortgage loans totaling $106.0 billion. These loans were sold under sales contracts that generally include provisions that hold the mortgage origination segment responsible for errors or omissions relating to its representations and warranties that loans sold meet certain requirements, including representations as to underwriting standards and the validity of certain borrower representations in connection with the loan. In addition, the sales contracts typically require the refund of purchased servicing rights plus certain investor servicing costs if a loan experiences an early payment default. While the mortgage origination segment sold loans prior to 2009, it does not anticipate experiencing significant losses in the future on loans originated prior to 2009 as a result of investor claims under these provisions of its sales contracts.

When a claim for indemnification of a loan sold is made by an agency, investor, or other party, the mortgage origination segment evaluates the claim and determines if the claim can be satisfied through additional documentation or other deliverables. If the claim is valid and cannot be satisfied in that manner, the mortgage origination segment negotiates with the claimant to reach a settlement of the claim. Settlements typically result in either the repurchase of a loan or reimbursement to the claimant for losses incurred on the loan.

Following is a summary of the mortgage origination segment’s claims resolution activity relating to loans sold between January 1, 2009 and June 30, 2018 (dollars in thousands).

	Original Loan Balance		Loss Recognized	
	Amount	% of Loans Sold	Amount	% of Loans Sold
Claims resolved with no payment	$ 207,536	0.20%	$ —	0.00%

Claims resolved because of a loan repurchase or payment to an investor for losses incurred (1)	208,269	0.20%	11,448	0.01%
	$ 415,805	0.40%	$ 11,448	0.01%

(1) Losses incurred include refunded purchased servicing rights.

The mortgage origination segment has established a specific claims indemnification liability reserve for each loan it concludes its obligation to a claimant is both probable and reasonably estimable. An additional indemnification liability 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.

At June 30, 2018 and December 31, 2017, the mortgage origination segment's indemnification liability reserve totaled $23.9 million and $23.5 million, respectively. The related provision for indemnification losses was $1.0 million and $1.1 million during the three months ended June 30, 2018 and 2017, respectively, and $1.7 million and $2.0 million during the six months ended June 30, 2018 and 2017, respectively.

Table of Contents

Insurance Segment

Income (losses) before income taxes in our insurance segment were ($2.4) million and ($10.4) million during the three months ended June 30, 2018 and 2017, respectively, and $2.4 million and ($8.6) million during the six months ended June 30, 2018 and 2017, respectively. The improvements in income (losses) before income taxes during the three and six months ended June 30, 2018, compared with the same periods in 2017, were driven primarily by decreases in loss and LAE due to fewer weather-related events, partially offset by a decline in net insurance premiums earned.

The insurance segment is subject to claims arising out of severe weather, the incidence and severity of which are inherently unpredictable. Generally, the insurance segment's insured risks exhibit higher losses in the second and third calendar quarters due to a seasonal concentration of weather-related events in its primary geographic markets. Although weather-related losses (including hail, high winds, tornadoes and hurricanes) can occur in any calendar quarter, the second calendar quarter, historically, has experienced the highest frequency of losses associated with these events. Hurricanes, however, are more likely to occur in the third calendar quarter of the year.

The insurance segment periodically reviews the pricing of its primary products in each state of operation utilizing a consulting actuarial firm to supplement normal review processes resulting in filings to adjust rates as deemed necessary. The benefit of these rate actions are not fully realized until all policies under the old rates expire, which typically occurs one year from the date of rate change implementation. Concurrently, business concentrations are reviewed and actions initiated, including cancellation of agents, non-renewal of policies and cessation of new business writing on certain products in problematic geographic areas. The insurance segment has historically utilized rate actions to reduce the rate of premium growth for targeted areas when compared with the patterns exhibited in prior quarters and years and reduced the insurance segment's exposure to volatile weather in these areas, but competition and customer response to rate increases has negatively impacted customer retention and new business. The insurance segment aims to manage and diversify its business concentrations and products to minimize the effects of future weather-related events.

We believe that current initiatives to evaluate product offerings and pricing, streamline business activities and expenses and mitigate the impact of future significant weather-related events are critical to improving the insurance segment's long-term financial condition and operating results. In the event future operating performance is below our forecasted projections, there are negative changes to long-term growth rates or discount rates increase, the fair value of the insurance reporting unit may decline and we may be required to record a goodwill impairment charge.

The insurance segment's operations resulted in combined ratios of 111.1% and 131.8% during the three months ended June 30, 2018 and 2017, respectively, and 98.1% and 115.1% during the six months ended June 30, 2018 and 2017. The decrease in the combined ratios during the three and six months ended June 30, 2018, compared with the same periods in 2017, were primarily driven by decreases in the loss and LAE ratios due to fewer weather-related events. The combined ratio is a measure of overall insurance underwriting profitability, and represents the sum of loss and LAE and underwriting expenses divided by net insurance premiums earned.

Noninterest income of $36.5 million and $38.4 million during the three months ended June 30, 2018 and 2017, respectively, included net insurance premiums earned of $34.1 million and $36.0 million, respectively. Noninterest income of $71.6 million and $76.7 million during the six months ended June 30, 2018 and 2017, respectively, included net insurance premiums earned of $68.4 million and $72.2 million, respectively. The year-over-year decrease in net insurance premiums earned was due to the effect of decreases in net premiums written.

Table of Contents

Direct insurance premiums written by major product line are presented in the table below (in thousands).

	Three Months Ended June 30,		Variance 2018 vs	Six Months Ended June 30,		Variance 2018 vs
	2018	2017	2017	2018	2017	2017
Direct Insurance Premiums Written:						
Homeowners	$ 14,248	$ 15,259	$ (1,011)	$ 26,721	$ 29,158	$ (2,437)
Fire	10,967	11,686	(719)	21,171	22,636	(1,465)
Mobile Home	9,848	10,018	(170)	19,579	20,164	(585)
Commercial	691	781	(90)	1,344	1,553	(209)
Other	47	48	(1)	71	77	(6)
	$ 35,801	$ 37,792	$ (1,991)	$ 68,886	$ 73,588	$ (4,702)

The total direct insurance premiums written for our three largest insurance product lines decreased by $1.9 million and $4.5 million during the three and six months ended June 30, 2018, respectively, compared with the same periods in 2017.

Net insurance premiums earned by major product line are presented in the table below (in thousands).

	Three Months Ended June 30,		Variance 2018 vs	Six Months Ended June 30,		Variance 2018 vs
	2018	2017	2017	2018	2017	2017
Net Insurance Premiums Earned:						
Homeowners	$ 13,605	$ 14,559	$ (954)	$ 26,540	$ 28,592	$ (2,052)
Fire	10,444	11,142	(698)	21,028	22,197	(1,169)
Mobile Home	9,353	9,529	(176)	19,446	19,773	(327)
Commercial	657	743	(86)	1,335	1,522	(187)
Other	46	47	(1)	71	76	(5)
	$ 34,105	$ 36,020	$ (1,915)	$ 68,420	$ 72,160	$ (3,740)

Net insurance premiums earned during the three and six months ended June 30, 2018 decreased compared to the same periods in 2017, primarily due to the decrease in net premiums written noted above.

Noninterest expenses of $39.7 million and $49.4 million during the three months ended June 30, 2018 and 2017, respectively, and $70.7 million and $86.4 million during the six months ended June 30, 2018 and 2017, respectively, include both loss and LAE expenses and policy acquisition and other underwriting expenses, as well as other noninterest expenses. Loss and LAE are recognized based on formula and case basis estimates for losses reported with respect to direct business, estimates of unreported losses based on past experience and deduction of amounts for reinsurance placed with reinsurers. Loss and LAE during the three months ended June 30, 2018 was $24.4 million, compared with $33.2 million during the same period in 2017, resulting in loss and LAE ratios of 71.6% and 92.1%, respectively. Loss and LAE during the six months ended June 30, 2018 and 2017 was $39.9 million, compared with $54.9 million during the same period in 2017, resulting in loss and LAE ratios of 58.4% and 76.1%, respectively. The decrease in the loss and LAE ratio during the three months ended June 30, 2018, compared to the same period in 2017, was primarily driven by a 26.4% decrease in loss and LAE expense, compared to premiums earned decreasing by 5.3%. The decrease in the loss and LAE ratio during the six months ended June 30, 2018, compared to the same period in 2017, was primarily driven by a 27.2% decrease in loss and LAE expense, compared to premiums earned decreasing by 5.2%.

Policy acquisition and other underwriting expenses encompass all expenses incurred relative to NLC operations, and include elements of multiple categories of expense otherwise reported as noninterest expense in the consolidated statements of operations.

The following table details the calculation of the underwriting expense ratio for the periods presented (dollars in thousands).

	Three Months Ended June 30,		Variance	Six Months Ended June 30,		Variance
	2018	2017	2018 vs 2017	2018	2017	2018 vs 2017
Amortization of deferred policy acquisition costs	$ 9,478	$ 9,531	$ (53)	$ 18,568	$ 18,627	$ (59)
Other underwriting expenses	5,046	5,792	(746)	10,577	11,468	(891)
Total	14,524	15,323	(799)	29,145	30,095	(950)
Agency expenses	(1,061)	(1,039)	(22)	(1,982)	(1,925)	(57)
Total less agency expenses	$ 13,463	$ 14,284	$ (821)	$ 27,163	$ 28,170	$ (1,007)
Net insurance premiums earned	$ 34,105	$ 36,020	$ (1,915)	$ 68,420	$ 72,160	$ (3,740)
Expense ratio	39.5 %	39.7 %	(0.2) %	39.7 %	39.0 %	0.7 %

Table of Contents

Corporate

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, merchant banking investment opportunities 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. Hilltop's merchant banking investment activities include the identification of attractive opportunities for capital deployment in companies engaged in non-financial activities through its merchant bank subsidiary, Hilltop Opportunity Partners LLC, formerly known as PlainsCapital Equity, LLC.

As a holding company, Hilltop's primary investment objectives are to support capital deployment for organic growth and to preserve capital to be deployed through acquisitions. Investment and interest income earned was $0.4 million and $0.1 million during the three months ended June 30, 2018 and 2017, respectively, and $0.7 million and $0.2 million during the six months ended June 30, 2018 and 2017, respectively.

Noninterest income was $1.4 million and $12.6 million during the three months ended June 30, 2018 and 2017, respectively, and $0.7 million and $12.6 million during the six months ended June 30, 2018 and 2017, respectively. Noninterest income during the three and six months ended June 30, 2018 included net noninterest income associated with activity within our merchant bank subsidiary. Noninterest income during both the three and six months ended June 30, 2017 was primarily comprised of the previously mentioned pre-tax net increase to other noninterest income of $11.6 million related to the resolution of the appraisal proceedings from the SWS Merger.

Interest expense was $2.8 million and $2.4 million during the three months ended June 30, 2018 and 2017, respectively, and $5.3 million and $5.0 million during the six months ended June 30, 2018 and 2017. Interest expense during each period was primarily associated with recurring quarterly interest expense of $1.9 million incurred on our $150.0 million aggregate principal amount of 5% senior notes due 2025 ("Senior Notes") and quarterly interest expense of approximately $0.9 million on junior subordinated debentures of $67.0 million issued by PCC (the "Debentures").

Noninterest expenses of $5.3 million and $6.3 million during the three months ended June 30, 2018 and 2017, respectively, and $14.7 million and $15.7 million during the six months ended June 30, 2018 and 2017, respectively, were primarily comprised of employees' compensation and benefits and professional fees, including corporate governance, legal and transaction costs.

Financial Condition

The following discussion contains a more detailed analysis of our financial condition at June 30, 2018 as compared with December 31, 2017.

Securities Portfolio

At June 30, 2018, investment securities consisted of securities of the U.S. Treasury, U.S. government and its agencies, obligations of municipalities and other political subdivisions, primarily in the State of Texas, mortgage-backed, corporate debt, and equity securities. We may categorize investments as trading, available for sale, held to maturity and equity securities.

Trading securities are bought and held principally for the purpose of selling them in the near term and are carried at fair value, marked to market through operations and held at the Bank and the Hilltop Broker-Dealers. Securities that may be sold in response to changes in market interest rates, changes in securities' prepayment risk, increases in loan demand, general liquidity needs and other similar factors are classified as available for sale and are carried at estimated fair value, with unrealized gains and losses recorded in accumulated other comprehensive income (loss). With the adoption of Accounting Standards Update 2016-01 in January 2018, we reclassified all equity investments out of available for sale securities, with all subsequent changes in fair value recognized in net income. Securities are classified as held to maturity based on the intent and ability of our management, at the time of purchase, to hold such securities to maturity. These securities are carried at amortized cost.

Table of Contents

The table below summarizes our securities portfolio (in thousands).

	June 30, 2018	December 31, 2017
Trading securities, at fair value		
U.S. Treasury securities	$ 1,033	$ —
U.S. government agencies:		
Bonds	57,996	52,078
Residential mortgage-backed securities	338,892	372,817
Commercial mortgage-backed securities	8,664	6,125
Collateralized mortgage obligations	1	5,122
Corporate debt securities	80,361	96,182