Hilltop Holdings Inc.
Form 10-Q
July 27, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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

Commission File Number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

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

200 Crescent Court, Suite 1330

Dallas, TX	75201
(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 27, 2017 was 96,347,034.

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HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2017

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

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

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

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(Unaudited)

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

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

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

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

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

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

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

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

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

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

See accompanying notes.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting and Reporting Policies

Nature of Operations

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

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

Basis of Presentation

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

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

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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

2. Recently Issued Accounting Standards

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

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

3. Fair Value Measurements

Fair Value Measurements and Disclosures

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

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

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

- Level 2 Inputs: Observable inputs other than Level 1 prices. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, yield curves, prepayment speeds, default rates, credit risks and loss severities), and inputs that are derived from or corroborated by market data, among others.

- Level 3 Inputs: Unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities. Level 3 inputs include pricing models and discounted cash flow techniques, among others.

Fair Value Option

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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

Three months ended June 30, 2017						
Loans held for sale	$ 30,214	$ 8,675	$ (6,722)	$ (2,130)	$ —	$ 30,037
MSR asset	45,573	1,266	—	(3,259)	—	43,580
Total	$ 75,787	$ 9,941	$ (6,722)	$ (5,389)	$ —	$ 73,617
Six months ended June 30, 2017						
Loans held for sale	$ 35,801	$ 16,503	$ (17,423)	$ (4,844)	$ —	$ 30,037
MSR asset	61,968	2,490	(17,499)	(3,379)	—	43,580
Total	$ 97,769	$ 18,993	$ (34,922)	$ (8,223)	$ —	$ 73,617
Three months ended June 30, 2016						
Trading securities	$ 1	$ —	$ —	$ —	$ —	$ 1
Loans held for sale	40,545	19,803	(10,894)	(3,809)	—	45,645
MSR asset	39,863	8,254	(7,586)	(7,040)	—	33,491
Total	$ 80,409	$ 28,057	$ (18,480)	$ (10,849)	$ —	$ 79,137
Six months ended June 30, 2016						
Trading securities	$ 1	$ —	$ —	$ —	$ —	$ 1
Loans held for sale	25,880	43,039	(15,131)	(8,143)	—	45,645
MSR asset	52,285	9,893	(7,586)	(21,101)	—	33,491
Total	$ 78,166	$ 52,932	$ (22,717)	$ (29,244)	$ —	$ 79,137

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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

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

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

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

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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

Other Real Estate Owned — The Company determines fair value primarily using independent appraisals of other real estate owned ("OREO") properties. The resulting fair value measurements are classified as Level 2 or Level 3 inputs, depending upon the extent to which unobservable inputs determine the fair value measurement. The Company considers a number of factors in determining the extent to which specific fair value measurements utilize unobservable inputs, including, but not limited to, the inherent subjectivity in appraisals, the length of time elapsed since the receipt of independent market price or appraised value, and current market conditions. At June 30, 2017, the most significant unobservable input used in the determination of fair value of OREO was a discount to independent appraisals for estimated holding periods of OREO properties. Level 3 inputs were used to determine the initial fair value at acquisition of a large group of smaller balance properties that were acquired in the FNB Transaction. In the FNB Transaction, the Bank acquired OREO of $135.2 million, all of which is covered by FDIC loss-share agreements. At June 30, 2017 and December 31, 2016, the estimated fair value of covered OREO was $42.3 million and $51.6 million, respectively, and the underlying fair value measurements utilized Level 2 and Level 3 inputs. The fair value of non-covered OREO at June 30, 2017 and December 31, 2016 was $4.6 million and $4.5 million, respectively, and is included in other assets within the consolidated balance sheets. During the reported periods, all fair value measurements for non-covered OREO subsequent to initial recognition utilized Level 2 inputs.

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

4. Securities

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

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

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

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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(Unaudited)

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

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

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

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

The Bank classifies loan modifications as TDRs when it concludes that it has both granted a concession to a debtor and that the debtor is experiencing financial difficulties. Loan modifications are typically structured to create affordable payments for the debtor and can be achieved in a variety of ways. The Bank modifies loans by reducing interest rates and/or lengthening loan amortization schedules. The Bank may also reconfigure a single loan into two or more loans ("A/B Note"). The typical A/B Note restructure results in a "bad" loan which is charged off and a "good" loan or loans, the terms of which comply with the Bank's customary underwriting policies. The debt charged off on the "bad" loan is not forgiven to the debtor.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

December 31, 2016	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 1,531,895	$ 72	$ 56,473	$ 8,672	$ 1,597,112
Unsecured	97,646	—	1,695	—	99,341
Real estate:					
Secured by commercial properties	1,888,231	3,693	34,661	28,510	1,955,095
Secured by residential properties	846,420	—	4,763	10,489	861,672
Construction and land development:					
Residential construction loans	128,624	—	28	—	128,652
Commercial construction loans and land development	653,808	—	923	3,467	