

Hilltop Holdings Inc.  
Form 10-Q  
July 26, 2018  
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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, 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  
(State or other jurisdiction of incorporation or  
organization)

84-1477939  
(I.R.S. Employer Identification No.)

2323 Victory Avenue, Suite 1400

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Dallas, TX

(Address of principal executive offices)

75219

(Zip Code)

(214) 855-2177

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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

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

The number of shares of the registrant's common stock outstanding at July 26, 2018 was 94,576,828.



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HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2018

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## 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

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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.

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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,	
	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:				

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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.



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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,	
	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.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

Common Stock		Additional	Accumulated	Retained	Deferred	Employee		Total	Noncontrolling
Shares	Amount	Paid-in	Comprehensive		Compensation	Stock Trust	Amount	Hilltop	
		Capital	Income	Earnings	Stock Trust, Net	Shares		Stockholders' Equity	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)

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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
—	—	—	(8,851)	—	—	—	—	(8,851)	—
—	—	4,549	—	—	—	—	—	4,549	—
10	—	248	—	—	—	—	—	248	—
281	3	(1,732)	—	—	—	—	—	(1,729)	—
(1,702)	(17)	(27,329)	—	(11,531)	—	—	—	(38,877)	—
—	—	—	—	(13,453)	—	—	—	(13,453)	—
—	—	—	—	—	9	(1)	(5)	4	—
—	—	—	(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.



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## 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)

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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.

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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.

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”).



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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.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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,

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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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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



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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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.

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## 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).

	Level 1	Level 2	Level 3	Total
June 30, 2018	Inputs	Inputs	Inputs	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

	Level 1	Level 2	Level 3	Total
December 31, 2017	Inputs	Inputs	Inputs	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

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	Balance at Beginning of Period	Purchases/ Additions	Sales/ Reductions	Total Gains or Losses (Realized or Unrealized) 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.

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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	Other	Total	Net	Other	Total
	Gains	Noninterest	Changes in	Gains (Losses)	Noninterest	Changes in
	(Losses)	Income	Fair Value	(Losses)	Income	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	Other	Total	Net	Other	Total
	Gains	Noninterest	Changes in	Gains (Losses)	Noninterest	Changes in
	(Losses)	Income	Fair Value	(Losses)	Income	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

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## 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					Total Gains (Losses) for the		Total Gains (Losses) for the	
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value	Three Months Ended June 30, 2018	2017	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).



June 30, 2018	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2017	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
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

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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, 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:				

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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			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
December 31, 2017				
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

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## 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.

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## 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

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	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



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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

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	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.

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## 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		Amortized	
	Cost	Fair Value	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.

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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).

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## 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

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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



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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.

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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	Balance at	Balance
	Loans	Extension	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	Balance at	Balance
	Loans	Extension	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	—	—	—

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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.

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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	Balance at	Balance at	Number of	Balance at	Balance at
	Loans	Extension	End of Period	Loans	Extension	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).

	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Non-PCI Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Interest (Non-PCI) Past Due 90 Days or More
June 30, 2018								
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								
Construction and land development:	1,171	—	769	1,940	819,217	3,929	825,086	688
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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non-PCI) Past Due 90 Days or More
December 31, 2017								
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.



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## 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.

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## 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		Construction and			
	Industrial	Real Estate	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		Construction and			
	Industrial	Real Estate	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		Construction and			
	Industrial	Real Estate	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

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Recoveries on charged  
off loans

Balance, end of period	\$ 21,834	\$ 28,734	\$ 7,645	\$ 524	\$ 471	\$ 59,208
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Six Months Ended	Commercial and		Construction and			
June 30, 2017	Industrial	Real Estate	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		Construction and			
	Industrial	Real Estate	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		Construction and			
	Industrial	Real Estate	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

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## 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.

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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.

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## 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).

	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
June 30, 2018					
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	—

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

	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
December 31, 2017					
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

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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.

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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).

	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
June 30, 2018								
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 Due 90 Days or More

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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

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## 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



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

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## 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.

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## 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,		December 31,	
	2018		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,		December 31,	
	2018		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	

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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	December
30,	31,