

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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 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

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

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 April 26, 2018 was 96,064,044.



Table of Contents

HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2018

TABLE OF CONTENTS

PART I — FINANCIAL INFORMATION

Item 1.	Financial Statements	
	<u>Consolidated Balance Sheets</u>	3
	<u>Consolidated Statements of Operations</u>	4
	<u>Consolidated Statements of Comprehensive Income</u>	5
	<u>Consolidated Statements of Stockholders' Equity</u>	6
	<u>Consolidated Statements of Cash Flows</u>	7
	<u>Notes to Consolidated Financial Statements</u>	8
	<u>Schedule I - Insurance Incurred and Cumulative Paid Losses and Allocated Loss and Loss Adjustment Expenses, Net of Reinsurance</u>	57
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	58
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	91
Item 4.	<u>Controls and Procedures</u>	94

PART II — OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	95
Item 1A.	<u>Risk Factors</u>	95
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	96
Item 6.	<u>Exhibits</u>	97

Table of Contents

## HILLTOP HOLDINGS INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	March 31, 2018	December 31, 2017
Assets		
Cash and due from banks	\$ 470,127	\$ 486,977
Federal funds sold	400	405
Securities purchased under agreements to resell	244,978	186,537
Assets segregated for regulatory purposes	198,170	186,578
Securities:		
Trading, at fair value	756,151	730,685
Available for sale, at fair value (amortized cost of \$819,113 and \$748,255, respectively)	806,583	744,319
Held to maturity, at amortized cost (fair value of \$344,593 and \$349,939, respectively)	356,452	355,849
Equity, at fair value	20,876	21,241
	1,940,062	1,852,094
Loans held for sale	1,409,634	1,715,357
Non-covered loans, net of unearned income	6,216,809	6,273,669
Allowance for non-covered loan losses	(60,371)	(60,957)
Non-covered loans, net	6,156,438	6,212,712
Covered loans, net of allowance of \$2,823 and \$2,729, respectively	167,781	179,400
Broker-dealer and clearing organization receivables	1,660,720	1,464,378
Premises and equipment, net	173,637	177,577
FDIC indemnification asset	25,458	29,340
Covered other real estate owned	35,777	36,744
Other assets	576,567	549,447
Goodwill	251,808	251,808
Other intangible assets, net	34,569	36,432
Total assets	\$ 13,346,126	\$ 13,365,786
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	\$ 2,565,825	\$ 2,411,849
Interest-bearing	5,393,897	5,566,270
Total deposits	7,959,722	7,978,119

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

Broker-dealer and clearing organization payables	1,504,172	1,287,563
Short-term borrowings	1,064,325	1,206,424
Securities sold, not yet purchased, at fair value	255,551	232,821
Notes payable	202,700	208,809
Junior subordinated debentures	67,012	67,012
Other liabilities	367,188	470,231
Total liabilities	11,420,670	11,450,979
Commitments and contingencies (see Notes 18 and 19)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, \$0.01 par value, 125,000,000 shares authorized; 96,048,067 and 95,982,184 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	960	960
Additional paid-in capital	1,526,867	1,526,369
Accumulated other comprehensive income (loss)	(9,698)	(394)
Retained earnings	404,260	384,545
Deferred compensation employee stock trust, net	857	848
Employee stock trust (11,217 and 11,672 shares, at cost, respectively)	(254)	(247)
Total Hilltop stockholders' equity	1,922,992	1,912,081
Noncontrolling interests	2,464	2,726
Total stockholders' equity	1,925,456	1,914,807
Total liabilities and stockholders' equity	\$ 13,346,126	\$ 13,365,786

See accompanying notes.

Table of Contents

## HILLTOP HOLDINGS INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(Unaudited)

	Three Months Ended	
	March 31,	
	2018	2017
Interest income:		
Loans, including fees	\$ 99,944	\$ 89,991
Securities borrowed	16,300	8,053
Securities:		
Taxable	10,953	6,600
Tax-exempt	1,772	1,244
Other	4,391	2,353
Total interest income	133,360	108,241
Interest expense:		
Deposits	8,675	4,690
Securities loaned	13,739	6,340
Short-term borrowings	4,043	1,418
Notes payable	2,497	2,814
Junior subordinated debentures	822	711
Other	164	168
Total interest expense	29,940	16,141
Net interest income	103,420	92,100
Provision (recovery) for loan losses	(1,807)	1,705
Net interest income after provision (recovery) for loan losses	105,227	90,395
Noninterest income:		
Net gains from sale of loans and other mortgage production income	105,767	124,150
Mortgage loan origination fees	20,626	19,556
Securities commissions and fees	39,383	39,057
Investment and securities advisory fees and commissions	17,625	22,202
Net insurance premiums earned	34,315	36,140
Other	17,427	30,334
Total noninterest income	235,143	271,439
Noninterest expense:		
Employees' compensation and benefits	182,600	186,886
Occupancy and equipment, net	27,830	27,293
Professional services	24,704	25,045

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

Loss and loss adjustment expenses	15,532	21,700
Other	57,536	59,568
Total noninterest expense	308,202	320,492
Income before income taxes	32,168	41,342
Income tax expense	7,488	15,035
Net income	24,680	26,307
Less: Net income (loss) attributable to noncontrolling interest	239	(127)
Income attributable to Hilltop	\$ 24,441	\$ 26,434
Earnings per common share:		
Basic	\$ 0.25	\$ 0.27
Diluted	\$ 0.25	\$ 0.27
Cash dividends declared per common share	\$ 0.07	\$ 0.06
Weighted average share information:		
Basic	95,985	98,441
Diluted	96,146	98,757

See accompanying notes.



Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended	
	March 31,	
	2018	2017
Net income	\$ 24,680	\$ 26,307
Other comprehensive income:		
Net unrealized gains (losses) on securities available for sale, net of tax of \$(1,893) and \$231, respectively	(6,703)	412
Comprehensive income	17,977	26,719
Less: comprehensive income (loss) attributable to noncontrolling interest	239	(127)
Comprehensive income applicable to Hilltop	\$ 17,738	\$ 26,846

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

Common Stock		Additional	Accumulated	Retained	Deferred	Employee		Total	
Shares	Amount	Paid-in	Other	Earnings	Compensation	Stock	Stock Trust	Hilltop	Noncontrolling
		Capital	Comprehensive	Income	Employee	Trust,	Shares	Stockholders'	Interest
			Income		Stock	Trust,	Amount	Equity	
					Trust,	Net			
					Net				
1,985,544	\$ 985	\$ 1,572,877	\$ 485	\$ 295,568	\$ 903	15	\$ (309)	\$ 1,870,509	\$ 4,011
—	—	—	—	26,434	—	—	—	26,434	(127)
—	—	—	412	—	—	—	—	412	—
—	—	2,577	—	—	—	—	—	2,577	—
3	—	105	—	—	—	—	—	105	—
122	2	(1,031)	—	—	—	—	—	(1,029)	—
of (262)	(3)	(4,199)	—	(3,003)	—	—	—	(7,205)	—
—	—	—	—	(5,802)	—	—	—	(5,802)	—
—	—	—	—	—	(10)	—	9	(1)	—
—	—	—	—	—	—	—	—	—	(575)

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

urch	98,407	\$ 984	\$ 1,570,329	\$ 897	\$ 313,197	\$ 893	15	\$ (300)	\$ 1,886,000	\$ 3,309	\$
l,	95,982	\$ 960	\$ 1,526,369	\$ (394)	\$ 384,545	\$ 848	12	\$ (247)	\$ 1,912,081	\$ 2,726	\$
	—	—	—	—	24,441	—	—	—	24,441	239	
ve	—	—	—	(6,703)	—	—	—	—	(6,703)	—	
n	—	—	2,164	—	—	—	—	—	2,164	—	
ck ard	5	—	124	—	—	—	—	—	124	—	
ck	129	1	(693)	—	—	—	—	—	(692)	—	
of ck	(68)	(1)	(1,097)	—	(608)	—	—	—	(1,706)	—	
n ck	—	—	—	—	(6,719)	—	—	—	(6,719)	—	
n	—	—	—	—	—	9	(1)	(7)	2	—	
ote	—	—	—	(2,601)	2,601	—	—	—	—	—	
o ng	—	—	—	—	—	—	—	—	—	(501)	
urch	96,048	\$ 960	\$ 1,526,867	\$ (9,698)	\$ 404,260	\$ 857	11	\$ (254)	\$ 1,922,992	\$ 2,464	\$

See accompanying notes.



Table of Contents

## HILLTOP HOLDINGS INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2018	2017
Operating Activities		
Net income	\$ 24,680	\$ 26,307
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (recovery) for loan losses	(1,807)	1,705
Depreciation, amortization and accretion, net	1,577	(1,031)
Net change in fair value of equity securities	572	—
Deferred income taxes	(534)	1,531
Other, net	2,590	1,990
Net change in securities purchased under agreements to resell	(58,441)	(23,798)
Net change in assets segregated for regulatory purposes	(11,592)	14,598
Net change in trading securities	(25,466)	(107,766)
Net change in broker-dealer and clearing organization receivables	(164,957)	(39,422)
Net change in FDIC indemnification asset	—	19,424
Net change in other assets	(2,949)	(8,702)
Net change in broker-dealer and clearing organization payables	217,443	110,694
Net change in other liabilities	(108,306)	(104,858)
Net change in securities sold, not yet purchased	22,730	(9,696)
Proceeds from sale of mortgage servicing rights asset	—	17,499
Net gains from sales of loans	(105,767)	(124,150)
Loans originated for sale	(3,021,516)	(2,939,349)
Proceeds from loans sold	3,405,633	3,514,340
Net cash provided by operating activities	173,890	349,316
Investing Activities		
Proceeds from maturities and principal reductions of securities held to maturity	14,095	15,152
Proceeds from sales, maturities and principal reductions of securities available for sale	44,925	83,048
Proceeds from sales, maturities and principal reductions of equity securities	15	—
Purchases of securities held to maturity	(14,848)	(831)
Purchases of securities available for sale	(116,393)	(240,757)
Purchases of equity securities	(217)	—
Net change in loans	48,859	57,902
Purchases of premises and equipment and other assets	(4,271)	(4,951)

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

Proceeds from sales of premises and equipment and other real estate owned	4,487	11,438
Net cash received from Federal Home Loan Bank and Federal Reserve Bank stock	9,716	34,953
Net cash used in investing activities	(13,632)	(44,046)
Financing Activities		
Net change in deposits	(19,231)	245,777
Net change in short-term borrowings	(142,099)	(663,512)
Proceeds from notes payable	69,808	72,382
Payments on notes payable	(75,799)	(65,573)
Payments to repurchase common stock	(1,706)	(7,205)
Dividends paid on common stock	(6,719)	(5,802)
Net cash distributed to noncontrolling interest	(501)	(575)
Taxes paid on employee stock awards netting activity	(689)	(838)
Other, net	(177)	(356)
Net cash used in financing activities	(177,113)	(425,702)
Net change in cash and cash equivalents	(16,855)	(120,432)
Cash and cash equivalents, beginning of period	487,382	690,764
Cash and cash equivalents, end of period	\$ 470,527	\$ 570,332
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	\$ 28,294	\$ 14,407
Cash paid for income taxes, net of refunds	\$ 542	\$ 1,262
Supplemental Schedule of Non-Cash Activities		
Conversion of loans to other real estate owned	\$ 2,496	\$ 1,945
Additions to mortgage servicing rights	\$ 6,661	\$ 1,224

See accompanying notes.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting and Reporting Policies

Nature of Operations

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

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

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 unaudited total assets, gross loans and deposits of approximately \$454 million, \$344 million and \$406 million, respectively. The transaction is subject to customary closing conditions, including regulatory approvals and approval by shareholders of BORO, and is expected to close during the third quarter of 2018.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (“GAAP”), and in conformity with the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of management, these financial statements contain all adjustments necessary for a fair statement of the results of the interim periods presented. Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (“2017 Form 10-K”). Results for interim periods are not necessarily indicative of results to be expected for a full year or any future period.

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

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



Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

PCC also owns 100% of the outstanding common securities of PCC Statutory Trusts I, II, III and IV (the “Trusts”), which are not included in the consolidated financial statements under the requirements of the Variable Interest Entities Subsections of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) because the primary beneficiaries of the Trusts are not within the consolidated group.

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

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

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

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

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

## Securities

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

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

Table of Contents

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 No. 2016-16 which addresses improvement in accounting for income tax consequences of intra-equity transfers of assets other than inventory. The amendment requires that an entity recognize the income tax consequences of the intra-equity transfer of an asset other than inventory when the transfer occurs. The amendment was effective for annual periods, and interim reporting periods within those annual periods, beginning after

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 15, 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 sheet consistent with the provisions of the amendments, while certain other equity investments of \$37.7 million are included in other assets within the consolidated balance sheets at March 31, 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 months ended March 31, 2018. As the measurement and timing of revenue

Table of Contents

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. 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. 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 beginning of the earliest period presented. The Company’s implementation efforts are ongoing,



Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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. However, the population of contracts subject to balance sheet recognition and their initial measurement 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 March 31, 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 \$1.28 billion and \$1.58 billion, respectively, and the unpaid principal balance of those loans was \$1.24 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.

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

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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
	Inputs	Inputs	Inputs	Fair Value
March 31, 2018				
Trading securities	\$ 753	\$ 755,398	\$ —	\$ 756,151
Available for sale securities	—	806,583	—	806,583
Equity securities	20,876	—	—	20,876
Loans held for sale	—	1,234,974	43,483	1,278,457
Derivative assets	—	51,432	—	51,432
MSR asset	—	—	63,957	63,957
Securities sold, not yet purchased	199,400	56,151	—	255,551
Derivative liabilities	—	25,157	—	25,157
December 31, 2017				
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

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

Total Gains or Losses

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

	Balance at Beginning of Period	Purchases/ Additions	Sales/ Reductions	(Realized or Unrealized)		Balance at End of Period
				Included in Net Income	Included in Other Comprehensive Income (Loss)	
Three months ended March 31, 2018						
Loans held for sale	\$ 36,972	\$ 12,479	\$ (3,975)	\$ (1,993)	\$ —	\$ 43,483
MSR asset	54,714	6,661	—	2,582	—	63,957
Total	\$ 91,686	\$ 19,140	\$ (3,975)	\$ 589	\$ —	\$ 107,440
Three months ended March 31, 2017						
Loans held for sale	35,801	7,828	(10,701)	(2,714)	—	30,214
MSR asset	61,968	1,224	(17,499)	(120)	—	45,573
Total	\$ 97,769	\$ 9,052	\$ (28,200)	\$ (2,834)	\$ —	\$ 75,787

All net realized and unrealized gains (losses) in the table above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at March 31, 2018.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

For Level 3 financial instruments measured at fair value on a recurring basis at March 31, 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	95 - 97 % ( 95 %)
MSR asset	Discounted cash flows	Constant prepayment rate	9.62 %
		Discount rate	10.99 %

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.

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 March 31, 2018			Three Months Ended March 31, 2017		
Net	Other Noninterest	Total Changes in	Net	Other Noninterest	Total Changes in

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

	Gains (Losses)	Income	Fair Value	Gains (Losses)	Income	Fair Value
Loans held for sale	\$ (14,880)	\$ —	\$ (14,880)	\$ 8,862	\$ —	\$ 8,862
MSR asset	2,582	—	2,582	(120)	—	(120)

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.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

At March 31, 2018, estimates for these significant unobservable inputs were as follows.

	PCI Loans					
	PlainsCapital Merger		FNB Transaction		SWS Merger	
Weighted average default rate	80	%	40	%	67	%
Weighted average loss severity rate	67	%	17	%	28	%
Weighted average prepayment speed	0	%	6	%	0	%

At March 31, 2018, the resulting weighted average expected loss on PCI loans associated with the PlainsCapital Merger, FNB Transaction and SWS Merger was 53%, 7% and 19%, 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 March 31, 2018 and December 31, 2017, the estimated fair value of covered OREO was \$35.8 million and \$36.7 million, respectively, and the underlying fair value measurements utilized Level 2 inputs. The fair value of non-covered OREO at March 31, 2018 and December 31, 2017 was \$2.6 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).

March 31, 2018	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value	Total Gains (Losses) for the Three Months Ended March	
					31, 2018	2017
Non-covered impaired loans	\$ —	\$ —	\$ 20,358	\$ 20,358	\$ (25)	\$ (196)
Covered impaired loans	—	—	74,337	74,337	(98)	(366)
Non-covered other real estate owned	—	—	—	—	(51)	(15)
Covered other real estate owned	—	16,739	—	16,739	(1,055)	(1,192)

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.



Table of Contents

## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

March 31, 2018	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Financial assets:					
Cash and cash equivalents	\$ 470,527	\$ 470,527	\$ —	\$ —	\$ 470,527
Securities purchased under agreements to resell	244,978	—	244,978	—	244,978
Assets segregated for regulatory purposes	198,170	198,170	—	—	198,170
Held to maturity securities	356,452	—	344,593	—	344,593
Loans held for sale	131,177	—	131,177	—	131,177
Non-covered loans, net	6,156,438	—	546,504	5,711,000	6,257,504
Covered loans, net	167,781	—	—	250,305	250,305
Broker-dealer and clearing organization receivables	1,660,720	—	1,660,720	—	1,660,720
FDIC indemnification asset	25,458	—	—	18,597	18,597
Other assets	64,475	—	59,605	120	59,725
Financial liabilities:					
Deposits	7,959,722	—	7,948,553	—	7,948,553
Broker-dealer and clearing organization payables	1,504,172	—	1,504,172	—	1,504,172
Short-term borrowings	1,064,325	—	1,064,325	—	1,064,325
Debt	269,712	—	267,415	—	267,415
Other liabilities	6,449	—	6,449	—	6,449

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

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

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

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The Company held equity investments other than securities of \$37.7 and \$38.7 million at March 31, 2018 and December 31, 2017, respectively, which are included within other assets in the consolidated balance sheets. Of the \$37.7 million held at March 31, 2018, \$21.9 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 during the three months ended March 31, 2018 (in thousands).

	Three months ended, March 31, 2018
Balance, beginning of period	\$ 22,946
Impairments and downward adjustments	(1,312)
Upward adjustments	272
Balance, end of period	\$ 21,906

4. Securities

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

	March 31, 2018	December 31, 2017
--	-------------------	-------------------------

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

U.S. Treasury securities	\$ 751	\$ —
U.S. government agencies:		
Bonds	51,229	52,078
Residential mortgage-backed securities	430,889	372,817
Commercial mortgage-backed securities	8,962	6,125
Collateralized mortgage obligations	12,907	5,122
Corporate debt securities	83,233	96,182
States and political subdivisions	114,421	170,413
Unit investment trusts	47,767	22,612
Private-label securitized product	2,525	1,631
Other	3,467	3,705
Totals	\$ 756,151	\$ 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 \$255.6 million and \$232.8 million at March 31, 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			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
March 31, 2018				
U.S. Treasury securities	\$ 33,642	\$ 13	\$ (118)	\$ 33,537
U.S. government agencies:				
Bonds	86,186	551	(644)	86,093
Residential mortgage-backed securities	301,658	292	(7,682)	294,268
Commercial mortgage-backed securities	11,874	47	(192)	11,729
Collateralized mortgage obligations	261,406	172	(5,810)	255,768
Corporate debt securities	64,848	596	(297)	65,147
States and political subdivisions	59,499	766	(224)	60,041
Totals	\$ 819,113	\$ 2,437	\$ (14,967)	\$ 806,583

Table of Contents

## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

December 31, 2017	Available for Sale			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
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

March 31, 2018	Held to Maturity			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. government agencies:				
Bonds	\$ 39,016	\$ —	\$ (1,823)	\$ 37,193
Residential mortgage-backed securities	25,150	—	(328)	24,822
Commercial mortgage-backed securities	73,210	26	(1,903)	71,333
Collateralized mortgage obligations	165,513	—	(5,947)	159,566
States and political subdivisions	53,563	67	(1,951)	51,679
Totals	\$ 356,452	\$ 93	\$ (11,952)	\$ 344,593

December 31, 2017	Held to Maturity			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
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 \$20.9 million and \$21.2 million held at March 31, 2018 and December 31, 2017, respectively. The Company recognized net losses of \$0.6 million during the three months ended March 31, 2018, due to changes in the fair value of equity securities still held at the balance sheet date. During the three months ended March 31, 2018, net gains recognized from equity securities sold were nominal.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	March 31, 2018		Unrealized Losses	December 31, 2017		Unrealized Losses
	Number of Securities	Fair Value		Number of Securities	Fair Value	
Available for Sale						
U.S. treasury securities:						
Unrealized loss for less than twelve months	6	\$ 25,408	\$ 89	6	\$ 15,449	\$ 69
Unrealized loss for twelve months or longer	3	3,153	29	1	4,150	34
	9	28,561	118	7	19,599	103
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	9	73,180	644	10	83,476	366
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	9	73,180	644	10	83,476	366
Residential						
mortgage-backed securities:						
Unrealized loss for less than twelve months	19	155,646	3,599	15	121,968	820
Unrealized loss for twelve months or longer	10	80,384	4,083	11	93,358	2,920
	29	236,030	7,682	26	215,326	3,740
Commercial						
mortgage-backed securities:						
Unrealized loss for less than twelve months	2	8,747	192	1	5,048	48
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	2	8,747	192	1	5,048	48
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	22	113,477	1,822	16	90,886	819
Unrealized loss for twelve months or longer	18	93,836	3,988	17	80,492	3,323

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

	40	207,313	5,810	33	171,378	4,142
Corporate debt securities:						
Unrealized loss for less than twelve months	14	29,326	297	1	5,073	25
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	14	29,326	297	1	5,073	25
States and political subdivisions:						
Unrealized loss for less than twelve months	20	11,222	189	9	6,981	97
Unrealized loss for twelve months or longer	7	2,400	35	9	2,876	18
	27	13,622	224	18	9,857	115
Total available for sale:						
Unrealized loss for less than twelve months	92	417,006	6,832	58	328,881	2,244
Unrealized loss for twelve months or longer	38	179,773	8,135	38	180,876	6,295
	130	\$ 596,779	\$ 14,967	96	\$ 509,757	\$ 8,539



Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	March 31, 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	\$ 5,743	\$ 257	1	\$ 5,950	\$ 50
Unrealized loss for twelve months or longer	3	31,449	1,566	3	31,877	1,138
	4	37,192	1,823	4	37,827	1,188
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	4	24,822	328	—	—	—
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	4	24,822	328	—	—	—
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	13	54,085	1,211	7	39,396	271
Unrealized loss for twelve months or longer	2	12,349	692	2	12,659	464
	15	66,434	1,903	9	52,055	735
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	11	35,120	654	10	37,064	264
Unrealized loss for twelve months or longer	14	124,446	5,293	12	128,270	3,705
	25	159,566	5,947	22	165,334	3,969
States and political subdivisions:						
Unrealized loss for less than twelve months	60	26,023	439	22	11,079	71
Unrealized loss for twelve months or longer	46	17,764	1,512	46	18,598	688

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

Total held to maturity:	106	43,787	1,951	68	29,677	759
Unrealized loss for less than twelve months	89	145,793	2,889	40	93,489	656
Unrealized loss for twelve months or longer	65	186,008	9,063	63	191,404	5,995
	154	\$ 331,801	\$ 11,952	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 months ended March 31, 2018 and 2017, the Company did not record any OTTI. While some of the securities held in the Company's investment portfolio have decreased in value since the date of acquisition, the severity of loss and the duration of the loss position are not significant enough to warrant recording any OTTI of the securities. Factors considered in the Company's analysis include the reasons for the unrealized loss position, the severity and duration of the unrealized loss position, credit worthiness, and forecasted performance of the investee. The Company does not intend to sell, nor does the Company believe that it is likely that the Company will be required to sell, these securities before the recovery of the cost basis.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The amortized cost and fair value of securities, excluding trading and equity securities, at March 31, 2018 are shown by contractual maturity below (in thousands).

	Available for Sale Amortized		Held to Maturity Amortized	
	Cost	Fair Value	Cost	Fair Value
Due in one year or less	\$ 101,940	\$ 101,919	\$ 2,255	\$ 2,253
Due after one year through five years	95,039	94,840	3,123	3,116
Due after five years through ten years	27,646	27,948	26,768	25,645
Due after ten years	19,550	20,111	60,433	57,858
	244,175	244,818	92,579	88,872
Residential mortgage-backed securities	301,658	294,268	25,150	24,822
Collateralized mortgage obligations	261,406	255,768	165,513	159,566
Commercial mortgage-backed securities	11,874	11,729	73,210	71,333
	\$ 819,113	\$ 806,583	\$ 356,452	\$ 344,593

The Company realized net losses of \$4.8 million and net gains of \$5.9 million from its trading portfolio during the three months ended March 31, 2018 and 2017, respectively. In addition, the Hilltop Broker-Dealers realized net gains from structured product trading activities of \$17.0 million and \$6.6 million during the three months ended March 31, 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 \$684.9 million and \$738.5 million (with a fair value of \$668.8 million and \$730.1 million, respectively) at March 31, 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 March 31, 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 March 31, 2018 and December 31, 2017, NLC had investments on deposit in custody for various state insurance departments with aggregate carrying values of \$9.3 million.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

	March 31, 2018	December 31, 2017
Commercial and industrial	\$ 1,650,096	\$ 1,681,205
Real estate	3,051,603	3,011,524
Construction and land development	929,708	962,605
Consumer	38,898	40,446
Broker-dealer (1)	546,504	577,889
	6,216,809	6,273,669
Allowance for non-covered loan losses	(60,371)	(60,957)
Total non-covered loans, net of allowance	\$ 6,156,438	\$ 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).

	March 31, 2018	December 31, 2017
Carrying amount	\$ 27,891	\$ 37,204
Outstanding balance	41,202	51,064

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

	Three Months Ended	
	March 31,	
	2018	2017
Balance, beginning of period	\$ 7,013	\$ 13,116
Reclassifications from nonaccretable difference, net(1)	642	139
Disposals of loans	(98)	—
Accretion	(1,464)	(1,813)
Balance, end of period	\$ 6,093	\$ 11,442

---

(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 \$19.2 million at both March 31, 2018 and December 31, 2017.

Impaired loans exhibit a clear indication that the borrower's cash flow may not be sufficient to meet contractual principal and interest payments, which generally occurs when a loan is 90 days past due unless the asset is both well secured and in the process of collection. Non-covered impaired loans include non-accrual loans, troubled debt restructurings ("TDRs"), PCI loans and partially charged-off loans.

The amounts shown in the following tables include loans accounted for on an individual basis, as well as acquired Pooled Loans. For Pooled Loans, the recorded investment with allowance and the related allowance consider impairment measured at the pool level. Non-covered impaired loans, segregated between those considered to be PCI loans and those without credit impairment at acquisition, are summarized by class in the following tables (in thousands).

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

March 31, 2018	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	\$ 16,560	\$ 2,735	\$ 2,643	\$ 5,378	\$ 72
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	25,365	7,465	9,651	17,116	1,031
Secured by residential properties	6,550	540	3,588	4,128	330
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	1,809	410	853	1,263	199
Consumer	2,150	6	—	6	