Hilltop Holdings Inc.
Form 10-Q
April 25, 2019
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, 2019

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

Commission File Number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

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

2323 Victory Avenue, Suite 1400

| Dallas, TX | 75219 |
| --- | --- |
| (Address of principal executive offices) | (Zip Code) |

(214) 855-2177

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 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 |
| | 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 25, 2019 was 93,983,247.

Table of Contents

HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2019

TABLE OF CONTENTS


PART I — FINANCIAL INFORMATION

| | | |
|---|---|---|
| Item 1. | Financial Statements | |
| | Consolidated Balance Sheets | 3 |
| | Consolidated Statements of Operations | 4 |
| | Consolidated Statements of Comprehensive Income | 5 |
| | Consolidated Statements of Stockholders' Equity | 6 |
| | Consolidated Statements of Cash Flows | 7 |
| | Notes to Consolidated Financial Statements | 8 |
| | Schedule I - Insurance Incurred and Cumulative Paid Losses and Allocated Loss and Loss Adjustment Expenses, Net of Reinsurance | 49 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 50 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 81 |
| Item 4. | Controls and Procedures | 84 |

PART II — OTHER INFORMATION

| | | |
|---|---|---|
| Item 1. | Legal Proceedings | 85 |
| Item 1A. | Risk Factors | 85 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 85 |
| Item 6. | Exhibits | 86 |

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $ 313,192 | $ 644,073 |
| Federal funds sold | 438 | 400 |
| Assets segregated for regulatory purposes | 156,851 | 133,993 |
| Securities purchased under agreements to resell | 65,205 | 61,611 |
| Securities: | | |
| Trading, at fair value | 703,295 | 745,466 |
| Available for sale, at fair value (amortized cost of $1,021,221 and $886,799, respectively) | 1,019,851 | 875,658 |
| Held to maturity, at amortized cost (fair value of $365,781 and $341,124, respectively) | 369,865 | 351,012 |
| Equity, at fair value | 19,343 | 19,679 |
| | 2,112,354 | 1,991,815 |
| Loans held for sale | 1,059,280 | 1,393,246 |
| Loans held for investment, net of unearned income | 7,011,679 | 6,930,458 |
| Allowance for loan losses | (58,809) | (59,486) |
| Loans held for investment, net | 6,952,870 | 6,870,972 |
| Broker-dealer and clearing organization receivables | 1,651,199 | 1,440,287 |
| Premises and equipment, net | 210,333 | 237,373 |
| Operating lease right-of-use assets | 108,806 | — |
| Other assets | 591,442 | 580,362 |
| Goodwill | 291,435 | 291,435 |
| Other intangible assets, net | 35,965 | 38,005 |
| Total assets | $ 13,549,370 | $ 13,683,572 |
| Liabilities and Stockholders' Equity | | |
| Deposits: | | |
| Noninterest-bearing | $ 2,490,144 | $ 2,560,750 |
| Interest-bearing | 5,807,975 | 5,975,406 |
| Total deposits | 8,298,119 | 8,536,156 |
| Broker-dealer and clearing organization payables | 1,490,227 | 1,294,925 |

| | | |
|---|---|---|
| Short-term borrowings | 914,525 | 1,065,807 |
| Securities sold, not yet purchased, at fair value | 69,354 | 81,667 |
| Notes payable | 225,372 | 228,872 |
| Operating lease liabilities | 118,452 | — |
| Junior subordinated debentures | 67,012 | 67,012 |
| Other liabilities | 351,178 | 435,240 |
| Total liabilities | 11,534,239 | 11,709,679 |
| Commitments and contingencies (see Notes 13 and 14) | | |
| Stockholders' equity: | | |
| Hilltop stockholders' equity: | | |
| Common stock, $0.01 par value, 125,000,000 shares authorized; 93,821,450 and 93,610,217 shares issued and outstanding at March 31, 2019 and December 31, 2018, respectively | 938 | 936 |
| Additional paid-in capital | 1,491,585 | 1,489,816 |
| Accumulated other comprehensive loss | (1,062) | (8,627) |
| Retained earnings | 499,452 | 466,737 |
| Deferred compensation employee stock trust, net | 827 | 825 |
| Employee stock trust (10,683 and 11,672 shares, at cost, at March 31, 2019 and December 31, 2018, respectively) | (213) | (217) |
| Total Hilltop stockholders' equity | 1,991,527 | 1,949,470 |
| Noncontrolling interests | 23,604 | 24,423 |
| Total stockholders' equity | 2,015,131 | 1,973,893 |
| Total liabilities and stockholders' equity | $ 13,549,370 | $ 13,683,572 |

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, | |
|---|---|---|
| | 2019 | 2018 |
| Interest income: | | |
| Loans, including fees | $ 110,870 | $ 99,944 |
| Securities borrowed | 16,859 | 16,300 |
| Securities: | | |
| Taxable | 15,616 | 10,953 |
| Tax-exempt | 1,498 | 1,772 |
| Other | 5,197 | 4,391 |
| Total interest income | 150,040 | 133,360 |
| Interest expense: | | |
| Deposits | 17,106 | 8,675 |
| Securities loaned | 14,738 | 13,739 |
| Short-term borrowings | 5,471 | 4,043 |
| Notes payable | 2,641 | 2,497 |
| Junior subordinated debentures | 1,001 | 822 |
| Other | 152 | 164 |
| Total interest expense | 41,109 | 29,940 |
| Net interest income | 108,931 | 103,420 |
| Provision (recovery) for loan losses | 951 | (1,807) |
| Net interest income after provision (recovery) for loan losses | 107,980 | 105,227 |
| Noninterest income: | | |
| Net gains from sale of loans and other mortgage production income | 96,139 | 105,767 |
| Mortgage loan origination fees | 21,873 | 20,626 |
| Securities commissions and fees | 35,969 | 38,717 |
| Investment and securities advisory fees and commissions | 20,160 | 18,354 |
| Net insurance premiums earned | 33,203 | 34,315 |
| Other | 45,124 | 17,364 |
| Total noninterest income | 252,468 | 235,143 |
| Noninterest expense: | | |
| Employees' compensation and benefits | 189,898 | 182,600 |
| Occupancy and equipment, net | 28,023 | 27,830 |
| Professional services | 22,942 | 24,704 |

| | | |
|---|---|---|
| Loss and loss adjustment expenses | 14,926 | 15,532 |
| Other | 53,296 | 57,536 |
| Total noninterest expense | 309,085 | 308,202 |
| | | |
| Income before income taxes | 51,363 | 32,168 |
| Income tax expense | 11,586 | 7,488 |
| | | |
| Net income | 39,777 | 24,680 |
| Less: Net income attributable to noncontrolling interest | 991 | 239 |
| Income attributable to Hilltop | $ 38,786 | $ 24,441 |
| | | |
| Earnings per common share: | | |
| Basic | $ 0.41 | $ 0.25 |
| Diluted | $ 0.41 | $ 0.25 |
| | | |
| Weighted average share information: | | |
| Basic | 93,669 | 95,985 |
| Diluted | 93,669 | 96,146 |

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Net income | $ 39,777 | $ 24,680 |
| Other comprehensive income: | | |
| Net unrealized gains (losses) on securities available for sale, net of tax of $2,208 and $(1,893), respectively | 7,549 | (6,703) |
| Reclassification adjustment for gains (losses) included in net income, net of tax of $5 and $0, respectively | 16 | — |
| Comprehensive income | 47,342 | 17,977 |
| Less: comprehensive income attributable to noncontrolling interest | 991 | 239 |
| Comprehensive income applicable to Hilltop | $ 46,351 | $ 17,738 |

See accompanying notes.

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

| | Common Stock | | Additional Paid-in | Accumulated Other Comprehensive | Retained | Deferred Compensation Employee Stock Trust, | Employee Stock Trust | | Total Hilltop Stockholders' | Noncontrollin |
|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Loss | Earnings | Net | Shares | Amount | Equity | Interest |
| , | 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 rd | 5 | — | 124 | — | — | — | — | — | 124 | — |
| k | 129 | 1 | (693) | — | — | — | — | — | (692) | — |
| of k n | (68) | (1) | (1,097) | — | (608) | — | — | — | (1,706) | — |
| k | — | — | — | — | (6,719) | — | — | — | (6,719) | — |
| n | — | — | — | — | — | 9 | (1) | (7) | 2 | — |
| | — | — | — | (2,601) | 2,601 | — | — | — | — | — |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| ng | — | — | — | — | — | — | — | — | — | (501) |
| rch | 96,048 | $ 960 | $ 1,526,867 | $ (9,698) | $ 404,260 | $ 857 | 11 | $ (254) | $ 1,922,992 | $ 2,464 |
| , | 93,610 | $ 936 | $ 1,489,816 | $ (8,627) | $ 466,737 | $ 825 | 11 | $ (217) | $ 1,949,470 | $ 24,423 |
| | — | — | — | — | 38,786 | — | — | — | 38,786 | 991 |
| ve | — | — | — | 7,565 | — | — | — | — | 7,565 | — |
| n | — | — | 2,354 | — | — | — | — | — | 2,354 | — |
| ck rd | 8 | — | 140 | — | — | — | — | — | 140 | — |
| ck | 203 | 2 | (725) | — | — | — | — | — | (723) | — |
| n ck | — | — | — | — | (7,464) | — | — | — | (7,464) | — |
| n | — | — | — | — | — | 2 | — | 4 | 6 | — |
| ote | — | — | — | — | 1,393 | — | — | — | 1,393 | — |
| ng | — | — | — | — | — | — | — | — | — | (1,810) |
| rch | 93,821 | $ 938 | $ 1,491,585 | $ (1,062) | $ 499,452 | $ 827 | 11 | $ (213) | $ 1,991,527 | $ 23,604 |

See accompanying notes.

6

Table of Contents

HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Operating Activities | | |
| Net income | $ 39,777 | $ 24,680 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision (recovery) for loan losses | 951 | (1,807) |
| Depreciation, amortization and accretion, net | (1,563) | 1,577 |
| Net change in fair value of equity securities | (1,256) | 572 |
| Deferred income taxes | 527 | (534) |
| Other, net | 2,616 | 2,590 |
| Net change in securities purchased under agreements to resell | (3,594) | (58,441) |
| Net change in trading securities | 42,171 | (25,466) |
| Net change in broker-dealer and clearing organization receivables | (124,407) | (164,957) |
| Net change in other assets | (8,824) | (2,949) |
| Net change in broker-dealer and clearing organization payables | 119,673 | 217,443 |
| Net change in other liabilities | (43,919) | (108,306) |
| Net change in securities sold, not yet purchased | (12,313) | 22,730 |
| Net gains from sales of loans | (96,139) | (105,767) |
| Loans originated for sale | (2,596,880) | (3,021,516) |
| Proceeds from loans sold | 3,009,282 | 3,405,633 |
| Net cash provided by operating activities | 326,102 | 185,482 |
| Investing Activities | | |
| Proceeds from maturities and principal reductions of securities held to maturity | 6,340 | 14,095 |
| Proceeds from sales, maturities and principal reductions of securities available for sale | 37,604 | 44,925 |
| Proceeds from sales, maturities and principal reductions of equity securities | 1,815 | 15 |
| Purchases of securities held to maturity | (25,243) | (14,848) |
| Purchases of securities available for sale | (172,511) | (116,393) |
| Purchases of equity securities | (223) | (217) |
| Net change in loans held for investment | (159,202) | 48,859 |
| Purchases of premises and equipment and other assets | (8,454) | (4,271) |
| Proceeds from sales of premises and equipment and other real estate owned | 5,892 | 4,487 |
| Net cash received from Federal Home Loan Bank and Federal Reserve Bank stock | 7,172 | 9,716 |

| | | |
|---|---|---|
| Net cash used in investing activities | (306,810) | (13,632) |
| Financing Activities | | |
| Net change in deposits | (162,408) | (19,231) |
| Net change in short-term borrowings | (151,282) | (142,099) |
| Proceeds from notes payable | 134,639 | 69,808 |
| Payments on notes payable | (138,160) | (75,799) |
| Payments to repurchase common stock | — | (1,706) |
| Dividends paid on common stock | (7,464) | (6,719) |
| Net cash distributed to noncontrolling interest | (1,810) | (501) |
| Taxes paid on employee stock awards netting activity | (723) | (689) |
| Other, net | (69) | (177) |
| Net cash used in financing activities | (327,277) | (177,113) |
| | | |
| Net change in cash and cash equivalents | (307,985) | (5,263) |
| Cash, cash equivalents and restricted cash, beginning of period | 778,466 | 673,960 |
| Cash, cash equivalents and restricted cash, end of period | $ 470,481 | $ 668,697 |
| | | |
| Reconciliation of Cash, Cash Equivalents and Restricted Cash to Consolidated Balance Sheets | | |
| Cash and due from banks | $ 313,192 | $ 470,127 |
| Federal funds sold | 438 | 400 |
| Assets segregated for regulatory purposes | 156,851 | 198,170 |
| Total cash, cash equivalents and restricted cash | $ 470,481 | $ 668,697 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid for interest | $ 39,297 | $ 28,294 |
| Cash paid for income taxes, net of refunds | $ (270) | $ 542 |
| Supplemental Schedule of Non-Cash Activities | | |
| Derecognition of construction in progress related to build-to-suit lease obligations | $ 29,195 | $ — |
| Conversion of loans to other real estate owned | $ 1,578 | $ 2,496 |
| Additions to mortgage servicing rights | $ 1,861 | $ 6,661 |

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.

### 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, 2018 ("2018 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, 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”).

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

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

("VIE") 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 Hilltop Securities 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 Hilltop Securities 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").

In addition, Hilltop owns 100% of the membership interest in each of HTH Hillcrest Project LLC ("HTH Project LLC") and Hilltop Investments I, LLC. Hilltop Investments I, LLC owns 50% of the membership interest in HTH Diamond Hillcrest Land LLC ("Hillcrest Land LLC") which is consolidated under the aforementioned VIE Subsections of the ASC. These entities are related to the Hilltop Plaza investment discussed in detail in Note 13 to the consolidated financial statements and are collectively referred to as the "Hilltop Plaza Entities."

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. As previously disclosed in the Company's Form 10-Q for the period ended September 30, 2018, filed with the SEC on October 25, 2018, the quarterly report on Form 10-Q for the period ended March 31, 2018, filed with the SEC on April 26, 2018, incorrectly included the change in assets segregated for regulatory purposes in the operating section of the statements of cash flows. Previously disclosed net changes in assets segregated for regulatory purposes of ($11.6) million for the three months ended March 31, 2018, should have been excluded from the cash flows from operating activities and the beginning-of-period and end-of-period balances of assets segregated for regulatory purposes are

included in total cash, cash equivalents and restricted cash in accordance with Accounting Standards Update (“ASU”) 2016-18. Accordingly, net cash provided by operating activities for the three months ended March 31, 2018, originally reported as $173.9 million, is $185.5 million. 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 2018 Form 10-K. As a result of the adoption of ASU 2016-02 and related amendments and technical corrections (collectively, the “Leasing Standard”), the Company has included a new significant accounting policy related to lease accounting as summarized below.

Leases

The Company determines if an arrangement is a lease at inception. Operating leases with a term of greater than one year are included in operating lease right-of-use (“ROU”) assets and operating lease liabilities on the Company’s consolidated balance sheets. Finance leases are included in premises and equipment and other liabilities on the Company’s consolidated balance sheets. The Company has lease agreements with lease and nonlease components, which are generally accounted for as a single lease component. Leases of low-value assets are assessed on a lease-by-lease basis to determine the need for balance sheet capitalization.

ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized on the lease commencement date based on the present value of lease payments over the lease term. As most of the Company's leases do not provide an implicit rate, the Company uses the incremental borrowing rate commensurate with the lease term based on the information available at the lease commencement date in determining the present value of lease payments. No significant judgments or assumptions were involved in developing the estimated operating lease liabilities as the Company's operating lease liabilities largely represent the future rental expenses associated with operating leases, and the incremental borrowing rates are based on publicly available interest rates. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. The Company's lease terms may include options to extend or terminate the lease. These options to extend or terminate are assessed on a lease-by-lease basis, and the ROU assets and lease liabilities are adjusted when it is reasonably certain that an option will be exercised. Rental expense for lease payments is recognized on a straight-line basis over the lease term and is included in occupancy and equipment, net within our consolidated statements of operations.

## 2. Recently Issued Accounting Standards

### Accounting Standards Adopted During 2019

In July 2018, the FASB issued ASU 2018-09 which clarifies, corrects and makes minor improvements to a wide variety of topics in the ASC. The amendments make the ASC easier to understand and apply by eliminating inconsistencies and providing clarifications. The transition and effective dates are based on the facts and circumstances of each amendment, with some amendments becoming effective upon issuance of the ASU, and others becoming effective for annual periods beginning after December 15, 2018. The Company adopted the amendments as of January 1, 2019, which did not have a material effect on the Company's consolidated financial statements.

In August 2017, the 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. The Company adopted the standard on January 1, 2019. The Company has not historically applied hedge accounting to its derivative transactions, so the provisions of the amendment did not

have a material effect on the Company's consolidated financial statements.

In February 2016, the FASB issued the Leasing Standard, which is codified in ASC 842, Leases, and is intended to increase transparency and comparability among organizations and require lessees to record an ROU asset and a liability representing the obligation to make lease payments for long-term leases. Accounting by lessors remains largely unchanged. The Company adopted the standard on January 1, 2019, using the modified retrospective transition under the option to apply the Leasing Standard at its effective date without adjusting the prior period comparative financial statements. The Company elected the package of practical expedients to not reassess: (i) whether any existing contracts are or contain a lease, (ii) the lease classification of any existing leases and (iii) initial direct costs related to existing leases. The Company also elected to apply an additional practical expedient to include both the lease and nonlease components of all leases as a single component and account for it as a lease. The Company implemented internal controls and key system functionality to enable the preparation of financial information upon adoption. The implementation of the Leasing Standard had a material impact on our consolidated balance sheets but did not have a material impact on our consolidated statements of operations. On January 1, 2019, the Company recorded operating lease liabilities of $121.8 million and ROU assets of $111.9 million upon adoption of the Leasing Standard. The lease liabilities (at their present value) represent predominantly all of the future minimum lease payments required under operating leases. The balance sheet effects of the new lease accounting standard also impacted regulatory capital ratios, performance ratios and other measures which are dependent upon asset or liability balances. In addition, the Company reassessed its accounting ownership of the Hilltop Plaza assets under construction as of January 1, 2019, under the build-to-suit provisions of ASC 842 and concluded it is not the accounting owner. As such, the assets and liabilities of the project were derecognized during the first quarter of 2019, with the $1.4 million offset representing deferred expenses

recognized on the project to date through January 1, 2019, recorded as an increase to retained earnings. Refer to Note 13 for more details regarding the Hilltop Plaza transaction.

Accounting Standards Issued But Not Yet Adopted

In August 2018, the FASB issued ASU 2018-15 which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software licenses). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this update. The amendment also includes presentation and disclosure provisions regarding capitalized implementation costs. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the provisions of the amendment and the impact on its future consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13 which includes various removals, modifications and additions to existing guidance regarding fair value disclosures. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the provisions of the amendments but does not expect the amendments to have a material impact on its future consolidated financial statements.

In June 2016, the 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 is continuing the implementation and testing of new credit forecasting models and a credit scoring system that will be utilized to estimate the likelihood of default and loss severity 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 and other credit 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.

## 3. Acquisition

### BORO Acquisition

On August 1, 2018, in an effort to expand its Houston-area banking operations, the Company acquired privately-held The Bank of River Oaks ("BORO") in an all-cash transaction (the "BORO Acquisition"). Pursuant to the terms of the definitive agreement, the Company paid cash in the aggregate amount of $85 million to the shareholders and option holders of BORO. The operations of BORO are included in the Bank's operating results beginning August 1, 2018. BORO's results of operations prior to the acquisition date are not included in the Company's consolidated operating results.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The BORO Acquisition was accounted for using the acquisition method of accounting, and accordingly, purchased assets, including identifiable intangible assets, and assumed liabilities were recorded at their respective acquisition date fair values. The resulting fair values of the identifiable assets acquired and liabilities assumed from BORO at August 1, 2018 are summarized in the following table (in thousands).

| | |
|---|---|
| Cash and due from banks | $ 21,756 |
| Securities | 60,477 |
| Loans held for investment | 326,618 |
| Other assets | 25,912 |
| Total identifiable assets acquired | 434,763 |
| | |
| Deposits | 376,393 |
| Short-term borrowings | 10,000 |
| Other liabilities | 2,996 |
| Total liabilities assumed | 389,389 |
| | |
| Net identifiable assets acquired | 45,374 |
| Goodwill resulting from the acquisition | 39,627 |
| Net assets acquired | $ 85,001 |

The goodwill of $39.6 million resulting from the BORO Acquisition represents the inherent long-term value expected from the business opportunities created from combining BORO with the Company. The Company used significant estimates and assumptions to value the identifiable assets acquired and liabilities assumed. The amount of goodwill recorded in connection with the Company's acquisition of BORO is not deductible for tax purposes.

Included within the fair value of other assets in the table above are $10.0 million of identifiable core deposits intangible assets recorded in connection with the BORO Acquisition which are being amortized on an accelerated basis over an estimated useful life of six years. The fair value of the core deposit intangible assets was estimated using the net cost savings method, a variation of the income approach. This involved the use of the following significant assumptions: cost of deposits, customer attrition rate, and discount rate.

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

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

| | Loans, excluding PCI Loans | PCI Loans | Total Loans Held for Investment |
|---|---|---|---|
| Commercial real estate | $ 119,188 | $ 5,350 | $ 124,538 |
| 1 - 4 family residential | 55,487 | 39 | 55,526 |
| Construction and land development | 37,134 | — | 37,134 |
| Commercial and industrial | 98,259 | 2,127 | 100,386 |
| Consumer | 9,021 | 13 | 9,034 |
| Total | $ 319,089 | $ 7,529 | $ 326,618 |

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

| | |
|---|---|
| Contractually required principal and interest payments | $ 10,730 |
| Nonaccretable difference | 2,859 |
| Cash flows expected to be collected | 7,871 |
| Accretable difference | 342 |
| Fair value of loans acquired with a deterioration of credit quality | $ 7,529 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| | |
|---|---|
| Contractually required principal and interest payments | $ 381,551 |
| Contractual cash flows not expected to be collected | 15,286 |
| Fair value at acquisition | 319,089 |

## 4. 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, 2019 and December 31, 2018, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was $0.93 billion and $1.26 billion, respectively, and the unpaid principal balance of those loans was $0.90 billion and $1.21 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).

| March 31, 2019 | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value |
|---|---|---|---|---|
| Trading securities | $ 2,122 | $ 701,173 | $ — | $ 703,295 |
| Available for sale securities | — | 1,019,851 | — | 1,019,851 |
| Equity securities | 19,343 | — | — | 19,343 |
| Loans held for sale | — | 870,363 | 57,844 | 928,207 |
| Derivative assets | — | 53,176 | — | 53,176 |
| MSR asset | — | — | 62,049 | 62,049 |
| Securities sold, not yet purchased | 37,462 | 31,892 | — | 69,354 |
| Derivative liabilities | — | 29,726 | — | 29,726 |

| December 31, 2018 | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value |
|---|---|---|---|---|
| Trading securities | $ 7,947 | $ 737,519 | $ — | $ 745,466 |
| Available for sale securities | — | 875,658 | — | 875,658 |
| Equity securities | 19,679 | — | — | 19,679 |
| Loans held for sale | — | 1,207,311 | 50,464 | 1,257,775 |
| Derivative assets | — | 35,010 | — | 35,010 |
| MSR asset | — | — | 66,102 | 66,102 |
| Securities sold, not yet purchased | 33,000 | 48,667 | — | 81,667 |
| Derivative liabilities | — | 26,355 | — | 26,355 |

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

Total Gains or Losses

| | Balance at Beginning of Period | Purchases/ Additions | Sales/ Reductions | Transfers into Level 3 | (Realized or Unrealized) Included in Net Income | Included in Other Comprehensive Income (Loss) | Balance at End of Period |
|---|---|---|---|---|---|---|---|
| Three months ended March 31, 2019 | | | | | | | |
| Loans held for sale | $ 50,464 | $ 15,427 | $ (6,976) | 1,037 | $ (2,108) | $ — | $ 57,844 |
| MSR asset | 66,102 | 1,861 | — | — | (5,914) | — | 62,049 |
| Total | $ 116,566 | $ 17,288 | $ (6,976) | $ 1,037 | $ (8,022) | $ — | $ 119,893 |
| 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 |

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 March 31, 2019.

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, 2019 and December 31, 2018, the significant unobservable inputs used in the fair value measurements were as follows.

| | | | Range (Weighted-Average) | |
|---|---|---|---|---|
| Financial instrument | Valuation Technique | Unobservable Inputs | March 31, 2019 | December 31, 2018 |
| Loans held for sale | Discounted cash flows / Market comparable | Projected price | 94 - 96 % ( 95 %) | 95 - 97 % ( 95 %) |
| MSR asset | Discounted cash flows | Constant prepayment rate | 11.72 % | 9.62 % |
| | | Discount rate | 11.11 % | 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. Any transfers are based on changes in the observability and/or significance of the valuation inputs and are assumed to occur at the beginning of the quarterly reporting period in which they occur.

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, 2019 | | | Three Months Ended March 31, 2018 | | |
|---|---|---|---|---|---|---|
| | Net Gains (Losses) | Other Noninterest Income | Total Changes in Fair Value | Net Gains (Losses) | Other Noninterest Income | Total Changes in Fair Value |
| Loans held for sale | $ (13,324) | $ — | $ (13,324) | $ (14,880) | $ — | $ (14,880) |
| MSR asset | (5,914) | — | (5,914) | 2,582 | — | 2,582 |

The Company also determines the fair value of certain assets and liabilities on a non-recurring basis. In particular, the fair value of all assets acquired and liabilities assumed in an acquisition of a business are determined at their respective acquisition date fair values. 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. PCI loans 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”), 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, and the BORO Acquisition (collectively, the “Bank Transactions”). 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)

Estimates for these significant unobservable inputs and the resulting weighted average expected loss on PCI loans were as follows.

| March 31, 2019 | PCI Loans PlainsCapital Merger | | FNB Transaction | | SWS Merger | | BORO Acquisition | |
|---|---|---|---|---|---|---|---|---|
| Weighted average default rate | 82 | % | 31 | % | 72 | % | 63 | % |
| Weighted average loss severity rate | 59 | % | 12 | % | 28 | % | 42 | % |
| Weighted average prepayment speed | 0 | % | 6 | % | 0 | % | 0 | % |
| Resulting weighted average expected loss on PCI loans | 48 | % | 4 | % | 20 | % | 26 | % |

| December 31, 2018 | PCI Loans PlainsCapital Merger | | FNB Transaction | | SWS Merger | | BORO Acquisition | |
|---|---|---|---|---|---|---|---|---|
| Weighted average default rate | 81 | % | 34 | % | 71 | % | 63 | % |
| Weighted average loss severity rate | 59 | % | 12 | % | 28 | % | 42 | % |
| Weighted average prepayment speed | 0 | % | 6 | % | 0 | % | 0 | % |
| Resulting weighted average expected loss on PCI loans | 48 | % | 4 | % | 20 | % | 26 | % |

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. At March 31, 2019 and December 31, 2018, the estimated fair value of OREO was $23.1 million and $27.6 million, respectively, and the underlying fair value measurements utilized Level 2 inputs. The amounts are included in other assets within the consolidated balance sheets. During the reported periods, all fair value measurements for 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, 2019 | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value | Total Gains (Losses) for the Three Months Ended March 31, 2019 | 2018 |
|---|---|---|---|---|---|---|
| Impaired loans held for investment | $ — | $ — | $ 70,963 | $ 70,963 | $ 100 | $ (123) |
| Other real estate owned | — | 14,865 | — | 14,865 | (494) | (1,106) |

The Fair Value of Financial Instruments Subsection of the ASC requires disclosure of the fair value of financial assets and liabilities, including the financial assets and liabilities previously discussed. There have been 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 2018 Form 10-K.

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| | | Estimated Fair Value | | | |
|---|---|---|---|---|---|
| March 31, 2019 | Carrying Amount | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total |
| Financial assets: | | | | | |
| Cash and cash equivalents | $ 313,630 | $ 313,630 | $ — | $ — | $ 313,630 |
| Assets segregated for regulatory purposes | 156,851 | 156,851 | — | — | 156,851 |
| Securities purchased under agreements to resell | 65,205 | — | 65,205 | — | 65,205 |
| Held to maturity securities | 369,865 | — | 365,781 | — | 365,781 |
| Loans held for sale | 131,073 | — | 131,073 | — | 131,073 |
| Loans held for investment, net | 6,952,870 | — | 491,857 | 6,646,402 | 7,138,259 |
| Broker-dealer and clearing organization receivables | 1,651,199 | — | 1,651,199 | — | 1,651,199 |
| Other assets | 72,777 | — | 71,577 | 1,200 | 72,777 |
| Financial liabilities: | | | | | |
| Deposits | 8,298,119 | — | 8,295,435 | — | 8,295,435 |
| Broker-dealer and clearing organization payables | 1,490,227 | — | 1,490,227 | — | 1,490,227 |
| Short-term borrowings | 914,525 | — | 914,525 | — | 914,525 |
| Debt | 292,384 | — | 290,179 | — | 290,179 |
| Other liabilities | 5,518 | — | 5,518 | — | 5,518 |

| | | Estimated Fair Value | | | |
|---|---|---|---|---|---|
| December 31, 2018 | Carrying Amount | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total |
| Financial assets: | | | | | |
| Cash and cash equivalents | $ 644,473 | $ 644,473 | $ — | $ — | $ 644,473 |
| Assets segregated for regulatory purposes | 133,993 | 133,993 | — | — | 133,993 |
| Securities purchased under agreements to resell | 61,611 | — | 61,611 | — | 61,611 |

| | | | | | |
|---|---|---|---|---|---|
| Held to maturity securities | 351,012 | — | 341,124 | — | 341,124 |
| Loans held for sale | 135,471 | — | 135,471 | — | 135,471 |
| Loans held for investment, net | 6,870,972 | — | 578,363 | 6,445,810 | 7,024,173 |
| Broker-dealer and clearing organization receivables | 1,440,287 | — | 1,440,287 | — | 1,440,287 |
| Other assets | 69,720 | — | 68,573 | 1,147 | 69,720 |
| | | | | | |
| Financial liabilities: | | | | | |
| Deposits | 8,536,155 | — | 8,528,947 | — | 8,528,947 |
| Broker-dealer and clearing organization payables | 1,294,925 | — | 1,294,925 | — | 1,294,925 |
| Short-term borrowings | 1,065,807 | — | 1,065,807 | — | 1,065,807 |
| Debt | 295,884 | — | 293,685 | — | 293,685 |
| Other liabilities | 3,482 | — | 3,482 | — | 3,482 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The Company held equity investments other than securities of $37.8 million and $35.8 million at March 31, 2019 and December 31, 2018, respectively, which are included within other assets in the consolidated balance sheets. Of the $37.8 million of such equity investments held at March 31, 2019, $21.7 million do not have readily determinable fair values and each is 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 periods presented (in thousands).

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Balance, beginning of period | $ 20,376 | $ 22,946 |
| Additional investments | 1,398 | — |
| Upward adjustments | 101 | 272 |
| Impairments and downward adjustments | (197) | (1,312) |
| Dispositions | — | — |
| Balance, end of period | $ 21,677 | $ 21,906 |

5. Securities

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

| | March 31, 2019 | December 31, 2018 |
|---|---|---|

| | | |
|---|---|---|
| U.S. Treasury securities | $ 2,121 | $ 7,945 |
| U.S. government agencies: | | |
| Bonds | 1,485 | 1,494 |
| Residential mortgage-backed securities | 334,090 | 309,455 |
| Commercial mortgage-backed securities | 2,225 | 4,239 |
| Collateralized mortgage obligations | 119,178 | 206,813 |
| Corporate debt securities | 67,442 | 59,293 |
| States and political subdivisions | 134,572 | 126,748 |
| Unit investment trusts | 33,276 | 19,913 |
| Private-label securitized product | 5,520 | 5,680 |
| Other | 3,386 | 3,886 |
| Totals | $ 703,295 | $ 745,466 |

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 $69.4 million and $81.7 million at March 31, 2019 and December 31, 2018, respectively.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| | Available for Sale | | | |
|---|---|---|---|---|
| March 31, 2019 | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| U.S. Treasury securities | $ 10,554 | $ 89 | $ (26) | $ 10,617 |
| U.S. government agencies: | | | | |
| Bonds | 85,415 | 819 | (223) | 86,011 |
| Residential mortgage-backed securities | 472,203 | 2,589 | (3,705) | 471,087 |
| Commercial mortgage-backed securities | 11,648 | 334 | (20) | 11,962 |
| Collateralized mortgage obligations | 343,765 | 1,250 | (4,250) | 340,765 |
| Corporate debt securities | 49,196 | 925 | (19) | 50,102 |
| States and political subdivisions | 48,440 | 911 | (44) | 49,307 |
| Totals | $ 1,021,221 | $ 6,917 | $ (8,287) | $ 1,019,851 |

| | Available for Sale | | | |
|---|---|---|---|---|
| December 31, 2018 | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| U.S. Treasury securities | $ 11,552 | $ 30 | $ (44) | $ 11,538 |
| U.S. government agencies: | | | | |
| Bonds | 85,492 | 552 | (433) | 85,611 |
| Residential mortgage-backed securities | 391,428 | 608 | (6,962) | 385,074 |
| Commercial mortgage-backed securities | 11,703 | 189 | (120) | 11,772 |
| Collateralized mortgage obligations | 281,450 | 385 | (5,436) | 276,399 |
| Corporate debt securities | 53,614 | 268 | (580) | 53,302 |
| States and political subdivisions | 51,560 | 608 | (206) | 51,962 |
| Totals | $ 886,799 | $ 2,640 | $ (13,781) | $ 875,658 |

| | Held to Maturity | | | |
|---|---|---|---|---|
| March 31, 2019 | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| U.S. Treasury securities | $ 9,932 | $ 12 | $ — | $ 9,944 |
| U.S. government agencies: | | | | |
| Bonds | 39,018 | — | (691) | 38,327 |
| Residential mortgage-backed securities | 21,154 | 22 | (26) | 21,150 |

| | | | | |
|---|---|---|---|---|
| Commercial mortgage-backed securities | 112,056 | 1,187 | (474) | 112,769 |
| Collateralized mortgage obligations | 137,053 | 9 | (3,488) | 133,574 |
| States and political subdivisions | 50,652 | 264 | (899) | 50,017 |
| Totals | $ 369,865 | $ 1,494 | $ (5,578) | $ 365,781 |

| | Held to Maturity | | | |
|---|---|---|---|---|
| December 31, 2018 | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| U.S. Treasury securities | $ 9,903 | $ 3 | $ — | $ 9,906 |
| U.S. government agencies: | | | | |
| Bonds | 39,018 | — | (1,479) | 37,539 |
| Residential mortgage-backed securities | 21,903 | — | (263) | 21,640 |
| Commercial mortgage-backed securities | 87,065 | 271 | (1,462) | 85,874 |
| Collateralized mortgage obligations | 142,474 | — | (5,000) | 137,474 |
| States and political subdivisions | 50,649 | 91 | (2,049) | 48,691 |
| Totals | $ 351,012 | $ 365 | $ (10,253) | $ 341,124 |

Additionally, the Company had unrealized net gains of $0.5 million and unrealized net losses of $0.9 million from equity securities with fair values of $19.3 million and $19.7 million held at March 31, 2019 and December 31, 2018,

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

respectively. The Company recognized net gains of $1.3 million and net losses of $0.6 million, respectively, during the three months ended March 31, 2019 and 2018, respectively, due to changes in the fair value of equity securities still held at the balance sheet date. During the three months ended March 31, 2019 and 2018, net gains recognized from equity securities sold were nominal.

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, 2019 | | | December 31, 2018 | | |
|---|---|---|---|---|---|---|
| | 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 | 1 | $ 986 | $ 3 | 1 | $ 981 | $ 6 |
| Unrealized loss for twelve months or longer | 2 | 2,572 | 23 | 3 | 3,556 | 39 |
| | 3 | 3,558 | 26 | 4 | 4,537 | 45 |
| U.S. government agencies: | | | | | | |
| Bonds: | | | | | | |
| Unrealized loss for less than twelve months | — | — | — | 3 | 24,772 | 5 |
| Unrealized loss for twelve months or longer | 3 | 30,678 | 223 | 3 | 30,472 | 428 |
| | 3 | 30,678 | 223 | 6 | 55,244 | 433 |
| Residential mortgage-backed securities: | | | | | | |
| Unrealized loss for less than twelve months | 2 | 16,539 | 53 | 8 | 66,791 | 432 |
| Unrealized loss for twelve months or longer | 26 | 176,090 | 3,652 | 27 | 194,228 | 6,530 |
| | 28 | 192,629 | 3,705 | 35 | 261,019 | 6,962 |
| Commercial mortgage-backed securities: | | | | | | |
| Unrealized loss for less than twelve months | — | — | — | — | — | — |
| Unrealized loss for twelve months or longer | 1 | 5,048 | 20 | 1 | 4,953 | 120 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | 1 | 5,048 | 20 | 1 | 4,953 | 120 |
| Collateralized mortgage obligations: | | | | | | |
| Unrealized loss for less than twelve months | 11 | 65,779 | 191 | 11 | 44,394 | 498 |
| Unrealized loss for twelve months or longer | 32 | 153,288 | 4,059 | 28 | 140,483 | 4,938 |
| | 43 | 219,067 | 4,250 | 39 | 184,877 | 5,436 |
| Corporate debt securities: | | | | | | |
| Unrealized loss for less than twelve months | — | — | — | 8 | 16,256 | 282 |
| Unrealized loss for twelve months or longer | 2 | 3,961 | 19 | 8 | 15,665 | 297 |
| | 2 | 3,961 | 19 | 16 | 31,921 | 579 |
| States and political subdivisions: | | | | | | |
| Unrealized loss for less than twelve months | 3 | 353 | — | 29 | 8,590 | 27 |
| Unrealized loss for twelve months or longer | 15 | 6,737 | 44 | 18 | 9,029 | 179 |
| | 18 | 7,090 | 44 | 47 | 17,619 | 206 |
| Total available for sale: | | | | | | |
| Unrealized loss for less than twelve months | 17 | 83,657 | 247 | 60 | 161,784 | 1,250 |
| Unrealized loss for twelve months or longer | 81 | 378,374 | 8,040 | 88 | 398,386 | 12,531 |
| | 98 | $ 462,031 | $ 8,287 | 148 | $ 560,170 | $ 13,781 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

| | March 31, 2019 | | | December 31, 2018 | | |
|---|---|---|---|---|---|---|
| | 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 | — | $ — | $ — | — | $ — | $ — |
| Unrealized loss for twelve months or longer | 4 | 38,327 | 691 | 4 | 37,539 | 1,479 |
| | 4 | 38,327 | 691 | 4 | 37,539 | 1,479 |
| Residential mortgage-backed securities: | | | | | | |
| Unrealized loss for less than twelve months | — | — | — | 1 | 8,411 | 89 |
| Unrealized loss for twelve months or longer | 3 | 12,908 | 26 | 3 | 13,229 | 174 |
| | 3 | 12,908 | 26 | 4 | 21,640 | 263 |
| Commercial mortgage-backed securities: | | | | | | |
| Unrealized loss for less than twelve months | 1 | 10,469 | 8 | 1 | 4,973 | 27 |
| Unrealized loss for twelve months or longer | 7 | 36,387 | 466 | 13 | 59,670 | 1,435 |
| | 8 | 46,856 | 474 | 14 | 64,643 | 1,462 |
| Collateralized mortgage obligations: | | | | | | |
| Unrealized loss for less than twelve months | — | — | — | 1 | 2,051 | 26 |
| Unrealized loss for twelve months or longer | 22 | 128,077 | 3,488 | 24 | 135,423 | 4,974 |
| | 22 | 128,077 | 3,488 | 25 | 137,474 | 5,000 |
| States and political subdivisions: | | | | | | |
| Unrealized loss for less than twelve months | 2 | 736 | 9 | 9 | 6,431 | 56 |
| Unrealized loss for twelve months or longer | 59 | 26,174 | 890 | 86 | 32,909 | 1,993 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | 61 | 26,910 | 899 | 95 | 39,340 | 2,049 |
| Total held to maturity: | | | | | | |
| Unrealized loss for less than twelve months | 3 | 11,205 | 17 | 12 | 21,866 | 198 |
| Unrealized loss for twelve months or longer | 95 | 241,873 | 5,561 | 130 | 278,770 | 10,055 |
| | 98 | $ 253,078 | $ 5,578 | 142 | $ 300,636 | $ 10,253 |
| Equity | | | | | | |
| Common and preferred stock: | | | | | | |
| Unrealized loss for less than twelve months | — | — | — | — | — | — |
| Unrealized loss for twelve months or longer | — | — | — | — | — | — |
| | — | $ — | $ — | — | $ — | $ — |

During the three months ended March 31, 2019 and 2018, the Company did not record any other-than-temporary impairment ("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 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.

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, 2019 are shown by contractual maturity below (in thousands).

| | Available for Sale | | Held to Maturity | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due in one year or less | $ 42,520 | $ 42,498 | $ 11,329 | $ 11,342 |
| Due after one year through five years | 90,202 | 91,604 | 25,730 | 25,347 |
| Due after five years through ten years | 40,668 | 41,050 | 4,902 | 4,875 |
| Due after ten years | 20,215 | 20,885 | 57,641 | 56,724 |
| | 193,605 | 196,037 | 99,602 | 98,288 |
| | | | | |
| Residential mortgage-backed securities | 472,203 | 471,087 | 21,154 | 21,150 |
| Collateralized mortgage obligations | 343,765 | 340,765 | 137,053 | 133,574 |
| Commercial mortgage-backed securities | 11,648 | 11,962 | 112,056 | 112,769 |
| | $ 1,021,221 | $ 1,019,851 | $ 369,865 | $ 365,781 |

The Company recognized net gains of $8.1 million and net losses of $4.8 million from its trading portfolio during the three months ended March 31, 2019 and 2018, respectively. In addition, the Hilltop Broker-Dealers realized net gains from structured product trading activities of $25.3 million and $17.0 million during the three months ended March 31, 2019 and 2018, 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 $576.2 million and $612.3 million (with a fair value of $572.3 million and $600.0 million, respectively) at March 31, 2019 and December 31, 2018, respectively, were pledged by the Bank 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, 2019 and December 31, 2018.

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 March 31, 2019 and December 31, 2018, NLC had investments on deposit in custody for various state insurance departments with aggregate carrying values of $9.3 million and $9.5 million, respectively.

## 6. Loans Held for Investment and Allowance for Loan Losses

The loans acquired in the FNB Transaction were subject to loss-share agreements with the FDIC. During the fourth quarter of 2018, the Bank and the FDIC entered into a Termination Agreement pursuant to which all rights and obligations of the Bank and the FDIC under the FDIC loss-share agreements were resolved and terminated. Accordingly, loans which were previously referred to as either "covered loans" if covered by the loss-share agreements or otherwise "non-covered loans" are now collectively referred to as "loans held for investment." Disclosures associated with loans that were previously covered by the FDIC loss-share agreements during the three months ended March 31, 2018 are included in the "covered" portfolio segment in the applicable tables that follow. The majority of the loans previously covered by the FDIC loss-share agreements are comprised primarily of commercial real estate and 1-4

family residential loans. Loans held for investment summarized by portfolio segment are as follows (in thousands).

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Commercial real estate | $ 2,939,855 | $ 2,940,120 |
| Commercial and industrial | 1,493,436 | 1,508,451 |
| Construction and land development | 995,698 | 932,909 |
| 1-4 family residential | 696,209 | 679,263 |
| Mortgage warehouse | 350,896 | 243,806 |
| Consumer | 43,728 | 47,546 |
| Broker-dealer (1) | 491,857 | 578,363 |
| | 7,011,679 | 6,930,458 |
| Allowance for loan losses | (58,809) | (59,486) |
| Total loans held for investment, net of allowance | $ 6,952,870 | $ 6,870,972 |

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

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Carrying amount | $ 90,571 | $ 93,072 |
| Outstanding balance | 164,753 | 172,808 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Balance, beginning of period | $ 80,693 | $ 98,846 |
| Additions | — | — |
| Reclassifications from nonaccretable difference, net (1) | 534 | 7,129 |
| Disposals of loans | (366) | (289) |
| Accretion | (8,689) | (12,000) |
| Balance, end of period | $ 72,172 | $ 93,686 |

(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 PCI loans was $63.8 million and $64.2 million at March 31, 2019 and December 31, 2018, respectively.

Impaired loans exhibit a clear indication that the borrower's cash flow may not be sufficient to meet 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. 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 and the related allowance consider impairment measured at the pool level. 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).

| March 31, 2019 | Unpaid Contractual Principal Balance | Recorded Investment with No Allowance | Recorded Investment with Allowance | Total Recorded Investment | Related Allowance |
|---|---|---|---|---|---|
| PCI | | | | | |
| Commercial real estate: | | | | | |
| Non-owner occupied | $ 36,025 | $ 5,452 | $ 7,596 | $ 13,048 | $ 1,251 |
| Owner occupied | 34,222 | 6,227 | 8,027 | 14,254 | 545 |
| Commercial and industrial | 27,636 | 4,918 | 1,287 | 6,205 | 54 |
| Construction and land development | 9,457 | 33 | 266 | 299 | 61 |
| 1-4 family residential | 101,570 | 40,573 | 16,187 | 56,760 | 1,548 |
| Mortgage warehouse | — | — | — | — | — |
| Consumer | 1,937 | 5 | — | 5 | — |
| Broker-dealer | — | — | — | — | — |
| | 210,847 | 57,208 | 33,363 | 90,571 | 3,459 |
| Non-PCI | | | | | |
| Commercial real estate: | | | | | |
| Non-owner occupied | 206 | 199 | — | 199 | — |
| Owner occupied | 5,103 | 3,962 | — | 3,962 | — |
| Commercial and industrial | 22,788 | 9,932 | 327 | 10,259 | 73 |
| Construction and land development | 1,580 | 950 | 510 | 1,460 | 12 |
| 1-4 family residential | 9,099 | 7,301 | — | 7,301 | — |
| Mortgage warehouse | — | — | — | — | — |
| Consumer | 146 | 38 | — | 38 | — |
| Broker-dealer | — | — | — | — | — |
| | 38,922 | 22,382 | 837 | 23,219 | 85 |
| | $ 249,769 | $ 79,590 | $ 34,200 | $ 113,790 | $ 3,544 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

| December 31, 2018 | Unpaid Contractual Principal Balance | Recorded Investment with No Allowance | Recorded Investment with Allowance | Total Recorded Investment | Related Allowance |
|---|---|---|---|---|---|
| PCI | | | | | |
| Commercial real estate: | | | | | |
| Non-owner occupied | $ 42,668 | $ 5,549 | $ 7,540 | $ 13,089 | $ 1,125 |
| Owner occupied | 36,246 | 11,657 | 2,967 | 14,624 | 304 |
| Commercial and industrial | 27,403 | 5,491 | 1,068 | 6,559 | 72 |
| Construction and land development | 10,992 | 74 | 390 | 464 | 92 |
| 1-4 family residential | 106,503 | 646 | 57,681 | 58,327 | 1,299 |
| Mortgage warehouse | — | — | — | — | — |
| Consumer | 2,185 | 9 | — | 9 | — |
| Broker-dealer | — | — | — | — | — |
| | 225,997 | 23,426 | 69,646 | 93,072 | 2,892 |
| Non-PCI | | | | | |
| Commercial real estate: | | | | | |
| Non-owner occupied | — | — | — | — | — |
| Owner occupied | 5,231 | 4,098 | — | 4,098 | — |
| Commercial and industrial | 22,277 | 9,891 | 1,740 | 11,631 | 721 |
| Construction and land development | 3,430 | 2,711 | 535 | 3,246 | 31 |
| 1-4 family residential | 8,695 | 6,922 | — | 6,922 | — |
| Mortgage warehouse | — | — | — | — | — |
| Consumer | 149 | 42 | — | 42 | — |
| Broker-dealer | — | — | — | — | — |
| | 39,782 | 23,664 | 2,275 | 25,939 | 752 |
| | $ 265,779 | $ 47,090 | $ 71,921 | $ 119,011 | $ 3,644 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Commercial real estate: | | |
| Non-owner occupied | $ 13,168 | $ 13,734 |

| | | |
|---|---|---|
| Owner occupied | 18,469 | 22,033 |
| Commercial and industrial | 17,327 | 23,946 |
| Construction and land development | 2,735 | 1,954 |
| 1-4 family residential | 64,655 | 4,904 |
| Mortgage warehouse | | |
| Consumer | 47 | 121 |
| Broker-dealer | — | — |
| Covered | — | 89,203 |
| | $ 116,401 | $ 155,895 |

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

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Commercial real estate: | | |
| Non-owner occupied | $ 1,370 | $ 1,226 |
| Owner occupied | 3,962 | 4,098 |
| Commercial and industrial | 13,350 | 14,870 |
| Construction and land development | 1,473 | 3,278 |
| 1-4 family residential | 7,395 | 7,026 |
| Mortgage warehouse | — | — |
| Consumer | 38 | 41 |
| Broker-dealer | — | — |
| | $ 27,588 | $ 30,539 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

At March 31, 2019 and December 31, 2018, non-accrual loans included PCI loans of $4.6 million and $4.9 million, respectively, for which discount accretion has been suspended because the extent and timing of cash flows from these PCI loans can no longer be reasonably estimated. In addition to the non-accrual loans in the table above, $3.3 million and $3.4 million of real estate loans secured by residential properties and classified as held for sale were in non-accrual status at March 31, 2019 and December 31, 2018, respectively.

Interest income, including recoveries and cash payments, recorded on impaired loans was $0.4 million and $0.2 million during the three months ended March 31, 2019 and 2018, respectively. Except as noted above, 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.

The Bank did not grant any TDRs during three months ended March 31, 2019 or 2018. At March 31, 2019 and December 31, 2018, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

There were no TDRs granted during the twelve months preceding March 31, 2019. The following table presents information regarding TDRs granted during the twelve months preceding March 31, 2018, for which a payment was at least 30 days past due (dollars in thousands).

| | Twelve Months Preceding March 31, 2018 | | |
|---|---|---|---|
| | Number of | Balance at | Balance at |

| | Loans | Extension | End of Period |
|---|---|---|---|
| Commercial real estate: | | | |
| Non-owner occupied | — | $ — | $ — |
| Owner occupied | — | — | — |
| Commercial and industrial | — | — | — |
| Construction and land development | 1 | 655 | 595 |
| 1-4 family residential | — | — | — |
| Mortgage warehouse | — | — | — |
| Consumer | — | — | — |
| Broker-dealer | — | — | — |
| | 1 | $ 655 | $ 595 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| March 31, 2019 | 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 | Accruin (Non-PC Past Due 90 Days |
|---|---|---|---|---|---|---|---|---|
| Commercial real estate: | | | | | | | | |
| Non-owner occupied | $ 979 | $ — | $ 199 | $ 1,178 | $ 1,713,901 | $ 13,048 | $ 1,728,127 | $ — |
| Owner occupied | 3,294 | — | 2,955 | 6,249 | 1,191,225 | 14,254 | 1,211,728 | — |
| Commercial and industrial | 4,894 | 4,752 | 9,107 | 18,753 | 1,468,478 | 6,205 | 1,493,436 | 3 |
| Construction and land development | 134 | 13 | — | 147 | 995,252 | 299 | 995,698 | — |
| 1-4 family residential | 5,345 | 1,742 | 2,799 | 9,886 | 629,563 | 56,760 | 696,209 | — |
| Mortgage warehouse | — | — | — | — | 350,896 | — | 350,896 | — |
| Consumer | 123 | 460 | — | 583 | 43,140 | 5 | 43,728 | — |
| Broker-dealer | — | — | — | — | 491,857 | — | 491,857 | — |
| | $ 14,769 | $ 6,967 | $ 15,060 | $ 36,796 | $ 6,884,312 | $ 90,571 | $ 7,011,679 | $ 3 |

| December 31, 2018 | Loans Past Due 30-59 Days | Loans Past Due 60-89 Days | Loans Past Due 90 Days or More | Total Past Due Loans | Current Loans | PCI Loans | Total Loans | Accruing Lo (Non-PCI) Past Due 90 Days or |
|---|---|---|---|---|---|---|---|---|
| Commercial real estate: | | | | | | | | |
| Non-owner occupied | $ 1,174 | $ 199 | $ — | $ 1,373 | $ 1,708,160 | $ 13,089 | $ 1,722,622 | $ — |
| Owner occupied | 1,364 | — | 4,173 | 5,537 | 1,197,337 | 14,624 | 1,217,498 | 75 |
| | 1,792 | 1,049 | 11,051 | 13,892 | 1,488,000 | 6,559 | 1,508,451 | 3 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Commercial and industrial | | | | | | | | |
| Construction and land development | 3,549 | — | — | 3,549 | 928,896 | 464 | 932,909 | — |
| 1-4 family residential | 5,987 | 2,484 | 1,950 | 10,421 | 610,515 | 58,327 | 679,263 | — |
| Mortgage warehouse | — | — | — | 0 | 243,806 | — | 243,806 | — |
| Consumer | 254 | 147 | — | 401 | 47,136 | 9 | 47,546 | — |
| Broker-dealer | — | — | — | — | 578,363 | — | 578,363 | — |
| | $ 14,120 | $ 3,879 | $ 17,174 | $ 35,173 | $ 6,802,213 | $ 93,072 | $ 6,930,458 | $ 78 |

In addition to the loans shown in the tables above, PrimeLending had $77.0 million and $83.1 million of loans included in loans held for sale (with an aggregate unpaid principal balance of $78.1 million and $84.0 million, respectively) that were 90 days past due and accruing interest at March 31, 2019 and December 31, 2018, 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 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.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

| March 31, 2019 | Pass | Special Mention | Substandard | PCI | Total |
|---|---|---|---|---|---|
| Commercial real estate: | | | | | |
| Non-owner occupied | $ 1,671,428 | $ 5,957 | $ 37,694 | $ 13,048 | $ 1,728,127 |
| Owner occupied | 1,168,015 | — | 29,459 | 14,254 | 1,211,728 |
| Commercial and industrial | 1,421,541 | 479 | 65,211 | 6,205 | 1,493,436 |
| Construction and land development | 993,927 | — | 1,472 | 299 | 995,698 |
| 1-4 family residential | 620,547 | 382 | 18,520 | 56,760 | 696,209 |
| Mortgage warehouse | 350,896 | — | — | — | 350,896 |
| Consumer | 43,595 | — | 128 | 5 | 43,728 |
| Broker-dealer | 491,857 | — | — | — | 491,857 |
| | $ 6,761,806 | $ 6,818 | $ 152,484 | $ 90,571 | $ 7,011,679 |

| December 31, 2018 | Pass | Special Mention | Substandard | PCI | Total |
|---|---|---|---|---|---|
| Commercial real estate: | | | | | |
| Non-owner occupied | $ 1,673,424 | $ — | $ 36,109 | $ 13,089 | $ 1,722,622 |
| Owner occupied | 1,175,225 | 2,083 | 25,566 | 14,624 | 1,217,498 |
| Commercial and industrial | 1,433,227 | 15,320 | 53,345 | 6,559 | 1,508,451 |
| Construction and land development | 929,130 | — | 3,315 | 464 | 932,909 |
| 1-4 family residential | 601,264 | 393 | 19,279 | 58,327 | 679,263 |
| Mortgage warehouse | 243,806 | — | — | — | 243,806 |
| Consumer | 47,416 | — | 121 | 9 | 47,546 |
| Broker-dealer | 578,363 | — | — | — | 578,363 |
| | $ 6,681,855 | $ 17,796 | $ 137,735 | $ 93,072 | $ 6,930,458 |

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 2018 Form 10-K.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Changes in the allowance for loan losses, distributed by portfolio segment, are shown below (in thousands).

| Three Months Ended March 31, 2019 | Balance, beginning of period | Provision (recovery) for loan losses | Loans charged off | Recoveries on charged off loans | Balance, end of period |
|---|---|---|---|---|---|
| Commercial real estate | $ 27,100 | $ (255) | $ — | $ — | $ 26,845 |
| Commercial and industrial | 21,980 | 458 | (1,818) | 648 | 21,268 |
| Construction and land development | 6,061 | (153) | — | — | 5,908 |
| 1-4 family residential | 3,956 | 389 | (28) | 14 | 4,331 |
| Mortgage warehouse | — | — | — | — | — |
| Consumer | 267 | 586 | (454) | 10 | 409 |
| Broker-dealer | 122 | (74) | — | — | 48 |
| Total | $ 59,486 | $ 951 | $ (2,300) | $ 672 | $ 58,809 |

| Three Months Ended March 31, 2018 | Balance, beginning of period | Provision (recovery) for loan losses | Loans charged off | Recoveries on charged off loans | Balance, end of period |
|---|---|---|---|---|---|
| Commercial real estate | $ 26,413 | $ 780 | $ — | $ — | $ 27,193 |
| Commercial and industrial | 23,674 | (1,696) | (1,183) | 2,474 | 23,269 |
| Construction and land development | 7,844 | (395) | — | — | 7,449 |
| 1-4 family residential | 2,362 | (277) | (6) | 28 | 2,107 |
| Mortgage warehouse | — | — | — | — | — |
| Consumer | 311 | (34) | (13) | 12 | 276 |
| Broker-dealer | 353 | (276) | — | — | 77 |
| Covered | 2,729 | 91 | — | 3 | 2,823 |
| Total | $ 63,686 | $ (1,807) | $ (1,202) | $ 2,517 | $ 63,194 |

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

| Loans individually | Loans collectively evaluated for | PCI |
|---|---|---|

| March 31, 2019 | evaluated for impairment | impairment | loans | Total |
|---|---|---|---|---|
| Commercial real estate | $ 3,581 | $ 2,908,972 | $ 27,302 | $ 2,939,855 |
| Commercial and industrial | 9,450 | 1,477,781 | 6,205 | 1,493,436 |
| Construction and land development | 1,358 | 994,041 | 299 | 995,698 |
| 1-4 family residential | 608 | 638,841 | 56,760 | 696,209 |
| Mortgage warehouse | — | 350,896 | — | 350,896 |
| Consumer | — | 43,723 | 5 | 43,728 |
| Broker-dealer | — | 491,857 | — | 491,857 |
| Total | $ 14,997 | $ 6,906,111 | $ 90,571 | $ 7,011,679 |

| December 31, 2018 | Loans individually evaluated for impairment | Loans collectively evaluated for impairment | PCI loans | Total |
|---|---|---|---|---|
| Commercial real estate | $ 3,909 | $ 2,908,498 | $ 27,713 | $ 2,940,120 |
| Commercial and industrial | 10,741 | 1,491,151 | 6,559 | 1,508,451 |
| Construction and land development | 3,241 | 929,204 | 464 | 932,909 |
| 1-4 family residential | — | 620,936 | 58,327 | 679,263 |
| Mortgage warehouse | — | 243,806 | — | 243,806 |
| Consumer | — | 47,537 | 9 | 47,546 |
| Broker-dealer | — | 578,363 | — | 578,363 |
| Total | $ 17,891 | $ 6,819,495 | $ 93,072 | $ 6,930,458 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| March 31, 2019 | Loans individually evaluated for impairment | Loans collectively evaluated for impairment | PCI loans | Total |
|---|---|---|---|---|
| Commercial real estate | $ — | $ 25,049 | $ 1,796 | $ 26,845 |
| Commercial and industrial | 73 | 21,141 | 54 | 21,268 |
| Construction and land development | 12 | 5,835 | 61 | 5,908 |
| 1-4 family residential | — | 2,783 | 1,548 | 4,331 |
| Mortgage warehouse | — | — | — | — |
| Consumer | — | 409 | — | 409 |
| Broker-dealer | — | 48 | — | 48 |
| Total | $ 85 | $ 55,265 | $ 3,459 | $ 58,809 |

| December 31, 2018 | Loans individually evaluated for impairment | Loans collectively evaluated for impairment | PCI loans | Total |
|---|---|---|---|---|
| Commercial real estate | $ — | $ 25,671 | $ 1,429 | $ 27,100 |
| Commercial and industrial | 721 | 21,187 | 72 | 21,980 |
| Construction and land development | 31 | 5,938 | 92 | 6,061 |
| 1-4 family residential | — | 2,657 | 1,299 | 3,956 |
| Mortgage warehouse | — | — | — | — |
| Consumer | — | 267 | — | 267 |
| Broker-dealer | — | 122 | — | 122 |
| Total | $ 752 | $ 55,842 | $ 2,892 | $ 59,486 |

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 March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Balance, beginning of period | $ 66,102 | $ 54,714 |
| Additions | 1,861 | 6,661 |
| Changes in fair value: | | |
| Due to changes in model inputs or assumptions (1) | (5,033) | 3,641 |
| Due to customer payoffs | (881) | (1,059) |
| Balance, end of period | $ 62,049 | $ 63,957 |

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Mortgage loans serviced for others | $ 5,077,800 | $ 5,086,461 |
| MSR asset as a percentage of serviced mortgage loans | 1.22 % | 1.30 % |

(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.

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Weighted average constant prepayment rate | 11.72 % | 10.51 % |
| Weighted average discount rate | 11.11 % | 11.11 % |
| Weighted average life (in years) | 6.5 | 7.1 |

Table of Contents

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).

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Constant prepayment rate: | | |
| Impact of 10% adverse change | $ (2,897) | $ (2,512) |
| Impact of 20% adverse change | (5,664) | (4,980) |
| Discount rate: | | |
| Impact of 10% adverse change | (2,434) | (2,677) |
| Impact of 20% adverse change | (4,677) | (5,139) |

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 $6.3 million and $5.8 million during the three months ended March 31, 2019 and 2018, 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).

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Noninterest-bearing demand | $ 2,490,144 | $ 2,560,750 |

| | | |
|---|---|---|
| Interest-bearing: | | |
| NOW accounts | 1,388,860 | 1,358,196 |
| Money market | 2,502,889 | 2,725,541 |
| Brokered - money market | 5,000 | 5,000 |
| Demand | 330,968 | 393,685 |
| Savings | 185,015 | 184,700 |
| Time | 1,395,243 | 1,308,284 |
| | $ 8,298,119 | $ 8,536,156 |

9. Short-term Borrowings

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

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Federal funds purchased | $ 132,800 | $ 100,100 |
| Securities sold under agreements to repurchase | 560,725 | 576,707 |
| Federal Home Loan Bank | — | 200,000 |
| Short-term bank loans | 221,000 | 189,000 |
| | $ 914,525 | $ 1,065,807 |

Federal funds purchased and securities sold under agreements to repurchase generally mature daily, on demand, or on some other short-term basis. The Bank and the Hilltop Broker-Dealers execute transactions to sell securities under agreements to repurchase with both customers and other broker-dealers. Securities involved in these transactions are held by the Bank, the Hilltop Broker-Dealers or a third-party dealer.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Information concerning federal funds purchased and securities sold under agreements to repurchase is shown in the following tables (dollars in thousands).

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Average balance during the period | $ 654,117 | $ 678,723 |
| Average interest rate during the period | 2.63 % | 1.50 % |

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Average interest rate at end of period | 2.47 % | 2.43 % |
| Securities underlying the agreements at end of period: | | |
| Carrying value | $ 562,897 | $ 587,609 |
| Estimated fair value | $ 598,304 | $ 618,231 |

Federal Home Loan Bank (“FHLB”) short-term borrowings mature over terms not exceeding 365 days and are collateralized by FHLB Dallas stock, nonspecified real estate loans and certain specific commercial real estate loans. Other information regarding FHLB short-term borrowings is shown in the following tables (dollars in thousands).

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Average balance during the period | $ 4,167 | $ 26,111 |
| Average interest rate during the period | 2.65 % | 2.03 % |

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Average interest rate at end of period | 0.00 % | 2.65 % |

The Hilltop Broker-Dealers use short-term bank loans periodically to finance securities owned, margin loans to customers and correspondents, and underwriting activities. Interest on the borrowings varies with the federal funds rate. The weighted average interest rate on the borrowings at March 31, 2019 and December 31, 2018 was 3.29% and

3.35%, respectively.

10. Notes Payable

Notes payable consisted of the following (in thousands).

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Senior Notes due April 2025, net of discount of $1,353 and $1,393, respectively | $ 148,647 | $ 148,607 |
| FHLB notes, including premium of $203 and $222, respectively, with maturities ranging from September 2020 to June 2030 | 4,284 | 4,391 |
| NLIC note payable due May 2033 | 10,000 | 10,000 |
| NLIC note payable due September 2033 | 10,000 | 10,000 |
| ASIC note payable due April 2034 | 7,500 | 7,500 |
| Insurance company line of credit due December 31, 2019 | — | — |
| Ventures Management lines of credit due May 2019 | 44,941 | 48,374 |
| | $ 225,372 | $ 228,872 |

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

11. Leases

Hilltop and its subsidiaries lease space, primarily for corporate offices, branch facilities and automated teller machines, under both operating and finance leases. Certain of the Company's leases have options to extend, with the longest extension option being ten years, and some of the Company's leases include options to terminate within one year. The Company's leases contain customary restrictions and covenants. The Company has certain intercompany leases and subleases between its subsidiaries, and these transactions and balances have been eliminated in consolidation and are not reflected in the tables and information presented below.

Supplemental balance sheet information related to finance leases is as follows (in thousands).

| | March 31, 2019 |
|---|---|
| Finance leases: | |
| Premises and equipment | $ 7,780 |
| Accumulated depreciation | (3,736) |
| Premises and equipment, net | $ 4,044 |

Operating lease rental cost and finance lease amortization of ROU assets is included within occupancy and equipment, net in the consolidated statements of operations. Finance lease interest expense is included within other interest expense in the consolidated statements of operations. The Company does not generally enter into leases which contain variable payments, other than due to the passage of time. The components of lease costs, including short-term lease costs, are as follows (in thousands).

| | Three Months Ended March 31, 2019 |
|---|---|
| Operating lease cost | $ 10,531 |
| Less operating lease and sublease income | (388) |
| Net operating lease cost | $ 10,143 |

| | |
|---|---|
| Finance lease cost: | |
| Amortization of lease assets | $ 147 |
| Interest on lease liabilities | 152 |
| Total finance lease cost | $ 299 |

Supplemental cash flow information related to leases is as follows (in thousands):

| | Three Months Ended March 31, 2019 |
|---|---|
| Cash paid for amounts included in the measurement of lease liabilities: | |
| Operating cash flows from operating leases | $ 8,220 |
| Operating cash flows from finance leases | 152 |
| Financing cash flows from finance leases | 144 |
| Right-of-use assets obtained in exchange for new lease obligations: | |
| Operating leases | $ 3,591 |
| Finance leases | — |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Information regarding the lease terms and discount rates of the Company's leases is as follows.

| | March 31, 2019 | |
|---|---|---|
| Lease Classification | Weighted Average Remaining Lease Term (Years) | Weighted Average Discount Rate |
| Operating | 5 | 5.18 % |
| Finance | 8 | 4.77 % |

Future minimum lease payments under the Leasing Standard as of March 31, 2019, under lease agreements that had commenced as of January 1, 2019, are presented below (in thousands).

| | Operating leases | Finance Leases |
|---|---|---|
| 2019 | $ 27,512 | $ 891 |
| 2020 | 31,127 | 1,197 |
| 2021 | 23,287 | 1,212 |
| 2022 | 17,922 | 1,241 |
| 2023 | 13,902 | 1,280 |
| Thereafter | 20,278 | 3,460 |
| Total minimum lease payments | $ 134,028 | $ 9,281 |
| Less amount representing interest | (15,576) | (1,374) |
| Lease liabilities | $ 118,452 | $ 7,907 |

The Company adopted the Leasing Standard on January 1, 2019, using the modified retrospective transition under the option to apply the new standard at its effective date without adjusting the prior period comparative financial statements. As such, disclosures for comparative periods under the predecessor standard, ASC 840, Leases, are required in the year of transition. Future minimum lease payments under ASC 840 as of December 31, 2018, under lease agreements that had commenced as of December 31, 2018, are presented below (in thousands).

| | Operating Leases | Capital Leases |
|---|---|---|
| 2019 | $ 36,171 | $ 1,186 |
| 2020 | 29,109 | 1,197 |
| 2021 | 21,058 | 1,212 |
| 2022 | 16,386 | 1,241 |
| 2023 | 12,361 | 1,280 |
| Thereafter | 18,264 | 3,460 |
| Total minimum lease payments | $ 133,349 | 9,576 |
| Amount representing interest | | (1,221) |
| Present value of minimum lease payments | | $ 8,355 |

As of March 31, 2019, the Company had additional operating leases that have not yet commenced with future minimum lease payments of approximately $38 million, primarily related to the Hilltop Plaza leases, as discussed in more detail in Note 13. These operating leases are expected to commence between April 2019 and December 2019 with lease terms ranging from three to ten years.

A related party is the lessor in an operating lease with the Bank. The Bank's minimum payment under the lease is $0.5 million annually through 2028, for an aggregate remaining obligation of $4.6 million at March 31, 2019.

12. Income Taxes

The Company applies an estimated annual effective rate to interim period pre-tax income to calculate the income tax provision for the quarter in accordance with the principal method prescribed by the accounting guidance established for computing income taxes in interim periods. The Company's effective tax rates were 22.6% and 23.3% during the three months ended March 31, 2019 and 2018, respectively, and approximated the applicable statutory rates for such periods.

Table of Contents



## 13. Commitments and Contingencies

### Legal Matters

The Company is subject to loss contingencies related to litigation, claims, investigations and legal and administrative cases and proceedings arising in the ordinary course of business. The Company evaluates these contingencies based on information currently available, including advice of counsel. The Company establishes accruals for those matters when a loss contingency is considered probable and the related amount is reasonably estimable. Any accruals are periodically reviewed and may be adjusted as circumstances change. A portion of the Company's exposure with respect to loss contingencies may be offset by applicable insurance coverage. In determining the amounts of any accruals or estimates of possible loss contingencies, the Company does not take into account the availability of insurance coverage, other than that provided by reinsurers in the insurance segment. When it is practicable, the Company estimates loss contingencies for possible litigation and claims, whether or not there is an accrued probable loss. When the Company is able to estimate such probable losses, and when it estimates that it is reasonably possible it could incur losses in excess of amounts accrued, the Company is required to make a disclosure of the aggregate estimation. As available information changes, however, the matters for which the Company is able to estimate, as well as the estimates themselves, will be adjusted accordingly.

Assessments of litigation and claims exposures are difficult due to many factors that involve inherent unpredictability. Those factors include the following: the varying stages of the proceedings, particularly in the early stages; unspecified, unsupported, or uncertain damages; damages other than compensatory, such as punitive damages; a matter presenting meaningful legal uncertainties, including novel issues of law; multiple defendants and jurisdictions; whether discovery has begun or is complete; whether meaningful settlement discussions have commenced; and whether the claim involves a class action and if so, how the class is defined. As a result of some of these factors, the Company may be unable to estimate reasonably possible losses with respect to some or all of the pending and threatened litigation and claims asserted against the Company.

While the final outcome of litigation and claims exposures is inherently unpredictable, management is currently of the opinion that the outcome of pending and threatened litigation will not have a material effect on the Company's business, consolidated financial position, results of operations or cash flows as a whole. However, in the event of unexpected future developments, it is reasonably possible that an adverse outcome in any matter could be material to the Company's business, consolidated financial position, results of operations or cash flows for any particular reporting period of occurrence.

Indemnification Liability Reserve

The mortgage origination segment may be responsible to agencies, investors, or other parties for errors or omissions relating to its representations and warranties that each loan sold meets certain requirements, including representations as to underwriting standards and the validity of certain borrower representations in connection with the loan. If determined to be at fault, the mortgage origination segment either repurchases the affected loan from or indemnifies the claimant against loss. The mortgage origination segment has established an indemnification liability reserve for such probable losses.

Generally, the mortgage origination segment first becomes aware that an agency, investor, or other party believes a loss has been incurred on a sold loan when it receives a written request from the claimant to repurchase the loan or reimburse the claimant’s losses. Upon completing its review of the claimant’s request, the mortgage origination segment establishes a specific claims reserve for the loan if it concludes its obligation to the claimant is both probable and reasonably estimable.

An additional reserve has been established for probable agency, investor or other party losses that may have been incurred, but not yet reported to the mortgage origination segment based upon a reasonable estimate of such losses. Factors considered in the calculation of this reserve include, but are not limited to, the total volume of loans sold

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

exclusive of specific claimant requests, actual claim settlements and the severity of estimated losses resulting from future claims, and the mortgage origination segment's history of successfully curing defects identified in claim requests. While the mortgage origination segment's sales contracts typically include borrower early payment default repurchase provisions, these provisions have not been a primary driver of claims to date, and therefore, are not a primary factor considered in the calculation of this reserve.

At both March 31, 2019 and December 31, 2018, the mortgage origination segment's indemnification liability reserve totaled $10.7 million. The provision for indemnification losses was $0.5 million and $0.7 million during the three months ended March 31, 2019 and 2018, respectively.

The following tables provide for a rollforward of claims activity for loans put-back to the mortgage origination segment based upon an alleged breach of a representation or warranty with respect to a loan sold and related indemnification liability reserve activity (in thousands).

| | Representation and Warranty Specific Claims Activity - Origination Loan Balance Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Balance, beginning of period | $ 33,784 | $ 33,702 |
| Claims made | 3,182 | 6,989 |
| Claims resolved with no payment | (5,687) | (5,861) |
| Repurchases | (1,167) | (2,089) |
| Indemnification payments | — | (420) |
| Balance, end of period | $ 30,112 | $ 32,321 |

| | Indemnification Liability Reserve Activity (1) Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Balance, beginning of period | $ 10,701 | $ 23,472 |
| Additions for new sales | 489 | 728 |
| Repurchases | (82) | (160) |
| Early payment defaults | (142) | (146) |
| Indemnification payments | (3) | (117) |
| Change in reserves for loans sold in prior years | (242) | (445) |
| Balance, end of period | $ 10,721 | $ 23,332 |

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Reserve for Indemnification Liability: | | |
| Specific claims | $ 916 | $ 676 |
| Incurred but not reported claims | 9,805 | 10,025 |
| Total | $ 10,721 | $ 10,701 |

(1) The Reserve for Indemnification Liability as of March 31, 2018 reflected $10.2 million of specific claims related to an inquiry by the U.S. Department of Housing and Urban Development ("HUD") and the U.S. Department of Justice which was resolved in the fourth quarter of 2018. The resolution of this matter is discussed in detail in Note 18 to the consolidated financial statements included in the Company's 2018 Form 10-K.

Although management considers the total indemnification liability reserve to be appropriate, there may be changes in the reserve over time to address incurred losses due to unanticipated adverse changes in the economy and historical loss patterns, discrete events adversely affecting specific borrowers or industries, and/or actions taken by institutions or investors. The impact of such matters is considered in the reserving process when probable and estimable.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Hilltop Plaza Investment

On July 31, 2018, Hillcrest Land LLC purchased approximately 1.7 acres of land in the City of University Park, Texas for $38.5 million. Hillcrest Land LLC is owned equally between Hilltop Investments I, LLC, a wholly owned entity of Hilltop, and Diamond Ground, LLC, an affiliate of Mr. Gerald J. Ford, Chairman of the Board of Directors. Each of Hilltop Investments I, LLC and Diamond Ground, LLC contributed $19.3 million to Hillcrest Land LLC to complete the purchase. As the voting rights of Hillcrest Land LLC are shared equally between the Company and Diamond Ground, LLC, there is no primary beneficiary, and Diamond Ground, LLC's interest in Hillcrest Land LLC has been reflected as a noncontrolling interest in the Company's consolidated financial statements. Therefore, the Company has consolidated Hillcrest Land LLC under the VIE model according to the "most-closely associated" test. The purchased land is included within premises and equipment, net in the consolidated balance sheets. Any income (loss) associated with Hillcrest Land LLC is included within other noninterest income in the consolidated statements of operations. Trusts for which Jeremy Ford, President and Chief Executive Officer, and the wife of Corey Prestidge, Executive Vice President, General Counsel and Secretary, are a beneficiary own 10.2% and 10.1%, respectively, of Diamond Ground, LLC.

In connection with the purchase of the land, Hillcrest Land LLC entered into a 99-year ground lease of the land with three tenants-in-common: SPC Park Plaza Partners LLC ("Park Plaza LLC"), an unaffiliated entity which received an undivided 50% leasehold interest; HTH Project LLC, a wholly owned subsidiary of Hilltop, which received an undivided 25% leasehold interest; and Diamond Hillcrest, LLC ("Diamond Hillcrest"), an entity owned by Mr. Gerald J. Ford, which received an undivided 25% leasehold interest (collectively, the "Co-Owners"). The ground lease is triple net. The base rent from the Co-Owners under the ground lease commences 18 months after the ground lease was signed at $1.8 million per year and increases 1.0% per year each January 1 thereafter. The ground lease was classified as an operating lease, and the accounting commencement date was determined to be July 31, 2018, the date the land was available to the Co-Owners.

Concurrent with the ground lease, the Co-Owners entered into an agreement to purchase the improvements currently being constructed on the land, which is a mixed-use project containing a six-story building ("Hilltop Plaza"). HTH Project LLC and Diamond Hillcrest each own an undivided 25% interest in Hilltop Plaza. Park Plaza LLC owns the remaining undivided 50% interest in Hilltop Plaza. Park Plaza LLC has agreed to serve as the Co-Owner property manager under the Co-Owners Agreement; however, certain actions require unanimous approval of all Co-Owners. Funding for Hilltop Plaza includes a $41.0 million construction loan from an unaffiliated third party bank, as well as cash contributions of $5.3 million from each of HTH Project LLC and Diamond Hillcrest. HTH Project LLC's undivided interest in Hilltop Plaza is accounted for as an equity method investment as the tenants-in-common have joint control over decisions regarding Hilltop Plaza. The investment is included within other assets in the consolidated balance sheets and any income (loss) is included within other noninterest income in the consolidated statements of operations.

Hilltop and the Bank entered into leases for an aggregate of approximately 72,000 of the total 119,000 square feet of rentable space in Hilltop Plaza to serve as the headquarters for both companies. The two separate 129-month office and retail leases have combined total base rent of approximately $35 million with the first nine months of rent abated. Move-in is expected in the fourth quarter of 2019. The office and retail leases were considered under the build-to-suit provisions of ASC 840, and the Company was determined to be the accounting owner of the project as its affiliate, HTH Project LLC, has an equity investment in the project. As such, the assets of Hilltop Plaza were recognized during the construction period through December 31, 2018, as costs were incurred to construct the asset, with a corresponding liability representing the costs paid for by the lessor (the Co-Owners). At December 31, 2018, the $27.8 million of costs incurred to date were included within premises and equipment and other liabilities, respectively, in the consolidated balance sheets. The Company reassessed its accounting ownership of the Hilltop Plaza assets under construction as of January 1, 2019, under the build-to-suit provisions of the newly adopted Leasing Standard and concluded it is not the accounting owner. As such, the assets and liabilities of the project were derecognized on January 1, 2019, with the $1.4 million offset representing deferred expenses recognized on the project to date through December 31, 2018, recorded as an increase to retained earnings.

All intercompany transactions associated with the Hilltop Plaza investment and the related transactions discussed above are eliminated in consolidation.

14. Financial Instruments with Off-Balance Sheet Risk

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit that involve varying degrees of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received. The contract amounts of those instruments reflect the extent of involvement (and therefore the exposure to credit loss) the Bank has in particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require payment of fees. Because some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers.

In the aggregate, the Bank had outstanding unused commitments to extend credit of $2.3 billion at March 31, 2019 and outstanding financial and performance standby letters of credit of $95.1 million at March 31, 2019.

The Bank uses the same credit policies in making commitments and standby letters of credit as it does for on-balance sheet instruments. The amount of collateral obtained, if deemed necessary, in these transactions is based on management's credit evaluation of the borrower. Collateral held varies but may include real estate, accounts receivable, marketable securities, interest-bearing deposit accounts, inventory, and property, plant and equipment.

In the normal course of business, the Hilltop Broker-Dealers execute, settle, and finance various securities transactions that may expose the Hilltop Broker-Dealers to off-balance sheet risk in the event that a customer or counterparty does not fulfill its contractual obligations. Examples of such transactions include the sale of securities not yet purchased by customers or for the accounts of the Hilltop Broker-Dealers, use of derivatives to support certain non-profit housing organization clients and to hedge changes in the fair value of certain securities, clearing agreements between the

Hilltop Broker-Dealers and various clearinghouses and broker-dealers, secured financing arrangements that involve pledged securities, and when-issued underwriting and purchase commitments.

## 15. Stock-Based Compensation

Pursuant to the Hilltop Holdings Inc. 2012 Equity Incentive Plan (the “2012 Plan”), the Company may grant nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units (“RSUs”), performance awards, dividend equivalent rights and other awards to employees of the Company, its subsidiaries and outside directors of the Company. In the aggregate, 4,000,000 shares of common stock may be delivered pursuant to awards granted under the 2012 Plan. At March 31, 2019, 666,839 shares of common stock remained available for issuance pursuant to awards granted under the 2012 Plan, excluding shares that may be delivered pursuant to outstanding awards. Compensation expense related to the 2012 Plan was $2.5 million and $2.3 million during the three months ended March 31, 2019 and 2018, respectively.

During the three months ended March 31, 2019 and 2018, Hilltop granted 7,958 and 4,921 shares of common stock, respectively, pursuant to the 2012 Plan to certain non-employee members of the Company’s board of directors for services rendered to the Company.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Restricted Stock Units

The following table summarizes information about nonvested RSU activity for the three months ended March 31, 2019 (shares in thousands).

| | RSUs | |
|---|---|---|
| | Outstanding | Weighted Average Grant Date Fair Value |
| Balance, December 31, 2018 | 1,270 | $ 22.44 |
| Granted | 574 | $ 19.20 |
| Vested/Released | (240) | $ 16.32 |
| Forfeited | (2) | $ 24.72 |
| Balance, March 31, 2019 | 1,602 | $ 21.24 |

Vested/Released RSUs include an aggregate of 36,553 shares withheld to satisfy employee statutory tax obligations during the three months ended March 31, 2019. Pursuant to certain RSU award agreements, an aggregate of 3,322 vested RSUs at March 31, 2019 require deferral of the settlement in shares and statutory tax obligations to a future date.

During the three months ended March 31, 2019, the Compensation Committee of the board of directors of the Company awarded certain executives and key employees an aggregate of 565,861 RSUs pursuant to the 2012 Plan. Of the RSUs granted during the three months ended March 31, 2019, 474,612 that were outstanding at March 31, 2019, are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date. Of the RSUs granted during the three months ended March 31, 2019, 91,249 that were outstanding at March 31, 2019, will cliff vest based upon the achievement of certain performance goals over a three-year period.

At March 31, 2019, in the aggregate, 1,350,926 of the outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 250,177 outstanding RSUs cliff vest based upon the achievement of certain performance goals over a three-year period. At March 31, 2019, unrecognized compensation expense related to outstanding RSUs of $20.6 million is expected to be recognized over a weighted average period of 1.83 years.

16. Regulatory Matters

Banking and Hilltop

PlainsCapital, which includes the Bank and PrimeLending, and Hilltop are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory — and possibly additional discretionary — actions by regulators that, if undertaken, could have a direct, material effect on the consolidated financial statements. The regulations require PlainsCapital and Hilltop to meet specific capital adequacy guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company performs reviews of the classification and calculation of risk-weighted assets to ensure accuracy and compliance with the Basel III regulatory capital requirements as implemented by the Board of Governors of the Federal Reserve System. The capital classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Quantitative measures established by regulation to ensure capital adequacy require the companies to maintain minimum amounts and ratios (set forth in the following table) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of common equity Tier 1, Tier 1 and total capital (as defined) to risk-weighted assets (as defined).

In order to avoid limitations on capital distributions, including dividend payments, stock repurchases and certain discretionary bonus payments to executive officers, Basel III requires banking organizations to maintain a capital conservation buffer above minimum risk-based capital requirements measured relative to risk-weighted assets. The phase-in of the capital conservation buffer requirements began on January 1, 2016 for Hilltop and PlainsCapital, and the requirements were fully phased in as of January 1, 2019.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following tables show PlainsCapital's and Hilltop's actual capital amounts and ratios in accordance with Basel III compared to the regulatory minimum capital requirements including conservation buffer in effect at the end of the period and on a fully phased-in basis as if such requirements were currently in effect at December 31, 2018 (dollars in thousands). Based on actual capital amounts and ratios shown in the following table, PlainsCapital's ratios place it in the "well capitalized" (as defined) capital category under regulatory requirements.

| | | | Minimum Capital Requirements Including Conservation Buffer | | |
|---|---|---|---|---|---|
| | Actual Amount | Ratio | In Effect at End of Period Ratio | Fully Phased In Ratio | To Be Well Capitalized Ratio |
| March 31, 2019 | | | | | |
| Tier 1 capital (to average assets): | | | | | |
| PlainsCapital | $ 1,195,051 | 12.61 % | 4.0 % | 4.0 % | 5.0 % |
| Hilltop | 1,718,119 | 13.22 % | 4.0 % | 4.0 % | N/A |
| Common equity Tier 1 capital (to risk-weighted assets): | | | | | |
| PlainsCapital | 1,195,051 | 13.89 % | 7.0 % | 7.0 % | 6.5 % |
| Hilltop | 1,671,530 | 16.75 % | 7.0 % | 7.0 % | N/A |
| Tier 1 capital (to risk-weighted assets): | | | | | |
| PlainsCapital | 1,195,051 | 13.89 % | 8.5 % | 8.5 % | 8.0 % |
| Hilltop | 1,718,119 | 17.22 % | 8.5 % | 8.5 % | N/A |
| Total capital (to risk-weighted assets): | | | | | |
| PlainsCapital | 1,256,067 | 14.60 % | 10.5 % | 10.5 % | 10.0 % |
| Hilltop | 1,760,772 | 17.64 % | 10.5 % | 10.5 % | N/A |

| | | | Minimum Capital Requirements Including Conservation Buffer | | |
|---|---|---|---|---|---|
| | Actual Amount | Ratio | In Effect at End of Period Ratio | Fully Phased In Ratio | To Be Well Capitalized Ratio |
| December 31, 2018 | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Tier 1 capital (to average assets): | | | | | |
| PlainsCapital | $ 1,183,447 | 12.47 % | 4.0 % | 4.0 % | 5.0 % |
| Hilltop | 1,680,364 | 12.53 % | 4.0 % | 4.0 % | N/A |
| Common equity Tier 1 capital (to risk-weighted assets): | | | | | |
| PlainsCapital | 1,183,447 | 13.90 % | 6.375 % | 7.0 % | 6.5 % |
| Hilltop | 1,634,978 | 16.58 % | 6.375 % | 7.0 % | N/A |
| Tier 1 capital (to risk-weighted assets): | | | | | |
| PlainsCapital | 1,183,447 | 13.90 % | 7.875 % | 8.5 % | 8.0 % |
| Hilltop | 1,680,364 | 17.04 % | 7.875 % | 8.5 % | N/A |
| Total capital (to risk-weighted assets): | | | | | |
| PlainsCapital | 1,245,177 | 14.63 % | 9.875 % | 10.5 % | 10.0 % |
| Hilltop | 1,722,602 | 17.47 % | 9.875 % | 10.5 % | N/A |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Broker-Dealer

Pursuant to the net capital requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), Hilltop Securities has elected to determine its net capital requirements using the alternative method. Accordingly, Hilltop Securities is required to maintain minimum net capital, as defined in Rule 15c3-1 promulgated under the Exchange Act, equal to the greater of $250,000 and $1,000,000, respectively, or 2% of aggregate debit balances, as defined in Rule 15c3-3 promulgated under the Exchange Act. Additionally, the net capital rule of the NYSE provides that equity capital may not be withdrawn or cash dividends paid if resulting net capital would be less than 5% of the aggregate debit items. HTS Independent Network follows the primary (aggregate indebtedness) method, as defined in Rule 15c3-1 promulgated under the Exchange Act, which requires the maintenance of the larger of minimum net capital of $250,000 or 1/15 of aggregate indebtedness.

At March 31, 2019, the net capital position of each of the Hilltop Broker-Dealers was as follows (in thousands).

| | Hilltop Securities | | HTS Independent Network |
|---|---|---|---|
| Net capital | $ 221,082 | | $ 3,028 |
| Less: required net capital | 9,722 | | 250 |
| Excess net capital | $ 211,360 | | $ 2,778 |
| | | | |
| Net capital as a percentage of aggregate debit items | 45.5 | % | |
| Net capital in excess of 5% aggregate debit items | $ 196,777 | | |

Under certain conditions, Hilltop Securities may be required to segregate cash and securities in a special reserve account for the benefit of customers under Rule 15c3-3 promulgated under the Exchange Act. Assets segregated under the provisions of the Exchange Act are not available for general corporate purposes. At March 31, 2019 and December 31, 2018, the Hilltop Broker-Dealers held cash of $156.9 million and $134.0 million, respectively, segregated in special reserve bank accounts for the benefit of customers. The Hilltop Broker-Dealers were not required to segregate cash and securities in special reserve accounts for the benefit of proprietary accounts of introducing broker-dealers at March 31, 2019 or December 31, 2018.

Mortgage Origination

As a mortgage originator, PrimeLending and its subsidiaries are subject to minimum net worth and liquidity requirements established by HUD and GNMA, as applicable. On an annual basis, PrimeLending and its subsidiaries submit audited financial statements to HUD and GNMA, as applicable, documenting their respective compliance with minimum net worth and liquidity requirements. As of March 31, 2019, PrimeLending and its subsidiaries' net worth and liquidity exceeded the amounts required by both HUD and GNMA, as applicable.

Insurance

The statutory financial statements of the Company's insurance subsidiaries, which are domiciled in the State of Texas, are presented on the basis of accounting practices prescribed or permitted by the Texas Department of Insurance. Texas has adopted the statutory accounting practices of the National Association of Insurance Commissioners ("NAIC") as the basis of its statutory accounting practices with certain differences that are not significant to the insurance company subsidiaries' statutory equity.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Statutory capital and surplus: | | |
| National Lloyds Insurance Company | $ 62,106 | $ 78,637 |
| American Summit Insurance Company | 18,641 | 17,908 |

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Statutory net income: | | |
| National Lloyds Insurance Company | $ 3,417 | $ 3,767 |
| American Summit Insurance Company | 417 | 889 |

Regulations of the Texas Department of Insurance require insurance companies to maintain minimum levels of statutory surplus to ensure their ability to meet their obligations to policyholders. At March 31, 2019, the Company's insurance subsidiaries had statutory surplus in excess of the minimum required.

The NAIC has adopted a risk based capital (“RBC”) formula for insurance companies that establishes minimum capital requirements indicating various levels of available regulatory action on an annual basis relating to insurance risk, asset credit risk, interest rate risk and business risk. The RBC formula is used by the NAIC and certain state insurance regulators as an early warning tool to identify companies that require additional scrutiny or regulatory action. At March 31, 2019, the Company's insurance subsidiaries' RBC ratio exceeded the level at which regulatory action would be required.

17. Stockholders’ Equity

Dividends

During the three months ended March 31, 2019 and 2018, the Company declared and paid cash dividends of $0.08 and $0.07 per common share, or $7.5 million and $6.7 million, respectively.

On April 25, 2019, the Company announced that its board of directors declared a quarterly cash dividend of $0.08 per common share, payable on May 31, 2019, to all common stockholders of record as of the close of business on May 15, 2019.

Stock Repurchase Program

In January 2019, the Hilltop board of directors authorized a new stock repurchase program through January 2020, pursuant to which the Company is authorized to repurchase, in the aggregate, up to $50.0 million of its outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation. The Company's stock repurchase program and related accounting policy are discussed in detail in Note 1 and Note 22 to the consolidated financial statements included in the Company's 2018 Form 10-K.

18. Derivative Financial Instruments

The Company uses various derivative financial instruments to mitigate interest rate risk. The Bank's interest rate risk management strategy involves effectively managing the re-pricing characteristics of certain assets and liabilities to mitigate potential adverse impacts from changes in interest rates on the Bank's net interest margin. PrimeLending has interest rate risk relative to interest rate lock commitments ("IRLCs") and its inventory of mortgage loans held for sale. PrimeLending is exposed to such interest rate risk from the time an IRLC is made to an applicant to the time the related mortgage loan is sold. To mitigate interest rate risk, PrimeLending executes forward commitments to sell mortgage-backed securities ("MBSs") and Eurodollar futures. Additionally, PrimeLending has interest rate risk relative to its MSR asset and uses derivative instruments, including interest rate swaps and U.S. Treasury bond futures and options to hedge this risk. The Hilltop Broker-Dealers use forward commitments to both purchase and sell MBSs to facilitate customer transactions and as a means to hedge related exposure to interest rate risk in certain inventory positions. Additionally,

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Hilltop Securities uses both U.S. Treasury bond and Eurodollar futures to hedge changes in the fair value of their securities.

Non-Hedging Derivative Instruments and the Fair Value Option

As discussed in Note 4 to the consolidated financial statements, the Company has elected to measure substantially all mortgage loans held for sale at fair value under the provisions of the Fair Value Option. The election provides the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without applying complex hedge accounting provisions. The fair values of PrimeLending's IRLCs and forward commitments are recorded in other assets or other liabilities, as appropriate, and changes in the fair values of these derivative instruments are recorded as a component of net gains from sale of loans and other mortgage production income. The fair value of PrimeLending's derivative instruments increased $18.2 million and $10.0 million during the three months ended March 31, 2019 and 2018, respectively. These changes in fair value are attributable to changes in the volume of IRLCs, mortgage loans held for sale, commitments to purchase and sell MBSs and MSR assets, and changes in market interest rates. Changes in market interest rates also conversely affect the value of PrimeLending's mortgage loans held for sale and its MSR asset, which are measured at fair value under the Fair Value Option. The effect of the change in market interest rates on PrimeLending's loans held for sale and MSR asset is discussed in Note 4 to the consolidated financial statements. The fair values of the Hilltop Broker-Dealers' and the Bank's derivative instruments are recorded in other assets or other liabilities, as appropriate. The fair values of the Hilltop Broker-Dealers' derivative instruments decreased $1.8 million and $5.2 million during the three months ended March 31, 2019 and 2018, respectively, while the fair values of the Bank's derivative instruments decreased $0.1 million and increased $0.1 million during the three months ended March 31, 2019 and 2018, respectively.

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

| | March 31, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| | Notional Amount | Estimated Fair Value | Notional Amount | Estimated Fair Value |
| Derivative instruments: | | | | |
| IRLCs | $ 1,165,947 | $ 29,860 | $ 677,267 | $ 17,421 |
| Customer-based written options | 31,200 | (9) | 31,200 | (49) |
| Customer-based purchased options | 31,200 | 9 | 31,200 | 49 |
| Commitments to purchase MBSs | 2,506,084 | 11,677 | 2,359,630 | 10,467 |
| Commitments to sell MBSs | 4,040,254 | (18,108) | 3,711,477 | (19,315) |

| | | | | |
|---|---|---|---|---|
| Interest rate swaps | 7,735 | 21 | 15,104 | 82 |
| U.S. Treasury bond futures and options (1) | 373,900 | — | 367,200 | — |
| Eurodollar futures (1) | 912,000 | — | 104,000 | — |

(1) Changes in the fair value of these contracts are settled daily with the respective counterparties of PrimeLending and the Hilltop Broker-Dealers.

PrimeLending had cash collateral advances totaling $13.1 million and $11.9 million to offset net liability derivative positions on its commitments to sell MBSs at March 31, 2019 and December 31, 2018, respectively. In addition, PrimeLending and the Hilltop Broker-Dealers advanced cash collateral totaling $3.5 million and $3.4 million on U.S. Treasury bond futures and options and Eurodollar futures at March 31, 2019 and December 31, 2018, respectively. These amounts are included in other assets within the consolidated balance sheets.

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

19. Balance Sheet Offsetting

Certain financial instruments, including resale and repurchase agreements, securities lending arrangements and derivatives, may be eligible for offset in the consolidated balance sheets and/or subject to master netting arrangements or similar agreements. The following tables present the assets and liabilities subject to enforceable master netting arrangements, repurchase agreements, or similar agreements with offsetting rights (in thousands).

| | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Balance Sheet | Net Amounts of Assets Presented in the Balance Sheet | Gross Amounts Not Offset in the Balance Sheet | | Net Amount |
|---|---|---|---|---|---|---|
| | | | | Financial Instruments | Cash Collateral Pledged | |
| March 31, 2019 | | | | | | |
| Securities borrowed: | | | | | | |
| Institutional counterparties | $ 1,540,803 | $ — | $ 1,540,803 | $ (1,491,092) | $ — | $ 49,711 |
| Interest rate options: | | | | | | |
| Customer counterparties | 9 | — | 9 | — | — | 9 |
| Interest rate swaps: | | | | | | |
| Institutional counterparties | 43 | — | 43 | — | — | 43 |
| Reverse repurchase agreements: | | | | | | |
| Institutional counterparties | 65,205 | — | 65,205 | (64,818) | — | 387 |
| Forward MBS derivatives: | | | | | | |
| Institutional counterparties | 11,684 | — | 11,684 | (11,684) | — | — |
| | $ 1,617,744 | $ — | $ 1,617,744 | $ (1,567,594) | $ — | $ 50,150 |
| December 31, 2018 | | | | | | |
| Securities borrowed: | | | | | | |
| | $ 1,365,547 | $ — | $ 1,365,547 | $ (1,307,121) | $ — | $ 58,426 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Institutional counterparties | | | | | | |
| Interest rate options: Customer counterparties | 49 | — | 49 | — | — | 49 |
| Interest rate swaps: Institutional counterparties | 88 | — | 88 | — | — | 88 |
| Reverse repurchase agreements: Institutional counterparties | 61,611 | — | 61,611 | (61,390) | — | 221 |
| Forward MBS derivatives: Institutional counterparties | 10,469 | — | 10,469 | (10,469) | — | — |
| | $ 1,437,764 | $ — | $ 1,437,764 | $ (1,378,980) | $ — | $ 58,784 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

| | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Balance Sheet | Net Amounts of Liabilities Presented in the Balance Sheet | Gross Amounts Not Offset in the Balance Sheet | | |
|---|---|---|---|---|---|---|
| | | | | Financial Instruments | Cash Collateral Pledged | Net Amount |
| March 31, 2019 | | | | | | |
| Securities loaned: | | | | | | |
| Institutional counterparties | $ 1,408,636 | $ — | $ 1,408,636 | $ (1,366,198) | $ — | $ 42,438 |
| Interest rate options: | | | | | | |
| Institutional counterparties | 9 | — | 9 | — | — | 9 |
| Interest rate swaps: | | | | | | |
| Institutional counterparties | 22 | — | 22 | — | — | 22 |
| Repurchase agreements: | | | | | | |
| Institutional counterparties | 504,537 | — | 504,537 | (504,537) | — | — |
| Customer counterparties | 56,188 | — | 56,188 | (56,188) | — | — |
| Forward MBS derivatives: | | | | | | |
| Institutional counterparties | 18,615 | (501) | 18,114 | (12,275) | — | 5,839 |
| | $ 1,988,007 | $ (501) | $ 1,987,506 | $ (1,939,198) | $ — | $ 48,308 |
| December 31, 2018 | | | | | | |
| Securities loaned: | | | | | | |
| Institutional counterparties | $ 1,186,073 | $ — | $ 1,186,073 | $ (1,136,033) | $ — | $ 50,040 |
| Interest rate options: | | | | | | |
| Institutional counterparties | 49 | — | 49 | — | — | 49 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Interest rate swaps: | | | | | | |
| Institutional counterparties | 6 | — | 6 | — | — | 6 |
| Repurchase agreements: | | | | | | |
| Institutional counterparties | 533,441 | — | 533,441 | (533,441) | — | — |
| Customer counterparties | 43,266 | — | 43,266 | (43,266) | — | — |
| Forward MBS derivatives: | | | | | | |
| Institutional counterparties | 19,331 | (15) | 19,316 | (7,728) | — | 11,588 |
| | $ 1,782,166 | $ (15) | $ 1,782,151 | $ (1,720,468) | $ — | $ 61,683 |

Secured Borrowing Arrangements

Secured Borrowings (Repurchase Agreements) — The Company participates in transactions involving securities sold under repurchase agreements, which are secured borrowings and generally mature one to thirty days from the transaction date or involve arrangements with no definite termination date. Securities sold under repurchase agreements are reflected at the amount of cash received in connection with the transactions. The Company may be required to provide additional collateral based on the fair value of the underlying securities, which is monitored on a daily basis.

Securities Lending Activities — The Company's securities lending activities include lending securities for other broker-dealers, lending institutions and its own clearing and retail operations. These activities involve lending securities to other broker-dealers to cover short sales, to complete transactions in which there has been a failure to deliver securities by the required settlement date and as a conduit for financing activities.

When lending securities, the Company receives cash or similar collateral and generally pays interest (based on the amount of cash deposited) to the other party to the transaction. Securities lending transactions are executed pursuant to written agreements with counterparties that generally require securities loaned to be marked-to-market on a daily basis. The Company receives collateral in the form of cash in an amount generally in excess of the fair value of securities loaned. The Company monitors the fair value of securities loaned on a daily basis, with additional collateral obtained or refunded, as necessary. Collateral adjustments are made on a daily basis through the facilities of various clearinghouses. The Company is a principal in these securities lending transactions and is liable for losses in the event of a failure of any other party to honor its contractual obligation. Management sets credit limits with each counterparty and reviews these limits regularly to monitor the risk level with each counterparty. The Company is subject to credit risk through its securities lending activities if securities prices decline rapidly because the value of the Company's collateral could fall below the amount of the indebtedness it secures. In rapidly appreciating markets, credit risk increases due to short positions. The Company's securities lending business subjects the Company to credit risk if a counterparty fails to

44

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

perform or if collateral securing its obligations is insufficient. In securities transactions, the Company is subject to credit risk during the period between the execution of a trade and the settlement by the customer.

The following tables present the remaining contractual maturities of repurchase agreement and securities lending transactions accounted for as secured borrowings (in thousands). The Company had no repurchase-to-maturity transactions outstanding at both March 31, 2019 and December 31, 2018.

| | Remaining Contractual Maturities | | | | |
|---|---|---|---|---|---|
| March 31, 2019 | Overnight and Continuous | Up to 30 Days | 30-90 Days | Greater Than 90 Days | Total |
| Repurchase agreement transactions: | | | | | |
| U.S. Treasury and agency securities | $ 85,345 | $ — | $ — | $ — | $ 85,345 |
| Asset-backed securities | 475,380 | — | — | — | 475,380 |
| Securities lending transactions: | | | | | |
| Corporate securities | 630 | — | — | — | 630 |
| Equity securities | 1,408,006 | — | — | — | 1,408,006 |
| Total | $ 1,969,361 | $ — | $ — | $ — | $ 1,969,361 |
| Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above | | | | | $ 1,969,361 |
| Amount related to agreements not included in offsetting disclosure above | | | | | $ — |

| | Remaining Contractual Maturities | | | | |
|---|---|---|---|---|---|
| December 31, 2018 | Overnight and Continuous | Up to 30 Days | 30-90 Days | Greater Than 90 Days | Total |
| Repurchase agreement transactions: | | | | | |
| U.S. Treasury and agency securities | $ 131,848 | $ — | $ — | $ — | $ 131,848 |
| Asset-backed securities | 444,859 | — | — | — | 444,859 |
| Securities lending transactions: | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Corporate securities | 113 | — | — | — | 113 |
| Equity securities | 1,185,960 | — | — | — | 1,185,960 |
| Total | $ 1,762,780 | $ — | $ — | $ — | $ 1,762,780 |

| | |
|---|---|
| Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above | $ 1,762,780 |
| Amount related to agreements not included in offsetting disclosure above | $ — |

20. Broker-Dealer and Clearing Organization Receivables and Payables

Broker-dealer and clearing organization receivables and payables consisted of the following (in thousands).

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Receivables: | | |
| Securities borrowed | $ 1,540,803 | $ 1,365,547 |
| Securities failed to deliver | 19,855 | 16,300 |
| Trades in process of settlement | 72,850 | 32,993 |
| Other | 17,691 | 25,447 |
| | $ 1,651,199 | $ 1,440,287 |
| Payables: | | |
| Securities loaned | $ 1,408,636 | $ 1,186,073 |
| Correspondents | 36,818 | 29,311 |
| Securities failed to receive | 39,313 | 75,015 |
| Other | 5,460 | 4,526 |
| | $ 1,490,227 | $ 1,294,925 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

21. Reserve for Losses and Loss Adjustment Expenses

A summary of NLC's reserve for unpaid losses and LAE, as included in other liabilities within the consolidated balance sheets, is as follows (in thousands).

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Reserve for unpaid losses and allocated LAE balance, net | $ 17,318 | $ 16,498 |
| Reinsurance recoverables on unpaid losses | 2,506 | 3,214 |
| Unallocated LAE | 767 | 840 |
| Reserve for unpaid losses and LAE balance, gross | $ 20,591 | $ 20,552 |

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

| Accident | Three Months Ended March 31, 2019 | | March 31, 2019 Total of IBNR Reserves Plus Expected Development on Reported Claims | Cumulative Number of Reported Claims |
|---|---|---|---|---|
| Year | Paid | Incurred | | |
| 2015 | $ 86,607 | $ 86,963 | $ 169 | 20,583 |
| 2016 | 83,265 | 84,085 | 401 | 20,180 |
| 2017 | 86,553 | 87,771 | 776 | 20,737 |
| 2018 | 68,015 | 76,110 | 4,542 | 15,288 |
| 2019 | 6,570 | 13,316 | 2,257 | 3,545 |
| Total | 331,010 | $ 348,245 | | |
| | 83 | All outstanding reserves prior to 2015, net of reinsurance | | |
| | $ 17,318 | | | |

Reserve for unpaid losses and allocated
LAE, net of reinsurance

## 22. Reinsurance Activity

NLC limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risk. Substantial amounts of business are ceded, and these reinsurance contracts do not relieve NLC from its obligations to policyholders. Such reinsurance includes quota share, excess of loss, catastrophe, and other forms of reinsurance on essentially all property and casualty lines of insurance. Net insurance premiums earned, losses and LAE and policy acquisition and other underwriting expenses are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE and unearned insurance premiums ceded to them are reported as assets. Failure of reinsurers to honor their obligations could result in losses to NLC; consequently, allowances are established for amounts deemed uncollectible as NLC evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. At March 31, 2019, total reinsurance recoverables and receivables had a carrying value of $3.9 million, which is included in other assets within the consolidated balance sheets. There was no allowance for uncollectible accounts at March 31, 2019, based on NLC's quality requirements.

The effects of reinsurance on premiums written and earned are summarized as follows (in thousands).

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | Written | Earned | Written | Earned |
| Premiums from direct business | $ 30,790 | $ 31,737 | $ 33,085 | $ 33,368 |
| Reinsurance assumed | 3,129 | 3,191 | 3,042 | 3,000 |
| Reinsurance ceded | (1,725) | (1,725) | (2,010) | (2,053) |
| Net premiums | $ 32,194 | $ 33,203 | $ 34,117 | $ 34,315 |

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Losses and LAE incurred | $ 14,985 | $ 13,452 |
| Reinsurance recoverables | (59) | 2,080 |
| Net loss and LAE incurred | $ 14,926 | $ 15,532 |

Catastrophic coverage

At March 31, 2019, NLC had catastrophic excess of loss reinsurance coverage of losses per event in excess of $8 million retention by NLIC and $1.5 million retention by ASIC. ASIC maintained an underlying layer of coverage, providing $6.0 million of reinsurance coverage in excess of its $2.0 million retention to bridge to the primary program. The reinsurance for NLIC and ASIC in excess of $8 million is comprised of three layers of protection: $17 million in excess of $8 million retention and/or loss; $30 million in excess of $25 million loss; and $50 million in excess of $55 million loss. NLIC and ASIC retain no participation in any of the layers, beyond the first $8 million and $1.5 million, respectively. At March 31, 2019, total retention for any one catastrophe that affects both NLIC and ASIC was limited to $8 million in the aggregate.

Effective January 1, 2019, NLC renewed its underlying excess of loss contract that provides $10.0 million aggregate coverage in excess of NLC's per event retention of $1.0 million and aggregate retention of $15.0 million for sub-catastrophic events. As of January 1, 2019, NLC retains 37.5% participation in this coverage, up from 17.5% participation during 2018.

23. Segment and Related Information

The Company currently has four reportable business segments that are organized primarily by the core products offered to the segments' respective customers. These segments reflect the manner in which operations are managed and

the criteria used by the chief operating decision maker, the Company's President and Chief Executive Officer, to evaluate segment performance, develop strategy and allocate resources.

The banking segment includes the operations of the Bank, and since August 1, 2018, the operations acquired in the BORO Acquisition. The broker-dealer segment includes the operations of Securities Holdings, the mortgage origination segment is composed of PrimeLending and the insurance segment is composed of NLC.

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, merchant banking investment opportunities and management and administrative services to support the overall operations of the Company.

Balance sheet amounts not discussed previously and the elimination of intercompany transactions are included in "All Other and Eliminations." The following tables present certain information about reportable business segment revenues, operating results, goodwill and assets (in thousands).

| Three Months Ended March 31, 2019 | Banking | Broker-Dealer | Mortgage Origination | Insurance | Corporate | All Other and Eliminations | Hilltop Consolidated |
|---|---|---|---|---|---|---|---|
| Net interest income (expense) | $ 92,690 | $ 12,850 | $ (467) | $ 642 | $ (1,330) | $ 4,546 | $ 108,931 |
| Provision (recovery) for loan losses | 1,025 | (74) | — | — | — | — | 951 |
| Noninterest income | 10,621 | 91,307 | 118,033 | 36,492 | 538 | (4,523) | 252,468 |
| Noninterest expense | 60,726 | 87,807 | 114,677 | 30,338 | 15,562 | (25) | 309,085 |
| Income (loss) before income taxes | $ 41,560 | $ 16,424 | $ 2,889 | $ 6,796 | $ (16,354) | $ 48 | $ 51,363 |

| Three Months | Banking | Broker-Dealer | Mortgage Origination | Insurance | Corporate | All Other and Eliminations | Hilltop Consolidated |
|---|---|---|---|---|---|---|---|

| Ended March 31, 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Net interest income (expense) | $ 86,638 | $ 12,550 | $ 941 | $ 787 | $ (2,091) | $ 4,595 | $ 103,420 |
| Provision for loan losses | (1,531) | (276) | — | — | — | — | (1,807) |
| Noninterest income | 10,180 | 68,547 | 127,102 | 35,018 | (712) | (4,992) | 235,143 |
| Noninterest expense | 59,370 | 77,776 | 130,704 | 31,013 | 9,403 | (64) | 308,202 |
| Income (loss) before income taxes | $ 38,979 | $ 3,597 | $ (2,661) | $ 4,792 | $ (12,206) | $ (333) | $ 32,168 |

47

Table of Contents

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

| | Banking | Broker-Dealer | Mortgage Origination | Insurance | Corporate | All Other and Eliminations | Hilltop Consolidat |
|---|---|---|---|---|---|---|---|
| March 31, 2019 | | | | | | | |
| Goodwill | $ 247,368 | $ 7,008 | $ 13,071 | $ 23,988 | $ — | $ — | $ 291,435 |
| Total assets | $ 9,748,950 | $ 3,333,574 | $ 1,348,924 | $ 252,857 | $ 2,275,342 | $ (3,410,277) | $ 13,549,3 |
| December 31, 2018 | | | | | | | |
| Goodwill | $ 247,368 | $ 7,008 | $ 13,071 | $ 23,988 | $ — | $ — | $ 291,435 |
| Total assets | $ 10,004,971 | $ 3,213,115 | $ 1,627,134 | $ 253,513 | $ 2,243,182 | $ (3,658,343) | $ 13,683,5 |

## 24. Earnings per Common Share

Net earnings, less any preferred dividends accumulated for the period (whether or not declared), is allocated between the common stock and participating securities pursuant to the two-class method, if applicable. Basic earnings per common share is computed by dividing net earnings available to common stockholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares. The Company calculated basic earnings per common share using the treasury method instead of the two-class method since there were no instruments which qualified as participating securities during the three months ended March 31, 2019 or 2018.

Diluted earnings per common share is computed in a similar manner, except that first the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares, excluding the participating securities, were issued using the treasury stock method. During the three months ended March 31, 2019 and 2018, RSUs were the only potentially dilutive non-participating instruments issued by Hilltop. Next, the Company determines and includes in the diluted earnings per common share calculation the more dilutive effect of the participating securities using the treasury stock method or the two-class method. Undistributed losses are not allocated to the nonvested share-based payment awards (the participating securities) under the two-class method as the holders are not contractually obligated to share in the losses of the Company.

The following table presents the computation of basic and diluted earnings per common share (in thousands, except per share data).

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Basic earnings per share: | | |
| Net earnings available to Hilltop common stockholders | $ 38,786 | $ 24,441 |
| Weighted average shares outstanding - basic | 93,669 | 95,985 |
| Basic earnings per common share | $ 0.41 | $ 0.25 |
| Diluted earnings per share: | | |
| Income attributable to Hilltop | $ 38,786 | $ 24,441 |
| Weighted average shares outstanding - basic | 93,669 | 95,985 |
| Effect of potentially dilutive securities | — | 161 |
| Weighted average shares outstanding - diluted | 93,669 | 96,146 |
| Diluted earnings per common share | $ 0.41 | $ 0.25 |

Table of Contents

SCHEDULE I – Insurance Incurred and Cumulative Paid Losses and Allocated Loss Adjustment Expenses,

Net of Reinsurance

(dollars in thousands)

| | Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance | | | | | March 31, 2019 | |
|---|---|---|---|---|---|---|---|
| Accident Year | March 31, 2019 2015 | 2016 | 2017 | 2018 | 2019 | Total of Incurred But Not Reported Reserves Plus Development On Reported Claims | Cumulative Number of Reported Claims |
| 2015 | $ 89,646 | $ 88,477 | $ 87,262 | $ 86,961 | $ 86,963 | $ 169 | 20,583 |
| 2016 | | 84,771 | 85,189 | 84,076 | 84,085 | 401 | 20,180 |
| 2017 | | | 87,899 | 88,025 | 87,771 | 776 | 20,737 |
| 2018 | | | | 75,217 | 76,110 | 4,542 | 15,288 |
| 2019 | | | | | 13,316 | 2,257 | 3,545 |
| | | | | | $ 348,245 | | |

| | Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance | | | | |
|---|---|---|---|---|---|
| Accident Year | March 31, 2019 2015 | 2016 | 2017 | 2018 | 2019 |
| 2015 | $ 71,820 | $ 82,940 | $ 85,507 | $ 86,549 | $ 86,607 |
| 2016 | | 71,543 | 81,682 | 83,169 | 83,265 |
| 2017 | | | 77,675 | 86,319 | 86,553 |
| 2018 | | | | 61,922 | 68,015 |
| 2019 | | | | | 6,570 |
| Total | | | | | $ 331,010 |
| All outstanding reserves prior to 2015, net of reinsurance | | | | | 83 |
| Reserve for unpaid losses and allocated loss adjustment expenses, net of reinsurance | | | | | $ 17,318 |

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the consolidated historical financial statements and notes appearing elsewhere in this Quarterly Report on Form 10-Q (this "Quarterly Report") and the financial information set forth in the tables herein.

Unless the context otherwise indicates, all references in this Management's Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, to the "Company," "we," "us," "our" or "ours" or similar words are to Hilltop Holdings Inc. and its direct and indirect wholly owned subsidiaries, references to "Hilltop" refer solely to Hilltop Holdings Inc., references to "PCC" refer to PlainsCapital Corporation (a wholly owned subsidiary of Hilltop), references to "Securities Holdings" refer to Hilltop Securities Holdings LLC (a wholly owned subsidiary of Hilltop), references to "Hilltop Securities" refer to Hilltop Securities Inc. (a wholly owned subsidiary of Securities Holdings), references to "HTS Independent Network" refer to Hilltop Securities Independent Network Inc. (a wholly owned subsidiary of Securities Holdings), Hilltop Securities and HTS Independent Network are collectively referred to as the "Hilltop Broker-Dealers", references to the "Bank" refer to PlainsCapital Bank (a wholly owned subsidiary of PCC), references to "FNB" refer to First National Bank, references to "SWS" refer to the former SWS Group, Inc., references to "PrimeLending" refer to PrimeLending, a PlainsCapital Company (a wholly owned subsidiary of the Bank) and its subsidiaries as a whole, references to "NLC" refer to National Lloyds Corporation (a wholly owned subsidiary of Hilltop) and its subsidiaries as a whole, references to "NLIC" refer to National Lloyds Insurance Company (a wholly owned subsidiary of NLC) and references to "ASIC" refer to American Summit Insurance Company (a wholly owned subsidiary of NLC).

FORWARD-LOOKING STATEMENTS

This Quarterly Report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included in this Quarterly Report that address results or developments that we expect or anticipate will or may occur in the future, and statements that are preceded by, followed by or include, words such as "anticipates," "believes," "could," "estimates," "expects," "forecasts," "goal," "intends," "may," "might," "plan," "probable," "projects," "seeks," "shoul "would" or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our financial condition, our efforts to make, and the timing of, strategic acquisitions, the costs of integration of the operations of acquired businesses, our revenue, our liquidity and sources of funding, market trends, operations and business, taxes, information technology expenses, capital levels, mortgage servicing rights ("MSR") assets, stock repurchases, dividend payments, expectations concerning mortgage loan origination volume and interest rate compression, expected levels of refinancing as a percentage of total loan origination volume, projected losses on mortgage loans originated, loss estimates related to natural disasters, total expenses and cost savings expected from PrimeLending's cost reduction efforts, the effects of government regulation applicable to our operations, the appropriateness of, and changes in, our allowance for loan losses and provision for loan losses, anticipated investment yields, our expectations regarding accretion of discount on loans in future periods, the collectability of loans, cybersecurity incidents and the outcome of litigation are forward-looking statements.

These forward-looking statements are based on our beliefs, assumptions and expectations of our future performance taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If an event occurs, our business, business plan, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Certain factors that could cause actual results to differ include, among others:

the credit risks of lending activities, including our ability to estimate loan losses as well as the effects of changes in the level of, and trends in, loan delinquencies and write-offs;

changes in the interest rate environment;

changes in general economic, market and business conditions in areas or markets where we compete, including changes in the price of crude oil;

· risks associated with concentration in real estate related loans;

50

Table of Contents

effectiveness of our data security controls in the face of cyber attacks;

severe catastrophic events in Texas and other areas of the southern United States;

- the effects of our indebtedness on our ability to manage our business successfully, including the restrictions imposed by the indenture governing our indebtedness;
- cost and availability of capital;

changes in state and federal laws, regulations or policies affecting one or more of our business segments, including changes in regulatory fees, deposit insurance premiums, capital requirements and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act");

changes in key management;

competition in our banking, broker-dealer, mortgage origination and insurance segments from other banks and financial institutions as well as investment banking and financial advisory firms, mortgage bankers, asset-based non-bank lenders, government agencies and insurance companies;

legal and regulatory proceedings;

failure of our insurance segment reinsurers to pay obligations under reinsurance contracts;

risks associated with merger and acquisition integration; and

our ability to use excess capital in an effective manner.

For a more detailed discussion of these and other factors that may affect our business and that could cause the actual results to differ materially from those anticipated in these forward-looking statements, see "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2018 ("2018 Form 10-K"), which was filed with the Securities and Exchange Commission (the "SEC") on February 15, 2019, this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," Part II, Item 1A, "Risk Factors" herein and other filings we have made with the SEC. We caution that the foregoing list of factors is not exhaustive, and new factors may emerge, or changes to the foregoing factors may occur, that could impact our business. All subsequent written and oral forward-looking statements concerning our business attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements above. We do not undertake any obligation to update any forward-looking statement, whether written or oral, relating to the matters discussed in this Quarterly Report except to the extent required by federal securities laws.

## OVERVIEW

We are a financial holding company registered under the Bank Holding Company Act of 1956. Our primary line of business is to provide business and consumer banking services from offices located throughout Texas through the Bank. We also provide an array of financial products and services through our broker-dealer, mortgage origination and insurance segments. The following includes additional details regarding the financial products and services provided

by each of our primary business units.

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

Securities Holdings. Securities Holdings is a holding company that provides, through its subsidiaries, investment banking and other related financial services, including municipal advisory, sales, trading and underwriting of taxable and tax-exempt fixed income securities, equity trading, clearing, securities lending, structured finance and retail brokerage services throughout the United States.

NLC. NLC is a property and casualty insurance holding company that provides, through its subsidiaries, fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the southern United States.

Table of Contents

During the three months ended March 31, 2019, our net income to common stockholders was $38.8 million, or $0.41 per diluted share. We declared total common dividends of $0.08 per share during the three months ended March 31, 2019, which resulted in a dividend payout ratio of 19.32%. Dividend payout ratio is defined as cash dividends declared per common share divided by basic earnings per common share.

We reported $51.4 million of consolidated income before income taxes during the three months ended March 31, 2019, including the following contributions from our four reportable business segments.

- The banking segment contributed $41.6 million of income before income taxes during the three months ended March 31, 2019;
- The broker-dealer segment contributed $16.4 million of income before income taxes during the three months ended March 31, 2019;
- The mortgage origination segment contributed $2.9 million of income before income taxes during the three months ended March 31, 2019; and
- The insurance segment contributed $6.8 million of income before income taxes during the three months ended March 31, 2019.

At March 31, 2019, on a consolidated basis, we had total assets of $13.5 billion, total deposits of $8.3 billion, total loans, including loans held for sale, of $8.0 billion and stockholders' equity of $2.0 billion.

Factors Affecting Results of Operations

Changes in Management

On February 21, 2019, we entered into a Separation and Release Agreement (the "Separation Agreement") with Alan B. White, our Vice Chairman and Co-Chief Executive Officer, in connection with his retirement effective April 1, 2019 (the "Retirement Date"). Pursuant to the Separation Agreement, effective as of the Retirement Date, Mr. White resigned from all positions with Hilltop and its subsidiaries, including, without limitation, Vice Chairman of our Board of Directors and Co-Chief Executive Officer of Hilltop. The Separation Agreement also provides that Mr. White's retention agreement by and between the Company and Mr. White, as amended, terminated on the Retirement Date, except for certain provisions that addressed, among other items, non-competition, non-solicitation, confidential information and arbitration. Effective April 1, 2019, Jeremy B. Ford became Hilltop's sole Chief Executive Officer, Chairman of the Executive Committee of the Board of Directors of Hilltop and the Chairman of the Bank. The Separation Agreement, in accordance with Mr. White's retention agreement, provided for aggregate payments of $12.4 million to Mr. White, subject to any delay required under Section 409A of the Internal Revenue Code. During the first quarter of 2019, our financial results included the recognition within corporate of a pre-tax charge within employees' compensation and benefits of $5.8 million associated with Mr. White's retirement, but we expect his retirement to reduce our employees' compensation and benefits expense in future periods.

On February 19, 2019, we entered into a retention agreement with Hill A. Feinberg (the “Feinberg Retention Agreement") to set forth the terms of his ongoing role with the Company. As disclosed in our current report on Form 8-K filed on December 12, 2018, we appointed M. Bradley Winges to succeed Mr. Feinberg as President and Chief Executive Officer of Hilltop Securities effective February 20, 2019. The Feinberg Retention Agreement provides that, as of February 20, 2019, Mr. Feinberg resigned as President and Chief Executive Officer of Hilltop Securities and from all other positions with Hilltop and its subsidiaries, other than as Chairman of the Board of Directors of Hilltop Securities, as a member of the Board of Directors of Hilltop and a member of Executive Committee of the Board of Directors of Hilltop. Pursuant to the Feinberg Retention Agreement, Mr. Feinberg will continue to serve as the Chairman of the Board of Directors of Hilltop Securities until June 30, 2019, at which time he will become Chairman Emeritus of Hilltop Securities and resign from his membership on the Executive Committee of the Board of Directors of Hilltop. The Feinberg Retention Agreement provides for aggregate payments of $1.4 million to Mr. Feinberg upon his termination, resignation or death, of which $0.9 million was paid during the first quarter of 2019. Mr. Feinberg may resign or be terminated at any time. In connection with the appointment of Mr. Winges, Hilltop and Mr. Winges entered into an employment agreement providing for a sign-on cash bonus of $1.5 million, among other benefits, on the effective date of his employment. During the first quarter of 2019, the broker-dealer segment’s financial results reflect aggregate pre-tax charges within employees’ compensation and benefits noninterest expenses of $2.2 million related to these items.

Table of Contents

During the three months ended March 31, 2019, the total impact of the above noted changes in management was $8.0 million before income taxes. These changes and the related impact on our results of operations are collectively referred to as the “Leadership Changes.”

Technology Enhancements and Corporate Initiatives

In furtherance of our goal of building a premier, diversified financial services company, we regularly evaluate strategic opportunities to invest in our business and technology platforms. Such investments are intended to support long-term technological competitiveness and improved operational efficiencies throughout our organization. During 2018, we began the significant investment in new technological solutions, substantial core system upgrades and other technology enhancements, and we are working on preliminary plans for additional investments in such solutions, upgrades and enhancements. Such significant investments specifically include single, enterprise-wide general ledger and procurement solutions, a mortgage loan origination system and a core system replacement within our broker-dealer segment (collectively referred to as “Core System Improvements”). In combination with these technology enhancements, we have begun the consolidation of common back office functions. We believe that costs incurred related to these Core System Improvements will continue to represent an increasingly significant portion of our noninterest expenses in the near term, but we are making such investments with the expectation that they will result in cost savings over the long term. Costs related to our Core System Improvements, disaggregated by segment between internal-use software costs that were capitalized as premises and equipment and costs that were recorded to noninterest expense, were as follows (in thousands).

| Three Months Ended March 31, 2019 | Banking | Broker-Dealer | Mortgage Origination | Insurance | Corporate | Hilltop Consolidated |
|---|---|---|---|---|---|---|
| Premises and equipment | $ — | $ 1,151 | $ 2,001 | $ — | $ 218 | $ 3,370 |
| Noninterest expense | — | 1,043 | 1,022 | — | 402 | 2,467 |
| Total | $ — | $ 2,194 | $ 3,023 | $ — | $ 620 | $ 5,837 |

| Three Months Ended March 31, 2018 | Banking | Broker-Dealer | Mortgage Origination | Insurance | Corporate | Hilltop Consolidated |
|---|---|---|---|---|---|---|
| Premises and equipment | $ — | $ 129 | $ — | $ — | $ — | $ 129 |
| Noninterest expense | — | 1,215 | 549 | — | 344 | 2,108 |
| Total | $ — | $ 1,344 | $ 549 | $ — | $ 344 | $ 2,237 |

Factors Affecting Comparability of Results of Operations

Prior Year Acquisition

On August 1, 2018, we acquired privately-held, Houston-based The Bank of River Oaks ("BORO") in an all-cash transaction (the "BORO Acquisition"). Pursuant to the terms of the definitive agreement, we paid cash in the aggregate amount of $85 million to the shareholders and option holders of BORO. The fair value of the assets acquired was $434.8 million, including $326.6 million in loans, while the fair value of liabilities assumed was $389.4 million, consisting primarily of $376.4 million in deposits. The operations of BORO were included in our operating results beginning August 1, 2018. The estimated fair value of the core deposit intangible asset acquired as of August 1, 2018 was $10.0 million and resulting goodwill was $39.6 million. In connection with the acquisition, we merged BORO into the Bank, and all customer accounts were converted to the PlainsCapital Bank platform.

Termination of FDIC Loss-Share Agreements

In the fourth quarter of 2018, the Bank terminated its loss-share agreements with the FDIC which were entered into in connection with the FNB Transaction, resulting in a $6.26 million payment from the FDIC to the Bank. Prior to the termination, the Bank recorded "true-up" accruals with respect to the FNB Transaction loss-share agreements with the FDIC of $0.1 million during the three months ended March 31, 2018. The true-up accrual was based on a formula within the loss-share agreements, pursuant to which we agreed to reimburse the FDIC if actual losses incurred and billed to the FDIC through loss sharing were below a stated threshold. During the three months ended March 31, 2018, the Bank also recorded $3.9 million of amortization of excess book value of its receivables under the loss-share agreements (the "FDIC Indemnification Asset") due to lower projected collections from the FDIC than were initially estimated at the acquisition date.

Table of Contents

## Segment Information

We have three primary business units, PCC (banking and mortgage origination), Securities Holdings (broker-dealer) and NLC (insurance). Under accounting principles generally accepted in the United States ("GAAP"), our business units are comprised of four reportable business segments organized primarily by the core products offered to the segments' respective customers: banking, broker-dealer, mortgage origination and insurance. Consistent with our historical segment operating results, we anticipate that future revenues will be driven primarily from the banking segment, with the remainder being generated by our broker-dealer, mortgage origination and insurance segments. Operating results for the mortgage origination segment have historically been more volatile than operating results for the banking, broker-dealer and insurance segments.

The banking segment includes the operations of the Bank, and since August 1, 2018, the operations acquired in the BORO Acquisition. The banking segment primarily provides business and consumer banking services from offices located throughout Texas and generates revenue from its portfolio of earning assets. The Bank's results of operations are primarily dependent on net interest income. The Bank also derives revenue from other sources, including service charges on customer deposit accounts and trust fees.

The broker-dealer segment includes the operations of Securities Holdings, which operates through its wholly owned subsidiaries Hilltop Securities and HTS Independent Network. The broker-dealer segment generates a majority of its revenues from fees and commissions earned from investment advisory and securities brokerage services. Hilltop Securities is a broker-dealer registered with the SEC and the Financial Industry Regulatory Authority ("FINRA") and a member of the New York Stock Exchange ("NYSE"), HTS Independent Network is an introducing broker-dealer that is also registered with the SEC and FINRA. Hilltop Securities, HTS Independent Network and Hilltop Securities Asset Management, LLC, a wholly-owned subsidiary of First Southwest Holdings, LLC, are registered investment advisers under the Investment Advisers Act of 1940.

The mortgage origination segment includes the operations of PrimeLending, which offers a variety of loan products and generates revenue predominantly from fees charged on the origination and servicing of loans and from selling these loans in the secondary market.

The insurance segment includes the operations of NLC, which operates through its wholly owned subsidiaries, NLIC and ASIC, in Texas and other areas of the southern United States. Insurance segment income is primarily generated from revenue earned on net insurance premiums less loss and loss adjustment expenses ("LAE") and policy acquisition and other underwriting expenses.

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, merchant banking investment opportunities, and management and administrative services to support the overall operations of the Company.

Table of Contents

The eliminations of intercompany transactions are included in "All Other and Eliminations." Additional information concerning our reportable segments is presented in Note 23, Segment and Related Information, in the notes to our consolidated financial statements. The following table presents certain information about the operating results of our reportable segments (in thousands). This table serves as a basis for the discussion and analysis in the segment operating results sections that follow.

| | Three Months Ended March 31, | | Variance 2019 vs 2018 | | |
|---|---|---|---|---|---|
| | 2019 | 2018 | Amount | Percent | |
| Net interest income (expense): | | | | | |
| Banking | $ 92,690 | $ 86,638 | $ 6,052 | 7 | % |
| Broker-Dealer | 12,850 | 12,550 | 300 | 2 | % |
| Mortgage Origination | (467) | 941 | (1,408) | (150) | % |
| Insurance | 642 | 787 | (145) | (18) | % |
| Corporate | (1,330) | (2,091) | 761 | 36 | % |
| All Other and Eliminations | 4,546 | 4,595 | (49) | (1) | % |
| Hilltop Consolidated | $ 108,931 | $ 103,420 | $ 5,511 | 5 | % |
| | | | | | |
| Provision (recovery) for loan losses: | | | | | |
| Banking | $ 1,025 | $ (1,531) | $ 2,556 | 167 | % |
| Broker-Dealer | (74) | (276) | 202 | 73 | % |
| Mortgage Origination | — | — | — | — | % |
| Insurance | — | — | — | — | % |
| Corporate | — | — | — | — | % |
| All Other and Eliminations | — | — | — | — | % |
| Hilltop Consolidated | $ 951 | $ (1,807) | $ 2,758 | 153 | % |
| | | | | | |
| Noninterest income: | | | | | |
| Banking | $ 10,621 | $ 10,180 | $ 441 | 4 | % |
| Broker-Dealer | 91,307 | 68,547 | 22,760 | 33 | % |
| Mortgage Origination | 118,033 | 127,102 | (9,069) | (7) | % |
| Insurance | 36,492 | 35,018 | 1,474 | 4 | % |
| Corporate | 538 | (712) | 1,250 | 176 | % |
| All Other and Eliminations | (4,523) | (4,992) | 469 | 9 | % |
| Hilltop Consolidated | $ 252,468 | $ 235,143 | $ 17,325 | 7 | % |
| | | | | | |
| Noninterest expense: | | | | | |
| Banking | $ 60,726 | $ 59,370 | $ 1,356 | 2 | % |
| Broker-Dealer | 87,807 | 77,776 | 10,031 | 13 | % |
| Mortgage Origination | 114,677 | 130,704 | (16,027) | (12) | % |
| Insurance | 30,338 | 31,013 | (675) | (2) | % |
| Corporate | 15,562 | 9,403 | 6,159 | 66 | % |
| All Other and Eliminations | (25) | (64) | 39 | 61 | % |
| Hilltop Consolidated | $ 309,085 | $ 308,202 | $ 883 | 0 | % |
| | | | | | |
| Income (loss) before income taxes: | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Banking | $ 41,560 | $ 38,979 | $ 2,581 | 7 | % |
| Broker-Dealer | 16,424 | 3,597 | 12,827 | 357 | % |
| Mortgage Origination | 2,889 | (2,661) | 5,550 | 209 | % |
| Insurance | 6,796 | 4,792 | 2,004 | 42 | % |
| Corporate | (16,354) | (12,206) | (4,148) | (34) | % |
| All Other and Eliminations | 48 | (333) | 381 | 114 | % |
| Hilltop Consolidated | $ 51,363 | $ 32,168 | $ 19,195 | 60 | % |

How We Generate Revenue

We generate revenue from net interest income and from noninterest income. Net interest income represents the difference between the income earned on our assets, including our loans and investment securities, and our cost of funds, including the interest paid on the deposits and borrowings that are used to support our assets. Net interest income is a significant contributor to our operating results and is primarily earned by our banking segment. Fluctuations in interest rates, as well as the amounts and types of interest-earning assets and interest-bearing liabilities we hold, affect net interest income. Net interest income increased during the three months ended March 31, 2019, compared with the three months ended March 31, 2018, primarily due to an increase within our banking segment and, to a lesser extent within our broker-dealer segment and corporate, partially offset by a decrease within our mortgage origination segment.

The other component of our revenue is noninterest income, which is primarily comprised of the following:

(i) Income from broker-dealer operations. Through Securities Holdings, we provide investment banking and other related financial services. We generated $56.1 million and $57.1 million in securities commissions and fees and investment and securities advisory fees and commissions, and $31.6 million and $7.0 million in gains from derivative and trading portfolio activities (included within other noninterest income), during the three months ended March 31, 2019 and 2018, respectively.

(ii) Income from mortgage operations. Through PrimeLending, we generate noninterest income by originating and selling mortgage loans. During the three months ended March 31, 2019 and 2018, we generated $118.0 million and $126.4 million, respectively, in net gains from the sale of loans, other mortgage production income (including income associated with retained mortgage servicing rights), and mortgage loan origination fees.

(iii) Income from insurance operations. Through NLC, we provide fire and limited homeowners insurance for low value dwellings and manufactured homes. We generated $33.2 million and $34.3 million in net insurance premiums earned during the three months ended March 31, 2019 and 2018, respectively.

The increase in noninterest income noted in the table above was primarily due to increases of $24.6 million in gains from derivative and trading portfolio activities and $1.8 million in investment and securities advisory fees and commissions, partially offset by decreases of $9.6 million in net gains from sale of loans and other mortgage production income and $2.7 million in securities commissions and fees.

We also incur noninterest expenses in the operation of our businesses. Our businesses engage in labor intensive activities and, consequently, employees’ compensation and benefits represent the majority of our noninterest expenses.

Consolidated Operating Results

Net income applicable to common stockholders during the three months ended March 31, 2019 was $38.8 million, or $0.41 per diluted share, compared with net income applicable to common stockholders of $24.4 million, or $0.25 per diluted share, during the three months ended March 31, 2018. The first quarter of 2019 included costs associated with significant Leadership Changes and other efficiency initiative-related charges which, in the aggregate, totaled $8.7 million before income taxes.

Certain items included in net income for the three months ended March 31, 2019 and 2018 resulted from purchase accounting associated with the merger of PlainsCapital Corporation with and into a wholly owned subsidiary of Hilltop on November 30, 2012 (the "PlainsCapital Merger"), the Federal Deposit Insurance Corporation ("FDIC") -assisted transaction (the "FNB Transaction") whereby the Bank acquired certain assets and assumed certain liabilities of FNB, the acquisition of SWS Group, Inc. in a stock and cash transaction (the "SWS Merger") and the BORO Acquisition (collectively, the "Bank Transactions"). Income before taxes during the three months ended March 31, 2019 and 2018, included the following purchase accounting items related to the Bank Transactions (in thousands).

| Three Months Ended March 31, 2019 | PlainsCapital Merger | FNB Transaction | SWS Merger | BORO Acquisition | Total |
|---|---|---|---|---|---|
| Net accretion on earning assets and liabilities | $ 544 | $ 5,533 | $ 561 | $ 1,977 | $ 8,615 |
| Amortization of identifiable intangibles | (1,001) | (76) | (174) | (714) | (1,965) |

| Three Months Ended March 31, 2018 | PlainsCapital Merger | FNB Transaction | SWS Merger | BORO Acquisition | Total |
|---|---|---|---|---|---|
| Net accretion on earning assets and liabilities | $ 574 | $ 8,377 | $ 708 | $ — | $ 9,659 |
| Amortization of identifiable intangibles | (1,448) | (114) | (195) | — | (1,757) |

Table of Contents

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Return on average stockholder's equity | 8.04 % | 5.19 % |
| Return on average assets | 1.21 % | 0.77 % |
| Net interest margin (1) (3) (4) | 3.69 % | 3.52 % |
| Net interest margin (taxable equivalent) (2) (3) (4) | 3.70 % | 3.53 % |

(1) Net interest margin is defined as net interest income divided by average interest-earning assets.
(2) Net interest margin (taxable equivalent), a non-GAAP measure, is defined as taxable equivalent net interest income divided by average interest-earning assets. Annualized taxable equivalent adjustments are based on the applicable corporate federal income tax rate of 21%. The interest income earned on certain earnings assets is completely or partially exempt from federal income tax. See footnote 2 to the following tables for the taxable equivalent adjustments to interest income.
(3) The securities financing operations within our broker-dealer segment had the effect of lowering both the net interest margin and taxable equivalent net interest margin by 43 basis points and 42 basis points during the three months ended March 31, 2019 and 2018, respectively.
(4) During the three months ended March 31, 2019 and 2018, purchase accounting contributed 32 basis points and 36 basis points, respectively, to both net interest margin and taxable equivalent net interest margin.

We present net interest margin in the previous table, and net interest margin and net interest income below, on a taxable equivalent basis. The interest income earned on certain earning assets is completely or partially exempt from federal income tax. As such, these tax-exempt instruments typically yield lower returns than taxable investments. To provide more meaningful comparisons of net interest margins for all earning assets, we use net interest income on a taxable- equivalent basis in calculating net interest margin by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments.

During the three months ended March 31, 2019 and 2018, purchase accounting contributed 32 and 36 basis points, respectively, to our consolidated taxable equivalent net interest margin of 3.70% and 3.53%, respectively, and primarily related to the following purchase accounting items associated with the Bank Transactions (in thousands).

| Three Months Ended March 31, 2019 | PlainsCapital Merger | FNB Transaction | SWS Merger | BORO Acquisition | Total |
|---|---|---|---|---|---|
| Accretion of discount on loans | $ 753 | $ 5,533 | $ 536 | $ 1,913 | $ 8,735 |
| Accretion (amortization) of discount (premium) on acquired securities | (209) | — | 7 | 64 | (138) |

| Three Months Ended March 31, 2018 | PlainsCapital Merger | FNB Transaction | SWS Merger | BORO Acquisition | Total |
|---|---|---|---|---|---|
| Accretion of discount on loans | $ 938 | $ 8,377 | $ 552 | $ — | $ 9,867 |
| Amortization of premium on acquired securities | (410) | — | — | — | (410) |

Table of Contents

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

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | | 2018 | | |
| | Average Outstanding Balance | Interest Earned or Paid | Annualized Yield or Rate | Average Outstanding Balance | Interest Earned or Paid | Annualized Yield or Rate |
| Assets | | | | | | |
| Interest-earning assets | | | | | | |
| Loans held for sale | $ 1,015,010 | $ 12,487 | 4.92 % | $ 1,294,245 | $ 14,613 | 4.52 % |
| Loans held for investment, gross (1) | 6,843,343 | 98,383 | 5.76 % | 6,308,756 | 85,331 | 5.42 % |
| Investment securities - taxable | 1,792,501 | 15,584 | 3.48 % | 1,613,608 | 10,928 | 2.71 % |
| Investment securities - non-taxable (2) | 221,602 | 1,658 | 2.99 % | 258,732 | 2,030 | 3.14 % |
| Federal funds sold and securities purchased under agreements to resell | 66,346 | 388 | 2.37 % | 189,623 | 481 | 1.03 % |
| Interest-bearing deposits in other financial institutions | 505,582 | 3,151 | 2.53 % | 632,727 | 2,478 | 1.59 % |
| Securities borrowed | 1,446,412 | 16,859 | 4.66 % | 1,537,306 | 16,300 | 4.24 % |
| Other | 61,263 | 1,671 | 11.01 % | 70,854 | 1,452 | 8.27 % |
| Interest-earning assets, gross (2) | 11,952,059 | 150,181 | 5.03 % | 11,905,851 | 133,613 | 4.50 % |
| Allowance for loan losses | (59,549) | | | (65,202) | | |
| Interest-earning assets, net | 11,892,510 | | | 11,840,649 | | |
| Noninterest-earning assets | 1,419,075 | | | 1,228,058 | | |
| Total assets | $ 13,311,585 | | | $ 13,068,707 | | |
| | | | | | | |
| Liabilities and Stockholders' Equity | | | | | | |
| Interest-bearing liabilities | | | | | | |
| | $ 5,825,886 | $ 17,106 | 1.19 % | $ 5,494,657 | $ 8,675 | 0.64 % |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Interest-bearing deposits | | | | | | | | |
| Securities loaned | 1,295,002 | 14,738 | 4.62 | % | 1,365,081 | 13,739 | 4.08 | % |
| Notes payable and other borrowings | 1,065,432 | 9,265 | 3.51 | % | 1,195,993 | 7,526 | 2.54 | % |
| Total interest-bearing liabilities | 8,186,320 | 41,109 | 2.03 | % | 8,055,731 | 29,940 | 1.50 | % |
| Noninterest-bearing liabilities | | | | | | | | |
| Noninterest-bearing deposits | 2,520,057 | | | | 2,419,725 | | | |
| Other liabilities | 623,710 | | | | 680,543 | | | |
| Total liabilities | 11,330,087 | | | | 11,155,999 | | | |
| Stockholders’ equity | 1,958,531 | | | | 1,911,160 | | | |
| Noncontrolling interest | 22,967 | | | | 1,548 | | | |
| Total liabilities and stockholders' equity | $ 13,311,585 | | | | $ 13,068,707 | | | |
| Net interest income (2) | | $ 109,072 | | | | $ 103,673 | | |
| Net interest spread (2) | | | 3.00 | % | | | 2.99 | % |
| Net interest margin (2) | | | 3.70 | % | | | 3.53 | % |

(2) Average balance includes non-accrual loans.

(3) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on the applicable corporate federal income tax rate of 21% for the periods presented. The adjustment to interest income was $0.2 million and $0.3 million for the three months ended March 31, 2019 and 2018, respectively.

The banking segment’s net interest margin exceeds our consolidated net interest margin shown above. Our consolidated net interest margin includes certain items that are not reflected in the calculation of our net interest margin within our banking segment and reduce our consolidated net interest margin, such as the borrowing costs of Hilltop and the yields and costs associated with certain items within interest-earning assets and interest-bearing liabilities in the broker-dealer segment, including items related to securities financing operations that particularly decrease net interest margin. In addition, yields and costs on certain interest-earning assets, such as warehouse lines of credit extended to subsidiaries by the banking segment, are eliminated from the consolidated financial statements.

On a consolidated basis, net interest income increased during the three months ended March 31, 2019, compared with the same period in 2018, primarily due to changes attributable to both volumes and yields within our banking segment, partially offset by a decrease in accretion of discount on loans. Refer to the discussion in the “Banking Segment” section below for more details on the changes in net interest income, including the component changes in the volume of average interest-earning assets and interest-bearing liabilities and changes in the rates earned or paid on

those items.

Table of Contents

The provision (recovery) for loan losses is determined by management as the amount to be added to (recovered from) the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. Substantially all of our consolidated provision (recovery) for loan losses is related to the banking segment. During the three months ended March 31, 2019, the provision for loan losses was impacted by the banking segment's release of a $2.0 reserve associated with previously estimated hurricane loss exposures due to improved customer performance. The provision for loan losses was comprised of the following (in thousands).

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Charges (recovery of charges) relating to newly originated loans and acquired loans without credit impairment at acquisition | $ 491 | $ (1,493) |
| Charges (recovery of charges) on PCI loans | 460 | (314) |
| Provision (recovery) for loan losses | $ 951 | $ (1,807) |

Consolidated noninterest income increased during the three months ended March 31, 2019, compared with the same period in 2018, primarily due to increases in noninterest income within our broker-dealer and insurance segments, partially offset by a decrease within our mortgage origination segment.

Consolidated noninterest expense increased during the three months ended March 31, 2019, compared with the same period in 2018, primarily due to increases within our broker-dealer and banking segments as well as corporate, partially offset by decreases within our mortgage origination and insurance segments.

Consolidated effective income tax rates during the three months ended March 31, 2019 and 2018, were 22.6% and 23.3%, respectively, and approximated the applicable statutory rate for such periods.

Segment Results

Banking Segment

The following table presents certain information about the operating results of our banking segment (in thousands).

| | Three Months Ended March 31, | | Variance |
|---|---|---|---|
| | 2019 | 2018 | 2019 vs 2018 |
| Net interest income | $ 92,690 | $ 86,638 | $ 6,052 |
| Provision (recovery) for loan losses | 1,025 | (1,531) | 2,556 |
| Noninterest income | 10,621 | 10,180 | 441 |
| Noninterest expense | 60,726 | 59,370 | 1,356 |
| Income before income taxes | $ 41,560 | $ 38,979 | $ 2,581 |

Income before income taxes increased during the three months ended March 31, 2019, compared with the same period in 2018, primarily due to an increase in net interest income associated with net volume and yield changes partially offset by an increase in deposit rates and a decline in accretion. Changes to net interest income related to the component changes in the volume of average interest-earning assets and interest-bearing liabilities and changes in the rates earned or paid on those items are discussed in more detail below.

During the second quarter of 2018, we were the victim of a "spear phishing" attack which resulted in a wire fraud loss of approximately $4.0 million and approximately $0.3 million of other related expenses. We have not recorded an accrual for future claims related to this matter as we have not concluded that such a loss is probable. We continue to seek recovery of the wire fraud loss arising from this incident through insurance providers and other means. We cannot currently estimate the amount of any future legal or insurance recoveries related to this loss.

Table of Contents

The ratios shown in the table below include certain key indicators of the performance and asset quality of our banking segment.

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| Efficiency ratio (1) | 58.78 | % | 61.32 | % |
| Return on average assets | 1.34 | % | 1.31 | % |
| Net interest margin (2) (4) | 4.24 | % | 4.15 | % |
| Net interest margin (taxable equivalent) (3) (4) | 4.25 | % | 4.16 | % |
| Net recoveries (charge-offs) to average loans outstanding | (0.10) | % | 0.09 | % |

(1) Efficiency ratio is defined as noninterest expenses divided by the sum of total noninterest income and net interest income for the period.
(2) Net interest margin is defined as net interest income divided by average interest-earning assets.
(3) Net interest margin (taxable equivalent), a non-GAAP measure, is defined as taxable equivalent net interest income divided by average interest-earning assets. Annualized taxable equivalent adjustments are based on the applicable corporate federal income tax rate of 21% for the periods presented. The interest income earned on certain earning assets is completely or partially exempt from federal income tax. See footnote 2 to the following tables for the taxable equivalent adjustments to interest income.
(4) During the three months ended March 31, 2019 and 2018, purchase accounting contributed 44 basis points and 51 basis points, respectively, to net interest margin and taxable equivalent net interest margin.

The banking segment presents net interest margin in the table above, and net interest margin and net interest income in the following discussion and tables below, on a taxable equivalent basis. The interest income earned on certain earning assets is completely or partially exempt from federal income tax. As such, these tax-exempt instruments typically yield lower returns than taxable investments. To provide more meaningful comparisons of net interest margins for all earning assets, we use net interest income on a taxable equivalent basis in calculating net interest margin by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments.

During the three months ended March 31, 2019 and 2018, purchase accounting contributed 44 and 51 basis points, respectively, to the banking segment's taxable equivalent net interest margin of 4.25% and 4.16%, respectively, and primarily related to the purchase accounting items associated with the Bank Transactions as detailed in the tables presented in the Consolidated Operating Results above.

The table below provides additional details regarding our banking segment's net interest income (dollars in thousands).

| Three Months Ended March 31, | |
|---|---|
| 2019 | 2018 |

| | Average Outstanding Balance | Interest Earned or Paid | Annualized Yield or Rate | | Average Outstanding Balance | Interest Earned or Paid | Annualized Yield or Rate | |
|---|---|---|---|---|---|---|---|---|
| Assets | | | | | | | | |
| Interest-earning assets | | | | | | | | |
| Loans held for investment, gross (1) | $ 6,359,924 | $ 91,310 | 5.75 | % | $ 5,794,528 | $ 79,191 | 5.47 | % |
| Subsidiary warehouse lines of credit | 936,457 | 11,085 | 4.73 | % | 1,212,755 | 11,699 | 3.86 | % |
| Investment securities - taxable | 1,113,797 | 7,092 | 2.55 | % | 904,625 | 4,826 | 2.13 | % |
| Investment securities - non-taxable (2) | 97,592 | 828 | 3.40 | % | 117,561 | 980 | 3.33 | % |
| Federal funds sold and securities purchased under agreements to resell | 416 | — | 0.13 | % | 495 | — | 0.38 | % |
| Interest-bearing deposits in other financial institutions | 316,319 | 1,914 | 2.45 | % | 382,353 | 1,474 | 1.56 | % |
| Other | 41,084 | 544 | 5.30 | % | 46,436 | 506 | 4.36 | % |
| Interest-earning assets, gross (2) | 8,865,589 | 112,773 | 5.09 | % | 8,458,753 | 98,676 | 4.67 | % |
| Allowance for loan losses | (59,410) | | | | (64,843) | | | |
| Interest-earning assets, net | 8,806,179 | | | | 8,393,910 | | | |
| Noninterest-earning assets | 945,409 | | | | 890,284 | | | |
| Total assets | $ 9,751,588 | | | | $ 9,284,194 | | | |
| | | | | | | | | |
| Liabilities and Stockholders' Equity | | | | | | | | |
| Interest-bearing liabilities | | | | | | | | |
| Interest-bearing deposits | $ 5,525,366 | $ 18,994 | 1.39 | % | $ 5,149,294 | $ 11,176 | 0.88 | % |
| Notes payable and other borrowings | 179,878 | 933 | 2.08 | % | 281,906 | 661 | 0.94 | % |
| Total interest-bearing liabilities | 5,705,244 | 19,927 | 1.42 | % | 5,431,200 | 11,837 | 0.88 | % |
| Noninterest-bearing liabilities | 2,487,922 | | | | 2,412,326 | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Noninterest-bearing deposits | | | | | | | |
| Other liabilities | 92,303 | | | 49,919 | | | |
| Total liabilities | 8,285,469 | | | 7,893,445 | | | |
| Stockholders’ equity | 1,466,119 | | | 1,390,749 | | | |
| Total liabilities and stockholders’ equity | $ 9,751,588 | | | $ 9,284,194 | | | |
| Net interest income (2) | | $ 92,846 | | | $ 86,839 | | |
| Net interest spread (2) | | | 3.68 % | | | 3.79 % | |
| Net interest margin (2) | | | 4.25 % | | | 4.16 % | |

Table of Contents

(1) Average balance includes non-accrual loans.
(2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on the applicable corporate federal income tax rate of 21% for the periods presented. The adjustment to interest income was $0.2 million for both the three months ended March 31, 2019 and 2018.

The banking segment's net interest margin exceeds our consolidated net interest margin. Our consolidated net interest margin includes certain items that are not reflected in the calculation of our net interest margin within our banking segment and reduce our consolidated net interest margin, such as the borrowing costs of Hilltop and the yields and costs associated with certain items within interest-earning assets and interest-bearing liabilities in the broker-dealer segment, including items related to securities financing operations that particularly decrease net interest margin. In addition, the banking segment's interest-earning assets include warehouse lines of credit extended to other subsidiaries, which are eliminated from the consolidated financial statements.

The following table summarizes the changes in the banking segment's net interest income for the periods indicated below, including the component changes in the volume of average interest-earning assets and interest-bearing liabilities and changes in the rates earned or paid on those items (in thousands).

| | Three Months Ended March 31, 2019 vs. 2018 | | |
|---|---|---|---|
| | Change Due To (1) | | |
| | Volume | Yield/Rate | Change |
| Interest income | | | |
| Loans held for investment, gross | $ 7,628 | $ 4,491 | $ 12,119 |
| Subsidiary warehouse lines of credit | (2,629) | 2,015 | (614) |
| Investment securities - taxable | 1,101 | 1,165 | 2,266 |
| Investment securities - non-taxable (2) | (164) | 12 | (152) |
| Federal funds sold and securities purchased under agreements to resell | — | — | — |
| Interest-bearing deposits in other financial institutions | (255) | 695 | 440 |
| Other | (57) | 95 | 38 |
| Total interest income (2) | 5,624 | 8,473 | 14,097 |
| | | | |
| Interest expense | | | |
| Deposits | $ 816 | $ 7,002 | $ 7,818 |
| Notes payable and other borrowings | (237) | 509 | 272 |
| Total interest expense | 579 | 7,511 | 8,090 |
| | | | |
| Net interest income (2) | $ 5,045 | $ 962 | $ 6,007 |

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

Changes in the yields earned on interest-earning assets increased taxable equivalent net interest income during the three months ended March 31, 2019, compared to the same period in 2018, primarily as a result of higher loan yields due to increased market rates, partially offset by a decrease in accretion of discount on loans of $1.1 million. Accretion of discount on loans is expected to continue to decrease in future periods as loans acquired in the Bank Transactions are repaid, refinanced or renewed. Changes in the volume of interest-earning assets, primarily due to an increase in the loan portfolio, increased taxable equivalent net interest income during the three months ended March 31, 2019, compared with the same period in 2018. Changes in rates paid on interest-bearing liabilities decreased taxable equivalent net interest income during the three months ended March 31, 2019, compared with the same period in 2018, due to increases in market interest rates. Short-term interest rates have risen faster than medium and longer term rates, which has reduced the favorable impact of our asset-sensitive position on net interest income. Our portfolio includes loans that periodically reprice or mature prior to the end of an amortized term. Some of our variable-rate loans remain at applicable rate floors, which may delay and/or limit changes in interest income in a period of changing rates. If interest rates were to fall, the impact on our interest income would be limited by these rate floors. If interest rates were to rise, yields on the portion of our portfolio that remain at applicable rate floor would rise more slowly than increases in market interest rates. Any changes in interest rates across the term structure will continue to impact net interest income and net interest margin. The impact of rate movements will change with the shape of the yield curve, including any changes in steepness or flatness and inversions at any points on the yield curve.

Table of Contents

The banking segment's noninterest income increased during the three months ended March 31, 2019, compared to the same period in 2018, primarily due to year-over-year increases in service charge income due to the restructuring of our products.

The banking segment's noninterest expenses increased during the three months ended March 31, 2019, compared to the same period in 2018, primarily due to increased expenses associated with the acquired BORO locations, offset by a reduction in net expenses associated with previously covered assets, including the FDIC Indemnification Asset discussed in the "Factors Affecting Comparability of Results of Operations" section above.

Broker-Dealer Segment

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

| | Three Months Ended March 31, | | Variance |
| --- | --- | --- | --- |
| | 2019 | 2018 | 2019 vs 2018 |
| Net interest income: | | | |
| Securities lending | $ 2,121 | $ 2,561 | $ (440) |
| Structured finance | 2,153 | 1,907 | 246 |
| Clearing | 2,651 | 3,061 | (410) |
| Other | 5,925 | 5,021 | 904 |
| Total net interest income | 12,850 | 12,550 | 300 |
| Noninterest income: | | | |
| Securities commissions and fees by business line (1): | | | |
| Capital markets | 11,208 | 10,138 | 1,070 |
| Retail | 18,051 | 20,944 | (2,893) |
| Clearing | 8,785 | 9,005 | (220) |
| Other | 774 | 1,393 | (619) |
| | 38,818 | 41,480 | (2,662) |
| Investment and securities advisory fees and commissions by business line: | | | |
| Public banking | 12,673 | 12,056 | 617 |
| Capital markets | 1,928 | 949 | 979 |
| Retail | 4,543 | 4,362 | 181 |
| Structured finance | 721 | 655 | 66 |
| Clearing | 275 | 292 | (17) |
| Other | 20 | 40 | (20) |
| | 20,160 | 18,354 | 1,806 |
| Other: | | | |
| Structured finance | 23,728 | 4,564 | 19,164 |

| | | | |
|---|---|---|---|
| Capital markets | 7,910 | 2,461 | 5,449 |
| Other | 691 | 1,688 | (997) |
| | 32,329 | 8,713 | 23,616 |
| Total noninterest income | 91,307 | 68,547 | 22,760 |
| Net revenue (2) | 104,157 | 81,097 | 23,060 |
| Noninterest expense (3): | | | |
| Employees' compensation and benefits | 63,075 | 52,265 | 10,810 |
| Other | 24,658 | 25,235 | (577) |
| Total noninterest expense | 87,733 | 77,500 | 10,233 |
| Income before income taxes | $ 16,424 | $ 3,597 | $ 12,827 |

(1) Securities commissions and fees includes income of $2.9 million and $2.8 million during the three months ended March 31, 2019 and 2018, respectively, that is eliminated in consolidation.
(2) Net revenue is defined as the sum of total net interest income and total noninterest income
(3) Noninterest expense includes provision for loan losses associated with the broker-dealer segment within other noninterest expenses.

Income before income taxes increased during the three months ended March 31, 2019, compared with the same period in 2018, primarily as a result of a 28% increase in net revenues, most notably in trading gains earned from our derivative and trading portfolio activities, primarily from our structured finance and capital markets businesses. The increase in trading gains during the three months ended March 31, 2019, compared to the same period in 2018, was primarily due to a more favorable market environment resulting in a 26% increase in trading volumes, enhanced spreads and an 8% increase in the structured finance business line’s to-be-announced (“TBA”) mortgage-backed securities volume. This increase was offset by a $10.8 million increase in compensation and benefits expense, primarily due to an increase in variable compensation based on more robust financial results, as well as the $2.2 million in pre-tax costs associated with Leadership Changes as noted in the “Factors Affecting Results of Operations” section above.

The broker-dealer segment is subject to interest rate risk as a consequence of maintaining inventory positions, trading in interest rate sensitive financial instruments and maintaining a matched stock loan book. Changes in interest rates are likely to have a meaningful impact on our overall financial performance. Our broker-dealer segment has historically earned a significant portion of its revenues from advisory fees upon the successful completion of the client’s transaction. Rapid or significant changes in interest rates could adversely affect the broker-dealer segment’s bond trading, sales,

Table of Contents

underwriting activities and other interest spread-sensitive activities described below. The broker-dealer segment also receives administrative fees for providing money market and FDIC investment alternatives to clients, which tend to be sensitive to short term interest rates. In addition, the profitability of the broker-dealer segment depends, to an extent, on the spread between revenues earned on customer loans and excess customer cash balances, and the interest expense paid on customer cash balances, as well as the interest revenue earned on trading securities, net of financing costs.

In the broker-dealer segment, interest is earned from securities lending activities, interest charged on customer margin loan balances and interest earned on investment securities used to support sales, underwriting and other customer activities. Net interest income increased between the three months ended March 31, 2019, and the comparable period in 2018 primarily due to an increase in net interest earned on trading securities, partially offset by a decrease in net interest income from the segment's stock lending activities due to an 11% decrease in both the average stock lending balance and the net interest spread. The segment also experienced a decrease in net interest income from our clearing operations due to a 35% decrease in receivables from correspondents.

Noninterest income increased between the three months ended March 31, 2019, and the comparable period in 2018, primarily due to increases in other noninterest income and investment and securities advisory fees and commissions, partially offset by decreases in and securities commissions and fees.

Securities commissions and fees decreased during the three months ended March 31, 2019, compared with the same period in 2018, primarily due to decreases in commissions earned by our retail brokers on municipal bond, mutual fund and insurance transactions.

Investment and securities advisory fees and commissions increased during the three months ended March 31, 2019, compared with the same period in 2018, primarily due to an increase in the aggregate dollar amount of municipal bond transactions. We expect a modest improvement in national municipal issuance volume in 2019, compared to that of 2018.

Other noninterest income increased during the three months ended March 31, 2019, compared with the same period in 2018, primarily as a result of a $24.6 million increase in trading gains earned from our derivative and trading portfolio activities, most notably in our structured finance business, which accounted for $19.2 million of the increase, while our capital markets business accounted for $4.9 million of the increase. The $19.2 million increase in our structured finance business was primarily due to the 24 basis-point decline in the 10-year treasury bond yield during the first quarter of 2019 compared to a 34 basis-point increase during the same period in 2018, and an 8% increase in the TBA mortgage-backed securities volume. The $4.9 million increase in our capital markets business is attributable to an improved market environment and improved spreads leading to a 26% increase in trading volume.

Noninterest expenses increased during the three months ended March 31, 2019, compared to the same period in 2018, primarily due to an increase in the variable compensation and benefits expense components that are based on performance. The $2.2 million in pre-tax costs associated with Leadership Changes as noted in the “Factors Affecting Results of Operations” section above also contributed to the increase in compensation and benefits expenses.



---

Table of Contents

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Compensation as a % of net revenue | 60.6 % | 64.4 % |
| FDIC insured program balances at the Bank (end of period) | $ 1,301,989 | $ 1,301,820 |
| Other FDIC insured program balances (end of period) | $ 746,925 | $ 1,011,032 |
| Customer margin balances (end of period) | $ 331,786 | $ 324,241 |
| Customer funds on deposit, including short credits (end of period) | $ 331,375 | $ 402,587 |
| | | |
| Public banking: | | |
| Number of issues | 215 | 236 |
| Aggregate amount of offerings | $ 11,927,733 | $ 10,649,121 |
| | | |
| Capital markets: | | |
| Total volumes | $ 20,031,917 | $ 15,871,265 |
| Net inventory (end of period) | $ 631,412 | $ 494,264 |
| | | |
| Retail: | | |
| Retail employee representatives (end of period) | 124 | 122 |
| Independent registered representatives (end of period) | 211 | 218 |
| | | |
| Structured finance: | | |
| Lock production/TBA volume | $ 1,148,214 | $ 1,061,512 |
| | | |
| Clearing: | | |
| Total tickets | 505,221 | 406,131 |
| Correspondents (end of period) | 148 | 156 |
| | | |
| Securities lending: | | |
| Interest-earning assets - stock borrowed (end of period) | $ 1,540,803 | $ 1,614,291 |
| Interest-bearing liabilities - stock loaned (end of period) | $ 1,408,636 | $ 1,431,009 |

Mortgage Origination Segment

The following table presents certain information regarding the operating results of our mortgage origination segment (in thousands).

| | Three Months Ended March 31, | | Variance |
|---|---|---|---|
| | 2019 | 2018 | 2019 vs 2018 |
| Net interest income (expense) | $ (467) | $ 941 | $ (1,408) |
| Noninterest income | 118,033 | 127,102 | (9,069) |
| Noninterest expense | 114,677 | 130,704 | (16,027) |
| Income (loss) before income taxes | $ 2,889 | $ (2,661) | $ 5,550 |

The mortgage lending business is subject to variables that can impact loan origination volume, including seasonal and interest rate fluctuations. Historically, the mortgage origination segment has typically experienced increased loan origination volume from purchases of homes during the spring and summer, when more people tend to move and buy or sell homes. An increase in mortgage interest rates tends to result in decreased loan origination volume from refinancings, while a decrease in mortgage interest rates tends to result in increased loan origination volume from refinancings. As average mortgage interest rates have increased slightly between the three months ended March 31, 2018 and the comparable period in 2019, refinancing volume as a percentage of total origination volume has decreased from 20.3% to 16.2% during the same periods. Changes in mortgage interest rates have historically had a lesser impact on home purchases volume than on refinancing volume. While mortgage interest rates have decreased since December 2018, we do not anticipate that current mortgage interest rates will significantly impact the percentage mix of refinancing and purchase volumes relative to total loan origination volume for the remainder of 2019.

The mortgage origination segment primarily originates its mortgage loans through a retail channel, with limited lending through its affiliated business arrangements (“ABAs”). For the three months ended March 31, 2019, funded volume through ABAs was approximately 7% of the mortgage origination segment’s total loan volume. Currently, PrimeLending owns a 51% membership interest in four ABAs. We expect production within the ABA channel to increase to approximately 10% of the total loan volume of the mortgage origination segment during 2019.

Table of Contents

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

| | Three Months Ended March 31, | | | | |
|---|---|---|---|---|---|
| | 2019 | | 2018 | | |
| | Amount | % of Total | Amount | % of Total | Variance 2019 vs 2018 |
| Mortgage Loan Originations - units | 10,278 | | 12,311 | | (2,033) |
| Mortgage Loan Originations - volume | $ 2,447,042 | | $ 2,959,797 | | $ (512,755) |
| Mortgage Loan Originations: | | | | | |
| Conventional | $ 1,490,935 | 60.93 % | $ 1,759,233 | 59.44 % | $ (268,298) |
| Government | 598,181 | 24.45 % | 756,078 | 25.54 % | (157,897) |
| Jumbo | 195,140 | 7.97 % | 275,609 | 9.31 % | (80,469) |
| Other | 162,786 | 6.65 % | 168,877 | 5.71 % | (6,091) |
| | $ 2,447,042 | 100.00 % | $ 2,959,797 | 100.00 % | $ (512,755) |
| Home purchases | $ 2,050,760 | 83.81 % | $ 2,358,692 | 79.69 % | $ (307,932) |
| Refinancings | 396,282 | 16.19 % | 601,105 | 20.31 % | (204,823) |
| | $ 2,447,042 | 100.00 % | $ 2,959,797 | 100.00 % | $ (512,755) |
| Texas | $ 468,883 | 19.16 % | $ 564,624 | 19.08 % | $ (95,741) |
| California | 237,734 | 9.72 % | 386,238 | 13.05 % | (148,504) |
| Florida | 197,087 | 8.05 % | 217,308 | 7.34 % | (20,221) |
| Arizona | 112,706 | 4.61 % | 116,791 | 3.95 % | (4,085) |
| Ohio | 103,536 | 4.23 % | 127,209 | 4.30 % | (23,673) |
| New York | 98,710 | 4.03 % | 72,899 | 2.46 % | 25,811 |
| Maryland | 86,754 | 3.55 % | 89,198 | 3.01 % | (2,444) |
| Washington | 82,140 | 3.36 % | 95,624 | 3.23 % | (13,484) |
| South Carolina | 76,893 | 3.14 % | 106,640 | 3.60 % | (29,747) |
| North Carolina | 74,813 | 3.06 % | 90,588 | 3.06 % | (15,775) |
| All other states | 907,786 | 37.09 % | 1,092,678 | 36.92 % | (184,892) |
| | $ 2,447,042 | 100.00 % | $ 2,959,797 | 100.00 % | $ (512,755) |
| Mortgage Loan Sales - volume | $ 2,711,114 | | $ 3,185,438 | | $ (474,324) |

The mortgage origination segment’s total loan origination volume during the three months ended March 31, 2019 decreased 17.3% compared to the same period in 2018, while income before income taxes during the three months ended March 31, 2019 increased 208.6% compared to the same period in 2018. The increase in income before taxes during the three months ended March 31, 2019, compared to the same period in 2018, was primarily due to decreases in segment operating costs and variable compensation and an increase in the change in net fair value and related derivative activity of interest rate lock commitments (“IRLCs”) and loans held for sale. These changes were partially

offset by a decrease in net gains from sale of loans.

Net interest income (expense) decreased $1.4 million during the three months ended March 31, 2019, compared to the same period in 2018. Net interest income (expense) during the comparative periods was primarily comprised of interest incurred on a warehouse line of credit held with the Bank as well as related intercompany financing costs, partially offset by interest earned on loans held for sale. Year-over-year increases in average mortgage interest rates contributed to increased yield on loans held for sale in the mortgage origination segment; however, an increase in average borrowing costs offset the benefit of the increase in average mortgage interest rates.

Noninterest income was comprised of the items set forth in the table below (in thousands).

| | Three Months Ended March 31, | | Variance |
|---|---|---|---|
| | 2019 | 2018 | 2019 vs 2018 |
| Net gains from sale of loans | $ 89,351 | $ 106,105 | $ (16,754) |
| Mortgage loan origination fees and other related income | 21,873 | 20,926 | 947 |
| Other mortgage production income: | | | |
| Change in net fair value and related derivative activity: | | | |
| IRLCs and loans held for sale | 3,203 | (4,539) | 7,742 |
| Mortgage servicing rights asset | (2,666) | (1,142) | (1,524) |
| Servicing fees | 6,272 | 5,752 | 520 |
| Total noninterest income | $ 118,033 | $ 127,102 | $ (9,069) |

The decrease in net gains from sale of loans during the three months ended March 31, 2019, compared with the same period in 2018, was primarily a result of a decrease in total loan sales volume in addition to a slight decrease in average

Table of Contents

loan sales margin during the three months ended March 31, 2019, compared with the same period in 2018. The increase in mortgage loan origination fees was primarily the result of an increase in average mortgage loan origination fees, partially offset by a decrease in total loan origination volume, during three months ended March 31, 2019, compared with the same period in 2018.

Noninterest income included the impact of changes between periods in the net fair value of the mortgage origination segment's IRLCs and loans held for sale and the related activity associated with forward commitments used by the mortgage origination segment to mitigate interest rate risk associated with its IRLCs and mortgage loans held for sale. The increase during the three months ended March 31, 2019, was primarily the result of an increase in the volume of IRLCs and mortgage loans, partially offset by a decrease in the average value of individual IRLCs and mortgage loans.

The mortgage origination segment sells substantially all mortgage loans it originates to various investors in the secondary market, the majority servicing released. During the three months ended March 31, 2019, the mortgage origination segment retained servicing on approximately 5% of loans sold, compared to 18% during the same period in 2018. The mortgage origination segment's determination of whether to retain or release servicing on mortgage loans it sells is impacted by, among other things, changes in mortgage interest rates, and refinancing and market activity. The related MSR asset was valued at $63.8 million on $5.3 billion of serviced loan volume at March 31, 2019, compared with a value of $67.9 million on $5.3 billion of serviced loan volume at December 31, 2018. The mortgage origination segment may, from time to time, manage its MSR asset through different strategies, including varying the percentage of mortgage loans sold servicing released and opportunistically selling MSR assets. The mortgage origination segment has also retained servicing on certain loans sold to the banking segment. Gains and losses associated with such sales to the banking segment and the related MSR asset are eliminated in consolidation. The mortgage origination segment uses derivative financial instruments, including U.S. Treasury bond futures and options, Eurodollar futures and forward commitments to sell mortgage-backed securities, as a means to mitigate interest rate risk associated with its MSR asset. Changes in the net fair value of the MSR asset and the related derivatives associated with normal customer payments, changes in discount rates, prepayment speed assumptions and customer payoffs resulted in net losses of $2.7 million during the three months ended March 31, 2019, compared to net losses of $1.1 million during the three months ended March 31, 2018. Additionally, net servicing income was $3.1 million during the three months ended March 31, 2019, compared with $2.5 million during the same period in 2018.

Noninterest expenses were comprised of the items set forth in the table below (in thousands).

| | Three Months Ended March 31, | | Variance 2019 vs |
|---|---|---|---|
| | 2019 | 2018 | 2018 |
| Variable compensation | $ 38,929 | $ 46,292 | $ (7,363) |
| Segment operating costs | 69,041 | 76,678 | (7,637) |
| Lender paid closing costs | 3,498 | 4,480 | (982) |

| | | | |
|---|---|---|---|
| Servicing expense | 3,209 | 3,254 | (45) |
| Total noninterest expense | $ 114,677 | $ 130,704 | $ (16,027) |

During the third quarter of 2018, PrimeLending committed to close certain underperforming branches, while at the same time reducing its fulfillment and corporate support staff. The purpose of this initiative was to better align resources and lower PrimeLending's cost structure. Costs under this initiative are expected to total up to $1.3 million, of which $0.9 million has been incurred to date. The decrease in segment operating costs during the three months ended March 31, 2019, compared to the three months ended March 31, 2018, was primarily the result of this initiative. We expect to realize additional cost savings as a result of this initiative of approximately $1.0 million per month for the remainder of 2019 compared to average monthly segment operating costs during the first three quarters of 2018. These savings have been partially offset by costs related to the "Technology Enhancements and Corporate Initiatives" discussed in detail within the "Overview" above.

Employees' compensation and benefits accounted for the majority of noninterest expenses incurred during all periods presented. Variable compensation comprised 49.3% and 50.8% of total employees' compensation and benefits expenses during the three months ended March 31, 2019 and 2018, respectively. Variable compensation, which is primarily driven by loan origination volume, tends to fluctuate to a greater degree than loan origination volume because mortgage loan originator and fulfillment staff incentive compensation plans are structured to pay at increasing rates as higher monthly volume tiers are achieved. However, certain other incentive compensation plans driven by non-mortgage production criteria may alter this trend. In addition to decreases in loan origination volume each year, a decrease in the average incentive rate paid and the impact of incentive plans driven by non-mortgage production criteria contributed to the decreases in variable compensation between the three months ended 2019 and 2018.

Table of Contents

While total loan origination volume decreased 17.3% for the three months ended March 31, 2019, compared to the same period in 2018, the mortgage origination segment's operating costs decreased 10.0%. The decrease in segment operating costs during the three months ended March 31, 2019, compared to the same period in 2018, was primarily due to a decrease in non-variable compensation and related benefits, in addition to decreases in professional services, and occupancy costs, partially offset by an increase in software license and maintenance fees. The decrease in non-variable compensation and benefits and occupancy costs during the three months ended March 31, 2019, was due to a reduction in fulfillment and corporate staff and the closure of certain underperforming branches primarily resulting from PrimeLending's cost reduction initiative implemented during the third quarter of 2018.

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

Between January 1, 2010 and March 31, 2019, the mortgage origination segment sold mortgage loans totaling $110.3 billion. These loans were sold under sales contracts that generally include provisions that hold the mortgage origination segment responsible for errors or omissions relating to its representations and warranties that loans sold meet certain requirements, including representations as to underwriting standards and the validity of certain borrower representations in connection with the loan. In addition, the sales contracts typically require the refund of purchased servicing rights plus certain investor servicing costs if a loan experiences an early payment default. While the mortgage origination segment sold loans prior to 2010, it does not anticipate experiencing significant losses in the future on loans originated prior to 2010 as a result of investor claims under these provisions of its sales contracts.

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

Following is a summary of the mortgage origination segment's claims resolution activity relating to loans sold between January 1, 2010 and March 31, 2019 (dollars in thousands).

| | Original Loan Balance | | Loss Recognized | |
|---|---|---|---|---|
| | | % of Loans | | % of Loans |

| | Amount | Sold | Amount | Sold |
|---|---|---|---|---|
| Claims resolved with no payment | $ 198,172 | 0.18% | $ — | 0.00% |
| Claims resolved because of a loan repurchase or payment to an investor for losses incurred (1) | 194,108 | 0.00% | 9,068 | 0.01% |
| | $ 392,280 | 0.18% | $ 9,068 | 0.01% |

(1) Losses incurred include refunded purchased servicing rights.

The mortgage origination segment has established a specific claims indemnification liability reserve for each loan it concludes its obligation to a claimant is both probable and reasonably estimable. An additional indemnification liability reserve has been established for probable agency, investor or other party losses that may have been incurred, but not yet reported to the mortgage origination segment based upon a reasonable estimate of such losses.

At both March 31, 2019 and December 31, 2018, the mortgage origination segment's indemnification liability reserve totaled $10.7 million. The related provision for indemnification losses was $0.5 million and $0.7 million during the three months ended March 31, 2019 and 2018, respectively.

Table of Contents

Insurance Segment

The following table presents certain information regarding the operating results of our insurance segment (in thousands).

| | Three Months Ended March 31, | | Variance 2019 vs |
|---|---|---|---|
| | 2019 | 2018 | 2018 |
| Net interest income | $ 642 | $ 787 | $ (145) |
| Noninterest income | 36,492 | 35,018 | 1,474 |
| Noninterest expense | 30,338 | 31,013 | (675) |
| Income before income taxes | $ 6,796 | $ 4,792 | $ 2,004 |

The increase in income before income taxes during the three months ended March 31, 2019, compared with the same period in 2018, was primarily due to a decrease in loss and LAE resulting from fewer weather-related events and an increase in the fair value of the equity securities held by the insurance segment, partially offset by a decline in net insurance premiums earned.

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

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

The insurance segment's operations resulted in combined ratios of 86.5% and 85.2% during the three months ended March 31, 2019 and 2018, respectively. The increase in the combined ratio during the three months ended March 31, 2019, compared with the same period in 2018, was primarily driven by an increase in the underwriting expense ratio due to a decrease in net insurance premiums earned, partially offset by a slight decrease in the loss and LAE ratio. The combined ratio is a measure of overall insurance underwriting profitability, and represents the sum of loss and LAE and underwriting expenses divided by net insurance premiums earned.

Noninterest income during the three months ended March 31, 2019 and 2018, respectively, was primarily comprised of net insurance premiums earned of $33.2 million and $34.3 million, respectively. The year-over-year decrease in net insurance premiums earned was driven by the effect of historical decreases in net premiums written.

Table of Contents

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

| | Three Months Ended March 31, | | Variance |
|---|---|---|---|
| | 2019 | 2018 | 2019 vs 2018 |
| Direct Insurance Premiums Written: | | | |
| Homeowners | $ 11,974 | $ 12,473 | $ (499) |
| Fire | 9,767 | 10,204 | (437) |
| Mobile Home | 9,049 | 9,731 | (682) |
| Commercial | — | 653 | (653) |
| Other | — | 24 | (24) |
| | $ 30,790 | $ 33,085 | $ (2,295) |

The total direct insurance premiums written for our three largest insurance product lines decreased by $1.6 million during the three months ended March 31, 2019, compared with the same period in 2018. These continued decreases were due to increased competition, rationalization of product offerings, including the non-renewal of commercial policies, and continued review of geographic concentrations. In the fourth quarter of 2018, in connection with a strategic initiative to focus on our insurance segment's key markets, we discontinued writing new insurance policies in five non-core states. Approximately 2% and 3% of total net insurance premiums earned during the three months ended March 31, 2019 and 2018, respectively, were from these five non-core states. As our insurance policies are generally in effect for one year, we anticipate that the full impact of this initiative on premiums earned will be complete by the end of 2019.

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

| | Three Months Ended March 31, | | Variance |
|---|---|---|---|
| | 2019 | 2018 | 2019 vs 2018 |
| Net Insurance Premiums Earned: | | | |
| Homeowners | $ 12,912 | $ 12,935 | $ (23) |
| Fire | 10,532 | 10,584 | (52) |
| Mobile Home | 9,759 | 10,093 | (334) |
| Commercial | — | 678 | (678) |
| Other | — | 25 | (25) |
| | $ 33,203 | $ 34,315 | $ (1,112) |

Net insurance premiums earned during the three months ended March 31, 2019 decreased compared to the same period in 2018, primarily due to the decrease in net premiums written noted above.

Noninterest expenses during the three months ended March 31, 2019 and 2018, respectively, include both loss and LAE expenses and policy acquisition and other underwriting expenses, as well as other noninterest expenses. Loss and LAE are recognized based on formula and case basis estimates for losses reported with respect to direct business, estimates of unreported losses based on past experience and deduction of amounts for reinsurance placed with reinsurers. Loss and LAE ratios during the three months ended March 31, 2019, compared with the same period in 2018, were 45.0% and 45.3%, respectively. The slight decrease in the loss and LAE ratio during the three months ended March 31, 2019, compared to the same period in 2018, was primarily driven by a 3.9% decrease in loss and LAE expense due to fewer weather-related events, while premiums earned decreased by 3.2%.

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

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

| | Three Months Ended March 31, | | Variance |
|---|---|---|---|
| | 2019 | 2018 | 2019 vs 2018 |
| Amortization of deferred policy acquisition costs | $ 8,092 | $ 9,090 | $ (998) |
| Other underwriting expenses | 6,562 | 5,531 | 1,031 |
| Total | 14,654 | 14,621 | 33 |
| Agency expenses | (865) | (921) | 56 |
| Total less agency expenses | $ 13,789 | $ 13,700 | $ 89 |
| Net insurance premiums earned | $ 33,203 | $ 34,315 | $ (1,112) |
| Expense ratio | 41.5 % | 39.9 % | 1.6 % |

Table of Contents

Corporate

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, merchant banking investment opportunities and management and administrative services to support the overall operations of the Company. Hilltop's merchant banking investment activities include the identification of attractive opportunities for capital deployment in companies engaged in non-financial activities through its merchant bank subsidiary, Hilltop Opportunity Partners LLC.

As a holding company, Hilltop's primary investment objectives are to support capital deployment for organic growth and to preserve capital to be deployed through acquisitions, dividend payments and potential stock repurchases. Investment and interest income during the three months ended March 31, 2019, was primarily comprised of dividend income from merchant banking investment activities, in addition to interest income earned on intercompany notes.

Interest expense during each period was primarily associated with recurring quarterly interest expense of $1.9 million incurred on our $150.0 million aggregate principal amount of 5% senior notes due 2025 ("Senior Notes"). Additionally, we incurred interest expense of $1.0 million and $0.8 million during the three months ended March 31, 2019 and 2018, respectively, on junior subordinated debentures of $67.0 million issued by PCC (the "Debentures").

Noninterest income during the three months ended March 31, 2019, included activity associated with the Hilltop Plaza investment. Noninterest income during the three months ended March 31, 2018, included losses associated with the write-off of a long-term, legacy investment held by our merchant bank subsidiary.

Noninterest expenses during the three months ended March 31, 2019 and 2018, respectively, were primarily comprised of employees' compensation and benefits, occupancy expenses and professional fees, including corporate governance, legal and transaction costs. Noninterest expenses during the three months ended March 31, 2019 included costs of $5.8 million associated with significant Leadership Changes and other efficiency initiative-related charges which, in the aggregate, totaled $6.5 million before income taxes.

Financial Condition

The following discussion contains a more detailed analysis of our financial condition at March 31, 2019, as compared with December 31, 2018.

Securities Portfolio

At March 31, 2019, investment securities consisted of securities of the U.S. Treasury, U.S. government and its agencies, obligations of municipalities and other political subdivisions, primarily in the State of Texas, mortgage-backed, corporate debt, and equity securities. We may categorize investments as trading, available for sale, held to maturity and equity securities.

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

Table of Contents

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

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Trading securities, at fair value | | |
| U.S. Treasury securities | $ 2,121 | $ 7,945 |
| U.S. government agencies: | | |
| Bonds | 1,485 | 1,494 |
| Residential mortgage-backed securities | 334,090 | 309,455 |
| Commercial mortgage-backed securities | 2,225 | 4,239 |
| Collateralized mortgage obligations | 119,178 | 206,813 |
| Corporate debt securities | 67,442 | 59,293 |
| States and political subdivisions | 134,572 | 126,748 |
| Unit investment trusts | 33,276 | 19,913 |
| Private-label securitized product | 5,520 | 5,680 |
| Other | 3,386 | 3,886 |
| | 703,295 | 745,466 |
| Securities available for sale, at fair value | | |
| U.S. Treasury securities | 10,617 | 11,538 |
| U.S. government agencies: | | |
| Bonds | 86,011 | 85,611 |
| Residential mortgage-backed securities | 471,087 | 385,074 |
| Commercial mortgage-backed securities | 11,962 | 11,772 |
| Collateralized mortgage obligations | 340,765 | 276,399 |
| Corporate debt securities | 50,102 | 53,302 |
| States and political subdivisions | 49,307 | 51,962 |
| | 1,019,851 | 875,658 |
| Securities held to maturity, at amortized cost | | |
| U.S. Treasury securities | 9,932 | 9,903 |
| U.S. government agencies: | | |
| Bonds | 39,018 | 39,018 |
| Residential mortgage-backed securities | 21,154 | 21,903 |
| Commercial mortgage-backed securities | 112,056 | 87,065 |
| Collateralized mortgage obligations | 137,053 | 142,474 |
| States and political subdivisions | 50,652 | 50,649 |
| | 369,865 | 351,012 |
| Equity securities, at fair value | 19,343 | 19,679 |
| Total securities portfolio | $ 2,112,354 | $ 1,991,815 |

We had net unrealized losses of $1.4 million and $11.1 million at March 31, 2019 and December 31, 2018, respectively, related to the available for sale investment portfolio, and net unrealized losses associated with the securities held to maturity portfolio of $4.1 million and $9.9 million at March 31, 2019 and December 31, 2018, respectively. We had net unrealized gains of $0.5 million and net unrealized losses of $0.9 million at March 31, 2019

and December 31, 2018, respectively, related to equity securities.

Banking Segment

The banking segment’s securities portfolio plays a role in the management of our interest rate sensitivity and generates additional interest income. In addition, the securities portfolio is used to meet collateral requirements for public and trust deposits, securities sold under agreements to repurchase and other purposes. The available for sale and equity securities portfolios serve as a source of liquidity. Historically, the Bank’s policy has been to invest primarily in securities of the U.S. government and its agencies, obligations of municipalities in the State of Texas and other high grade fixed income securities to minimize credit risk. At March 31, 2019, the banking segment’s securities portfolio of $1.3 billion was comprised of trading securities of $2.5 million, available for sale securities of $924.7 million, equity securities of $0.1 million and held to maturity securities of $369.9 million, in addition to $14.0 million of other investments included in other assets within the consolidated balance sheets.

Table of Contents

Broker-Dealer Segment

The broker-dealer segment holds securities to support sales, underwriting and other customer activities. The interest rate risk inherent in holding these securities is managed by setting and monitoring limits on the size and duration of positions and on the length of time the securities can be held. The Hilltop Broker-Dealers are required to carry their securities at fair value and record changes in the fair value of the portfolio in operations. Accordingly, the securities portfolio of the Hilltop Broker-Dealers included trading securities of $700.8 million at March 31, 2019. In addition, 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 $69.4 million at March 31, 2019.

Insurance Segment

The insurance segment's primary investment objective is to preserve capital and manage for a total rate of return. NLC's strategy is to purchase securities in sectors that represent the most attractive relative value. Our insurance segment invests the premiums it receives from policyholders until they are needed to pay policyholder claims or other expenses. At March 31, 2019, the insurance segment's securities portfolio was comprised of $95.2 million in available for sale securities, $19.2 million of equity securities and $6.0 million of other investments included in other assets within the consolidated balance sheets.

Loan Portfolio

Consolidated loans held for investment are detailed in the tables below, classified by portfolio segment and segregated between those considered to be purchased credit impaired, or PCI, loans and all other originated or acquired loans (in thousands). PCI loans showed evidence of credit deterioration on the date of acquisition that made it probable that all contractually required principal and interest payments would not be collected.

| March 31, 2019 | Loans, excluding PCI Loans | PCI Loans | Total Loans Held for Investment |
|---|---|---|---|
| Commercial real estate | $ 2,912,553 | $ 27,302 | $ 2,939,855 |
| Commercial and industrial | 1,487,231 | 6,205 | 1,493,436 |
| Construction and land development | 995,399 | 299 | 995,698 |

| | | | |
|---|---|---|---|
| 1-4 family residential | 639,449 | 56,760 | 696,209 |
| Mortgage warehouse | 350,896 | — | 350,896 |
| Consumer | 43,723 | 5 | 43,728 |
| Broker-dealer | 491,857 | — | 491,857 |
| Loans held for investment, gross | 6,921,108 | 90,571 | 7,011,679 |
| Allowance for loan losses | (55,350) | (3,459) | (58,809) |
| Loans held for investment, net of allowance | $ 6,865,758 | $ 87,112 | $ 6,952,870 |

| December 31, 2018 | Loans, excluding PCI Loans | PCI Loans | Total Loans Held for Investment |
|---|---|---|---|
| Commercial real estate | $ 2,912,407 | $ 27,713 | $ 2,940,120 |
| Commercial and industrial | 1,501,892 | 6,559 | 1,508,451 |
| Construction and land development | 932,445 | 464 | 932,909 |
| 1-4 family residential | 620,936 | 58,327 | 679,263 |
| Mortgage warehouse | 243,806 | — | 243,806 |
| Consumer | 47,537 | 9 | 47,546 |
| Broker-dealer | 578,363 | — | 578,363 |
| Loans held for investment, gross | 6,837,386 | 93,072 | 6,930,458 |
| Allowance for loan losses | (56,594) | (2,892) | (59,486) |
| Loans held for investment, net of allowance | $ 6,780,792 | $ 90,180 | $ 6,870,972 |

Table of Contents

Banking Segment

The loan portfolio constitutes the major earning asset of the banking segment and typically offers the best alternative for obtaining the maximum interest spread above the banking segment’s cost of funds. The overall economic strength of the banking segment generally parallels the quality and yield of its loan portfolio.

The banking segment’s total loans held for investment, net of the allowance for loan losses, were $7.4 billion and $7.5 billion at March 31, 2019 and December 31, 2018, respectively. The banking segment’s loan portfolio includes warehouse lines of credit extended to PrimeLending of $2.3 billion, of which $891.0 million and $1.2 billion was drawn at March 31, 2019 and December 31, 2018, respectively. Amounts advanced against the warehouse line of credit are eliminated from net loans held for investment on our consolidated balance sheets. The banking segment does not generally participate in syndicated loan transactions and has no foreign loans in its portfolio.

At March 31, 2019, the banking segment had loan concentrations (loans to borrowers engaged in similar activities) that exceeded 10% of total loans in its real estate portfolio. The areas of concentration within our real estate portfolio were non-construction commercial real estate loans, construction and land development loans and non-construction residential real estate loans which represented 45.1%, 15.3% and 10.7%, respectively, of the banking segment’s total loans held for investment, excluding warehouse lines of credit extended to PrimeLending, at March 31, 2019. The banking segment’s loan concentrations were within regulatory guidelines at March 31, 2019.

Broker-Dealer Segment

The loan portfolio of the broker-dealer segment consists primarily of margin loans to customers and correspondents. These loans are collateralized by the securities purchased or by other securities owned by the clients and, because of collateral coverage ratios, are believed to present minimal collectability exposure. Additionally, these loans are subject to a number of regulatory requirements as well as the Hilltop Broker-Dealers’ internal policies. The broker-dealer segment’s total loans held for investment, net of the allowance for loan losses, were $491.8 million and $578.2 million at March 31, 2019 and December 31, 2018, respectively. This decrease from December 31, 2018 to March 31, 2019 was primarily attributable to a decrease of $84.0 million, or 35%, in receivables from correspondents.

Mortgage Origination Segment

The loan portfolio of the mortgage origination segment consists of loans held for sale, primarily single-family residential mortgages funded through PrimeLending, and IRLCs with customers pursuant to which we agree to originate a mortgage loan on a future date at an agreed-upon interest rate. The components of the mortgage origination

segment's loans held for sale and IRLCs are as follows (in thousands).

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Loans held for sale: | | |
| Unpaid principal balance | $ 896,824 | $ 1,213,068 |
| Fair value adjustment | 31,383 | 44,707 |
| | $ 928,207 | $ 1,257,775 |
| IRLCs: | | |
| Unpaid principal balance | $ 1,165,947 | $ 677,267 |
| Fair value adjustment | 29,859 | 17,421 |
| | $ 1,195,806 | $ 694,688 |

The mortgage origination segment uses forward commitments to mitigate interest rate risk associated with its loans held for sale and IRLCs. The notional amounts of these forward commitments at March 31, 2019 and December 31, 2018 were $1.7 billion and $1.4 billion, respectively, while the related estimated fair values were ($5.8) million and ($11.6) million, respectively.

Table of Contents

Allowance for Loan Losses

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses inherent in our existing loan portfolio. Management has responsibility for determining the level of the allowance for loan losses, subject to review by the Loan Review Committee of the Bank's board of directors.

The allowance for loan losses is subject to regulatory examination, which may take into account such factors as the methodology used to calculate the allowance and the size of the allowance. While we believe we have an appropriate allowance for our existing loan portfolio at March 31, 2019, additional provisions for losses on existing loans may be necessary in the future.

For additional information regarding the allowance for loan losses, refer to the sections captioned "Allowance for Loan Losses" and "Critical Accounting Policies and Estimates" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2018 Form 10-K. There have been no significant changes in our application of critical accounting policies related to the allowance for loan losses since December 31, 2018.

The Bank acquired certain assets and assumed certain liabilities of FNB in connection with the FNB Transaction. The FNB Transaction is discussed in detail in Note 6 to the consolidated financial statements included in the Company's 2018 Form 10-K. As discussed in the "Factors Affecting Comparability of Results of Operations" section above, the loss-share agreements with the FDIC were terminated during the fourth quarter of 2018. Accordingly, loans which were previously referred to as either "covered loans" if covered by the loss-share agreements or otherwise "non-covered loans" are now collectively referred to as "loans held for investment."

The following tables present the activity in our allowance for loan losses within our loan portfolio for the periods presented (in thousands). Substantially all of the activity shown below occurred within the banking segment.

| | Three Months Ended March 31, | |
|---|---|---|
| Loans Held for Investment | 2019 | 2018 |
| Balance, beginning of period | $ 59,486 | $ 63,686 |
| Provision (recovery) for loan losses | 951 | (1,807) |
| Recoveries of loans previously charged off: | | |
| Commercial real estate | — | — |
| Commercial and industrial | 648 | 2,474 |
| Construction and land development | — | — |

| | | |
|---|---|---|
| 1-4 family residential | 14 | 28 |
| Mortgage warehouse | — | — |
| Consumer | 10 | 12 |
| Broker-dealer | — | — |
| Covered | — | 3 |
| Total recoveries | 672 | 2,517 |
| Loans charged off: | | |
| Commercial real estate | — | — |
| Commercial and industrial | 1,818 | 1,183 |
| Construction and land development | — | — |
| 1-4 family residential | 28 | 6 |
| Mortgage warehouse | — | — |
| Consumer | 454 | 13 |
| Broker-dealer | — | — |
| Covered | — | — |
| Total charge-offs | 2,300 | 1,202 |
| Net recoveries (charge-offs) | (1,628) | 1,315 |
| Balance, end of period | $ 58,809 | $ 63,194 |
| Allowance for loan losses as a percentage of gross loans held for investment | 0.84 % | 0.99 % |

Table of Contents

The distribution of the allowance for loan losses among loan types and the percentage of the loans for that type to gross loans, excluding unearned income, within our loan portfolio are presented in the tables below (dollars in thousands).

| | March 31, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| Loans Held for Investment | Reserve | % of Gross Non-Covered Loans | Reserve | % of Gross Non-Covered Loans |
| Commercial real estate | $ 26,845 | 41.93 % | $ 27,100 | 42.42 % |
| Commercial and industrial | 21,268 | 21.30 % | 21,980 | 21.77 % |
| Construction and land development | 5,908 | 14.20 % | 6,061 | 13.46 % |
| 1-4 family residential | 4,331 | 9.93 % | 3,956 | 9.80 % |
| Mortgage warehouse | — | 5.00 % | — | 3.52 % |
| Consumer | 409 | 0.62 % | 267 | 0.69 % |
| Broker-dealer | 48 | 7.02 % | 122 | 8.34 % |
| Total | $ 58,809 | 100.00 % | $ 59,486 | 100.00 % |

Potential Problem Loans

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor's potential operating or financial difficulties. Management monitors these loans and reviews their performance on a regular basis. Potential problem loans contain potential weaknesses that could improve, persist or further deteriorate. If such potential weaknesses persist without improving, the loan is subject to downgrade, typically to substandard, in three to six months. Potential problem loans are assigned a grade of special mention within our risk grading matrix. Potential problem loans do not include PCI loans because PCI loans exhibited evidence of credit deterioration at acquisition that made it probable that all contractually required principal payments would not be collected. Within our loan portfolio, we had three credit relationships totaling $6.8 million of potential problem loans at March 31, 2019, compared with seven credit relationships totaling $17.8 million of potential problem loans at December 31, 2018.

Non-Performing Assets

The following table presents components of our non-performing assets (dollars in thousands).

| | March 31, 2019 | December 31, 2018 | Variance 2019 vs 2018 |
|---|---|---|---|
| Loans accounted for on a non-accrual basis: | | | |
| Commercial real estate | $ 5,332 | $ 5,324 | $ 8 |
| Commercial and industrial | 13,350 | 14,870 | (1,520) |
| Construction and land development | 1,473 | 3,278 | (1,805) |
| 1-4 family residential | 10,662 | 10,437 | 225 |
| Mortgage warehouse | — | — | — |
| Consumer | 38 | 41 | (3) |
| Broker-dealer | — | — | — |
| | $ 30,855 | $ 33,950 | $ (3,095) |
| Non-performing loans as a percentage of total loans | 0.38 % | 0.41 % | (0.03) % |
| Other real estate owned | $ 23,066 | $ 27,578 | $ (4,512) |
| Other repossessed assets | $ 30 | $ 68 | $ (38) |
| Non-performing assets | $ 53,951 | $ 61,596 | $ (7,645) |
| Non-performing assets as a percentage of total assets | 0.40 % | 0.45 % | (0.05) % |
| Non-PCI loans past due 90 days or more and still accruing | $ 77,045 | $ 83,131 | $ (6,086) |
| Troubled debt restructurings included in accruing loans held for investment | $ 1,313 | $ 1,339 | $ (26) |

Table of Contents

At March 31, 2019, non-accrual loans included 17 commercial and industrial relationships with loans secured by accounts receivable, life insurance, oil and gas, livestock and equipment. Non-accrual loans at March 31, 2019 also included $3.3 million of loans secured by residential real estate which were classified as loans held for sale. At December 31, 2018, non-accrual loans included 16 commercial and industrial relationships with loans secured by accounts receivable, life insurance, oil and gas, livestock, and equipment. Non-accrual loans at December 31, 2018 included $3.4 million of loans secured by residential real estate which were classified as loans held for sale.

OREO decreased from December 31, 2018 to March 31, 2019, due $6.0 million of disposals and fair valuation decreases related to 20 properties, offset by the addition of 15 properties totaling $1.5 million. At both March 31, 2019 and December 31, 2018, the OREO balance was primarily comprised of commercial properties.

Non-PCI loans past due 90 days or more and still accruing at March 31, 2019 and December 31, 2018, were primarily comprised of loans held for sale and guaranteed by U.S. government agencies, including loans that are subject to repurchase, or have been repurchased, by PrimeLending. Loans past due 90 days or more and still accruing include Government National Mortgage Association related loans subject to repurchase within our mortgage origination segment.

At March 31, 2019, troubled debt restructurings ("TDRs") were comprised of $1.3 million of loans that are considered to be performing and non-performing loans of $3.6 million reported in non-accrual loans. At December 31, 2018, TDRs were comprised of $1.3 million of loans that are considered to be performing and non-performing loans of $5.9 million reported in non-accrual loans.

Current Expected Credit Loss (CECL) Standard

In June 2016, the FASB issued ASU 2016-13 which sets forth a "current expected credit loss" (CECL) model for measuring credit losses on certain exposures. The new model will require the measurement of expected credit losses to reflect the lifetime of an exposure (or pool of exposures) represented by certain financial instruments to be based on historical experience, current conditions and reasonable and supportable forecasts. Under the current "incurred loss" model, the allowance for loan losses is based only on estimates of loan losses that currently exist in the portfolio as of the reporting date. The new model will become effective on January 1, 2020, and applies to most debt instruments, trade receivables, lease receivables, reinsurance receivables, financial guarantees and loan commitments. Our ongoing transition CECL efforts include reassessing risk ratings, developing and validating the new model, collecting and processing new data and establishing internal controls and accounting policies. New model development has increased expenses associated with the collection and processing of data, and these increases in expenses will continue for the remainder of 2019 as we perform parallel calculations of our allowance for loan and other credit losses under both the current allowance model and under the CECL model. We expect that the new model may require a material increase in our allowance for loan losses upon adoption on January 1, 2020.

Insurance Losses and Loss Adjustment Expenses

At both March 31, 2019 and December 31, 2018, our gross reserve for unpaid losses and LAE was $20.6 million, including estimated recoveries from reinsurance of $2.5 million and $3.2 million, respectively. The liability for insurance losses and LAE represents estimates of the ultimate unpaid cost of all losses incurred, including losses for claims that have not yet been reported, less a reduction for reinsurance recoverables related to those liabilities. Separately for each of NLIC and ASIC and each line of business, our actuaries estimate the liability for unpaid losses and LAE by first estimating ultimate losses and LAE amounts for each year, prior to recognizing the impact of reinsurance. The amount of liabilities for reported claims is based primarily on a claim-by-claim evaluation of coverage, liability, injury severity or scope of property damage, and any other information considered relevant to estimating exposure presented by the claim.

NLC’s liabilities for unpaid losses represent the best estimate at a given point in time of what it expects to pay claimants, based on facts, circumstances and historical trends then known. During the loss settlement period, additional facts regarding individual claims may become known and, consequently, it often becomes necessary to refine and adjust the estimates of liability. This process is commonly referred to as loss development. To project ultimate losses and LAE, our actuaries examine the paid and reported losses and LAE for each accident year and multiply these values by a loss development factor. The selected loss development factors are based upon a review of the loss development patterns

Table of Contents

indicated in the companies' historical loss triangles (which utilize historical trends, adjusted for changes in loss costs, underwriting standards, policy provisions, product mix and other factors) and applicable insurance industry loss development factors. Estimating the liability for unpaid losses and LAE is inherently judgmental and is influenced by factors that are subject to significant variation. Liabilities for LAE are intended to cover the ultimate cost of settling claims, including investigation and defense of lawsuits resulting from such claims.

The reserve analysis performed by our actuaries provides preliminary central estimates of the unpaid losses and LAE. At each quarter-end, the results of the reserve analysis are summarized and discussed with our senior management. The senior management group considers many factors in determining the amount of reserves to record for financial statement purposes. These factors include the extent and timing of any recent catastrophic events, historical pattern and volatility of the actuarial indications, the sensitivity of the actuarial indications to changes in paid and reported loss patterns, the consistency of claims handling processes, the consistency of case reserving practices, changes in our pricing and underwriting, and overall pricing and underwriting trends in the insurance market.

Deposits

The banking segment's major source of funds and liquidity is its deposit base. Deposits provide funding for its investments in loans and securities. Interest paid for deposits must be managed carefully to control the level of interest expense and overall net interest margin. The composition of the deposit base (time deposits versus interest-bearing demand deposits and savings), as discussed in more detail within the section entitled "Liquidity and Capital Resources — Banking Segment" below, is constantly changing due to the banking segment's needs and market conditions.

The table below presents the average balance of, and rate paid on, consolidated deposits (dollars in thousands).

| | Three Months Ended March 31, | | | | Year Ended December 31, | |
|---|---|---|---|---|---|---|
| | 2019 | | 2018 | | 2018 | |
| | Average Balance | Average Rate Paid | Average Balance | Average Rate Paid | Average Balance | Average Rate Paid |
| Noninterest-bearing demand deposits | $ 2,520,057 | 0.00 % | $ 2,419,725 | 0.00 % | $ 2,504,599 | 0.00 % |
| Interest-bearing demand deposits | 4,301,403 | 1.03 % | 3,868,738 | 0.44 % | 4,025,259 | 0.66 % |
| Savings deposits | 182,161 | 0.18 % | 222,232 | 0.12 % | 201,328 | 0.11 % |
| Time deposits | 1,342,322 | 1.83 % | 1,403,687 | 1.27 % | 1,341,886 | 1.42 % |
| | $ 8,345,943 | 0.83 % | $ 7,914,382 | 0.44 % | $ 8,073,072 | 0.57 % |

Borrowings

Our borrowings are shown in the table below (dollars in thousands).

| | March 31, 2019 | | | December 31, 2018 | | | |
|---|---|---|---|---|---|---|---|
| | | Average | | | Average | | Variance |
| | Balance | Rate Paid | | Balance | Rate Paid | | 2019 vs 2018 |
| Short-term borrowings | $ 914,525 | 2.79 | % | $ 1,065,807 | 2.15 | % | $ (151,282) |
| Notes payable | 225,372 | 5.35 | % | 228,872 | 4.95 | % | (3,500) |
| Junior subordinated debentures | 67,012 | 6.06 | % | 67,012 | 5.47 | % | - |
| | $ 1,206,909 | 3.49 | % | $ 1,361,691 | 2.70 | % | $ (154,782) |

Short-term borrowings consisted of federal funds purchased, securities sold under agreements to repurchase, borrowings at the Federal Home Loan Bank (“FHLB”) and short-term bank loans. The decrease in short-term borrowings at March 31, 2019, compared with December 31, 2018, included a decrease in borrowings in our banking segment primarily associated with the increased utilization of available internal funds and a decrease in securities sold under agreements to repurchase used by the Bank and the Hilltop Broker-Dealers to finance their activities, partially offset by an increase in short-term bank loans used by the Hilltop Broker-Dealers to finance their activities. Notes payable at March 31, 2019, was comprised of $148.6 million related to Senior Notes, net of loan origination fees, FHLB borrowings with an original maturity greater than one year within the banking segment of $4.3 million, insurance segment line of credit and term notes of $27.5 million, and mortgage origination segment borrowings of $44.9 million.

Table of Contents

## Liquidity and Capital Resources

Hilltop is a financial holding company whose assets primarily consist of the stock of its subsidiaries and invested assets. Hilltop's primary investment objectives, as a holding company, are to support capital deployment for organic growth and to preserve capital to be deployed through acquisitions, dividend payments and potential stock repurchases. At March 31, 2019, Hilltop had $62.6 million in cash and cash equivalents, an increase of $18.7 million from $43.9 million at December 31, 2018. This increase in cash and cash equivalents was primarily due to $46.5 million of dividends from subsidiaries, partially offset by $7.5 million in cash dividends declared, and other general corporate expenses. Subject to regulatory restrictions, Hilltop has received, and may also continue to receive, dividends from its subsidiaries. If necessary or appropriate, we may also finance acquisitions with the proceeds from equity or debt issuances. We believe that Hilltop's liquidity is sufficient for the foreseeable future, with current short-term liquidity needs including operating expenses, interest on debt obligations, dividend payments to stockholders and potential stock repurchases.

### Dividend Declaration

On April 25, 2019, our board of directors declared a quarterly cash dividend of $0.08 per common share, payable on May 31, 2019 to all common stockholders of record as of the close of business on May 15, 2019.

Future dividends on our common stock are subject to the determination by the board of directors based on an evaluation of our earnings and financial condition, liquidity and capital resources, the general economic and regulatory climate, our ability to service any equity or debt obligations senior to our common stock and other factors.

### Senior Notes due 2025

The Senior Notes bear interest at a rate of 5% per year, payable semi-annually in arrears in cash on April 15 and October 15 of each year, commencing on October 15, 2015. The Senior Notes will mature on April 15, 2025, unless we redeem the Senior Notes, in whole at any time or in part from time to time, on or after January 15, 2025 (three months prior to the maturity date of the Senior Notes) at our election at a redemption price equal to 100% of the principal amount of the Senior Notes to be redeemed plus accrued and unpaid interest to, but excluding, the redemption date. At March 31, 2019, $150.0 million of our Senior Notes was outstanding.

### Junior Subordinated Debentures

The Debentures have a stated term of 30 years with maturities ranging from July 2031 to February 2038 with interest payable quarterly. The rate on the Debentures, which resets quarterly, is 3-month LIBOR plus an average spread of 3.22%. The total average interest rate at March 31, 2019 was 5.87%. The Debentures are callable at PCC's discretion with a minimum of a 45- to 60- day notice. At March 31, 2019, $67.0 million of PCC's Debentures were outstanding.

Stock Repurchase Program

In January 2019, our board of directors authorized a new stock repurchase program through January 2020, pursuant to which we are authorized to repurchase, in the aggregate, up to $50.0 million of our outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation. Under the stock repurchase program authorized, we may repurchase shares in the open market or through privately negotiated transactions as permitted under Rule 10b-18 promulgated under the Exchange Act. The extent to which we repurchase our shares and the timing of such repurchases depends upon market conditions and other corporate considerations, as determined by Hilltop's management team. Repurchased shares will be returned to our pool of authorized but unissued shares of common stock.

Regulatory Capital

We are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements may prompt certain actions by regulators that, if undertaken, could have a direct material adverse effect on our financial condition and results of operations. Under capital adequacy and regulatory requirements, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Table of Contents

In order to avoid limitations on capital distributions, including dividend payments, stock repurchases and certain discretionary bonus payments to executive officers, Basel III requires banking organizations to maintain a capital conservation buffer above minimum risk-based capital requirements measured relative to risk-weighted assets. The phase-in of the capital conservation buffer requirements began on January 1, 2016 for Hilltop and PlainsCapital, and the requirements were fully phased in as of January 1, 2019.

Bank holding companies with less than $15 billion in assets as of December 31, 2009 are allowed to continue to include junior subordinated debentures in Tier 1 capital, subject to certain restrictions. However, if an institution grows to above $15 billion in assets as a result of an acquisition, or organically grows to above $15 billion in assets and then makes an acquisition, the combined trust preferred issuances must be phased out of Tier 1 and into Tier 2 capital. All of the debentures issued to the PCC Statutory Trusts I, II, III and IV (the "Trusts"), less the common stock of the Trusts, qualified as Tier 1 capital as of March 31, 2019, under guidance issued by the Board of Governors of the Federal Reserve System.

At March 31, 2019, Hilltop had a total capital to risk weighted assets ratio of 17.64%, Tier 1 capital to risk weighted assets ratio of 17.22%, common equity Tier 1 capital to risk weighted assets ratio of 16.75% and a Tier 1 capital to average assets, or leverage, ratio of 13.22%. Accordingly, Hilltop's actual capital amounts and ratios in accordance with Basel III exceeded the regulatory capital requirements including conservation buffer in effect at the end of the period.

At March 31, 2019, PlainsCapital had a total capital to risk weighted assets ratio of 14.60%, Tier 1 capital to risk weighted assets ratio of 13.89%, common equity Tier 1 capital to risk weighted assets ratio of 13.89% and a Tier 1 capital to average assets, or leverage, ratio of 12.61%. Accordingly, PlainsCapital's actual capital amounts and ratios in accordance with Basel III resulted in it being considered "well-capitalized" and exceeded the regulatory capital requirements including conservation buffer in effect at the end of the period.

We discuss regulatory capital requirements in more detail in Note 16 to our consolidated financial statements, as well as under the caption "Government Supervision and Regulation — Corporate — Capital Adequacy Requirements and BASEL III" set forth in Part I, Item I. of our 2018 Form 10-K.

Banking Segment

Within our banking segment, our primary uses of cash are for customer withdrawals and extensions of credit as well as our borrowing costs and other operating expenses. Our asset and liability group is responsible for continuously monitoring our liquidity position to ensure that our assets and liabilities are managed in a manner that will meet our short-term and long-term cash requirements. Our goal is to manage our liquidity position in a manner such that we can meet our customers' short-term and long-term deposit withdrawals and anticipated and unanticipated increases in loan

demand without penalizing earnings. Funds invested in short-term marketable instruments, the continuous maturing of other interest-earning assets, cash flows from self-liquidating investments such as mortgage-backed securities and collateralized mortgage obligations, the possible sale of available for sale securities and the ability to securitize certain types of loans provide sources of liquidity from an asset perspective. The liability base provides sources of liquidity through deposits and the maturity structure of short-term borrowed funds. For short-term liquidity needs, we utilize federal fund lines of credit with correspondent banks, securities sold under agreements to repurchase, borrowings from the Federal Reserve and borrowings under lines of credit with other financial institutions. For intermediate liquidity needs, we utilize advances from the FHLB. To supply liquidity over the longer term, we have access to brokered time deposits, term loans at the FHLB and borrowings under lines of credit with other financial institutions.

Within our banking segment, deposit flows are affected by the level of market interest rates, the interest rates and products offered by competitors, the volatility of equity markets and other factors. The Bank regularly evaluates its deposit products and pricing structures relative to the market to maintain competitiveness over time.

The Bank’s 15 largest depositors, excluding Hilltop and Hilltop Securities, accounted for 10.37% of the Bank’s total deposits, and the Bank’s five largest depositors, excluding Hilltop and Hilltop Securities, accounted for 5.83% of the Bank’s total deposits at March 31, 2019. The loss of one or more of our largest Bank customers, or a significant decline in our deposit balances due to ordinary course fluctuations related to these customers’ businesses, could adversely affect our liquidity and might require us to raise deposit rates to attract new deposits, purchase federal funds or borrow funds on a short-term basis to replace such deposits.

Table of Contents

Broker-Dealer Segment

The Hilltop Broker-Dealers rely on their equity capital, short-term bank borrowings, interest-bearing and non-interest-bearing client credit balances, correspondent deposits, securities lending arrangements, repurchase agreement financings and other payables to finance their assets and operations, subject to their respective compliance with broker-dealer net capital and customer protection rules. At March 31, 2019, Hilltop Securities had credit arrangements with five unaffiliated banks with maximum aggregate commitments of up to $725.0 million. These credit arrangements are used to finance securities owned, securities held for correspondent accounts, receivables in customer margin accounts and underwriting activities. These credit arrangements are provided on an "as offered" basis and are not committed lines of credit. In addition, Hilltop Securities has a committed revolving credit facility with an unaffiliated bank of up to $50.0 million. At March 31, 2019, Hilltop Securities had borrowed $221.0 million under its credit arrangements and had no borrowings under its credit facility.

Mortgage Origination Segment

PrimeLending funds the mortgage loans it originates through warehouse lines of credit maintained with the Bank which have an aggregate commitment of $2.3 billion, of which $891.0 million was drawn at March 31, 2019. PrimeLending sells substantially all mortgage loans it originates to various investors in the secondary market, the majority with servicing released. As these mortgage loans are sold in the secondary market, PrimeLending pays down its warehouse line of credit with the Bank. In addition, PrimeLending has an available line of credit with an unaffiliated bank of up to $1.0 million, of which no borrowings were outstanding at March 31, 2019.

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 ABAs. At March 31, 2019, these ABAs have combined available lines of credit totaling $130.0 million, $70.0 million of which was with a single unaffiliated bank, and the remaining $60.0 million of which was with the Bank. At March 31, 2019, Ventures Management had outstanding borrowings of $51.3 million, $6.4 million of which was with the Bank.

Insurance Segment

Our insurance operating subsidiary's primary investment objectives are to preserve capital and manage for a total rate of return. NLC's strategy is to purchase securities in sectors that represent the most attractive relative value. Bonds, cash and short-term investments of $130.0 million, or 83.8%, equity investments of $19.2 million and other investments of $6.0 million comprised NLC's $155.2 million in total cash and investments at March 31, 2019. NLC does not currently have any significant concentration in both direct and indirect guarantor exposure or any investments in subprime mortgages. NLC has custodial agreements with an unaffiliated bank and an investment management agreement with DTF Holdings, LLC.

Impact of Inflation and Changing Prices

Our consolidated financial statements included herein have been prepared in accordance with GAAP, which presently require us to measure financial position and operating results primarily in terms of historic dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on our operations is reflected in increased operating costs. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond our control, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the U.S. government, its agencies and various other governmental regulatory authorities.

Off-Balance Sheet Arrangements; Commitments; Guarantees

In the normal course of business, we enter into various transactions, which, in accordance with GAAP, are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in our consolidated balance sheets.

Table of Contents

We enter into contractual loan commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of our commitments to extend credit are contingent upon customers maintaining specific credit standards until the time of loan funding. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. We assess the credit risk associated with certain commitments to extend credit and have recorded a liability related to such credit risk in our consolidated financial statements.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, we would be required to fund the commitment. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, we would be entitled to seek recovery from the customer. Our policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

In the aggregate, the Bank had outstanding unused commitments to extend credit of $2.3 billion at March 31, 2019 and outstanding financial and performance standby letters of credit of $95.1 million at March 31, 2019.

In the normal course of business, the Hilltop Broker-Dealers execute, settle and finance various securities transactions that may expose the Hilltop Broker-Dealers to off-balance sheet risk in the event that a customer or counterparty does not fulfill its contractual obligations. Examples of such transactions include the sale of securities not yet purchased by customers or for the account of the Hilltop Broker-Dealers, use of derivatives to support certain non-profit housing organization clients, clearing agreements between the Hilltop Broker-Dealers and various clearinghouses and broker-dealers, secured financing arrangements that involve pledged securities, and when-issued underwriting and purchase commitments.

Critical Accounting Policies and Estimates

Our accounting policies are fundamental to understanding our management's discussion and analysis of our results of operations and financial condition. We have identified certain significant accounting policies which involve a higher degree of judgment and complexity in making certain estimates and assumptions that affect amounts reported in our consolidated financial statements. The significant accounting policies which we believe to be the most critical in preparing our consolidated financial statements relate to allowance for loan losses, reserve for losses and LAE, goodwill and identifiable intangible assets, mortgage loan indemnification liability, mortgage servicing rights asset and acquisition accounting. Since December 31, 2018, there have been no changes in critical accounting policies as further described under "Critical Accounting Policies and Estimates" and Note 1 to the Consolidated Financial Statements in our 2018 Form 10-K, except that we no longer consider estimates related to the FDIC Indemnification Asset to be a critical accounting policy.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our assessment of market risk as of March 31, 2019 indicates there are no material changes in the quantitative and qualitative disclosures from those previously reported in our 2018 Form 10-K, except as discussed below.

The primary objective of the following information is to provide forward-looking quantitative and qualitative information about our potential exposure to market risks. Market risk represents the risk of loss that may result from changes in value of a financial instrument as a result of changes in interest rates, market prices and the credit perception of an issuer. The disclosure is not meant to be a precise indicator of expected future losses, but rather an indicator of reasonably possible losses, and therefore our actual results may differ from any of the following projections. This forward-looking information provides an indicator of how we view and manage our ongoing market risk exposures.

### Banking Segment

The banking segment is engaged primarily in the business of investing funds obtained from deposits and borrowings in interest-earning loans and investments, and our primary component of market risk is sensitivity to changes in interest rates. Consequently, our earnings depend to a significant extent on our net interest income, which is the difference between interest income on loans and investments and our interest expense on deposits and borrowings. To the extent

that our interest-bearing liabilities do not reprice or mature at the same time as our interest-bearing assets, we are subject to interest rate risk and corresponding fluctuations in net interest income.

There are several common sources of interest rate risk that must be effectively managed if there is to be minimal impact on our earnings and capital. Repricing risk arises largely from timing differences in the pricing of assets and liabilities. Reinvestment risk refers to the reinvestment of cash flows from interest payments and maturing assets at lower or higher rates. Basis risk exists when different yield curves or pricing indices do not change at precisely the same time or in the same magnitude such that assets and liabilities with the same maturity are not all affected equally. Yield curve risk refers to unequal movements in interest rates across a full range of maturities.

We have employed asset/liability management policies that attempt to manage our interest-earning assets and interest-bearing liabilities, thereby attempting to control the volatility of net interest income, without having to incur unacceptable levels of risk. We employ procedures which include interest rate shock analysis, repricing gap analysis and balance sheet decomposition techniques to help mitigate interest rate risk in the ordinary course of business. In addition, the asset/liability management policies permit the use of various derivative instruments to manage interest rate risk or hedge specified assets and liabilities.

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. The management of interest rate risk is performed by analyzing the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at specific points in time (“GAP”) and by analyzing the effects of interest rate changes on net interest income over specific periods of time by projecting the performance of the mix of assets and liabilities in varied interest rate environments. Interest rate sensitivity reflects the potential effect on net interest income resulting from a movement in interest rates. A company is considered to be asset sensitive, or have a positive GAP, when the amount of its interest-earning assets maturing or repricing within a given period exceeds the amount of its interest-bearing liabilities also maturing or repricing within that time period. Conversely, a company is considered to be liability sensitive, or have a negative GAP, when the amount of its interest-bearing liabilities maturing or repricing within a given period exceeds the amount of its interest-earning assets also maturing or repricing within that time period. During a period of rising interest rates, a negative GAP would tend to affect net interest income adversely, while a positive GAP would tend to result in an increase in net interest income. During a period of falling interest rates, a negative GAP would tend to result in an increase in net interest income, while a positive GAP would tend to affect net interest income adversely. However, it is our intent to remain relatively balanced so that changes in rates do not have a significant impact on earnings.

As illustrated in the table below, the banking segment is asset sensitive overall. Loans that adjust daily or monthly to the Wall Street Journal Prime rate comprise a large percentage of interest sensitive assets and are the primary cause of the banking segment’s asset sensitivity. To help neutralize interest rate sensitivity, the banking segment has kept the terms of most of its borrowings under one year as shown in the following table (dollars in thousands).

| | March 31, 2019<br>3 Months or Less | > 3 Months to 1 Year | > 1 Year to 3 Years | > 3 Years to 5 Years | > 5 Years | Total |
|---|---|---|---|---|---|---|
| Interest sensitive assets: | | | | | | |
| Loans | $ 4,151,100 | $ 1,250,579 | $ 1,524,568 | $ 285,206 | $ 201,882 | $ 7,413,335 |
| Securities | 160,133 | 171,511 | 316,053 | 147,987 | 500,530 | 1,296,214 |
| Federal funds sold and securities purchased under agreements to resell | 438 | — | — | — | — | 438 |
| Other interest sensitive assets | 150,113 | — | — | — | 29,218 | 179,331 |
| Total interest sensitive assets | 4,461,784 | 1,422,090 | 1,840,621 | 433,193 | 731,630 | 8,889,318 |
| | | | | | | |
| Interest sensitive liabilities: | | | | | | |
| Interest bearing checking | $ 3,955,623 | $ — | $ — | $ — | $ — | $ 3,955,623 |
| Savings | 185,015 | — | — | — | — | 185,015 |
| Time deposits | 158,288 | 874,499 | 303,189 | 13,007 | 46,261 | 1,395,244 |
| Notes payable and other borrowings | 189,368 | 549 | 3,704 | 592 | 5,001 | 199,214 |
| Total interest sensitive liabilities | 4,488,294 | 875,048 | 306,893 | 13,599 | 51,262 | 5,735,096 |
| | | | | | | |
| Interest sensitivity gap | $ (26,510) | $ 547,042 | $ 1,533,728 | $ 419,594 | $ 680,368 | $ 3,154,222 |
| | | | | | | |
| Cumulative interest sensitivity | $ (26,510) | $ 520,532 | $ 2,054,260 | $ 2,473,854 | $ 3,154,222 | |

| gap | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Percentage of cumulative gap to total interest sensitive assets | (0.30) | % | 5.86 | % | 23.11 | % | 27.83 | % | 35.48 | % |

The positive GAP in the interest rate analysis indicates that banking segment net interest income would generally rise if rates increase. Because of inherent limitations in interest rate GAP analysis, the banking segment uses multiple interest

rate risk measurement techniques. Simulation analysis is used to subject the current repricing conditions to rising and falling interest rates in increments and decrements of 1%, 2% and 3% to determine the effect on net interest income changes for the next twelve months. The banking segment also measures the effects of changes in interest rates on economic value of equity by discounting projected cash flows of deposits and loans. Economic value changes in the investment portfolio are estimated by discounting future cash flows and using duration analysis. Investment security prepayments are estimated using current market information. We believe the simulation analysis presents a more accurate picture than the GAP analysis. Simulation analysis recognizes that deposit products may not react to changes in interest rates as quickly or with the same magnitude as earning assets contractually tied to a market rate index. The sensitivity to changes in market rates varies across deposit products. Also, unlike GAP analysis, simulation analysis takes into account the effect of embedded options in the securities and loan portfolios as well as any off-balance-sheet derivatives.

The table below shows the estimated impact of increases of 1%, 2% and 3% and a decrease of 0.5% in interest rates on net interest income and on economic value of equity for the banking segment at March 31, 2019 (dollars in thousands).