

Hilltop Holdings Inc.  
Form 10-Q  
October 26, 2017  
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

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

Commission File Number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

Maryland  
(State or other jurisdiction of incorporation or  
organization)

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

2323 Victory Avenue, Suite 1400

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Dallas, TX  
(Address of principal executive offices)

75219  
(Zip Code)

(214) 855-2177

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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

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

The number of shares of the registrant's common stock outstanding at October 26, 2017 was 95,910,314.



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HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2017

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## HILLTOP HOLDINGS INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

|   | September 30,<br>2017 | December 31,<br>2016 |
|---|-----------------------|----------------------|
| Assets  |                       |                      |
| Cash and due from banks   | \$ 354,569            | \$ 669,357           |
| Federal funds sold  | 400                   | 21,407               |
| Securities purchased under agreements to resell   | 134,654               | 89,430               |
| Assets segregated for regulatory purposes   | 207,336               | 180,993              |
| Securities:   |                       |                      |
| Trading, at fair value  | 676,411               | 265,534              |
| Available for sale, at fair value (amortized cost of \$762,984 and \$598,198, respectively) | 765,542               | 598,007              |
| Held to maturity, at amortized cost (fair value of \$364,122 and \$345,088, respectively)   | 368,031               | 351,831              |
|   | 1,809,984             | 1,215,372            |
| Loans held for sale   | 1,939,321             | 1,795,463            |
| Non-covered loans, net of unearned income   | 6,148,813             | 5,843,499            |
| Allowance for non-covered loan losses   | (58,779)              | (54,186)             |
| Non-covered loans, net  | 6,090,034             | 5,789,313            |
| Covered loans, net of allowance of \$2,141 and \$413, respectively                          | 188,269               | 255,714              |
| Broker-dealer and clearing organization receivables   | 1,672,123             | 1,497,741            |
| Premises and equipment, net   | 176,281               | 190,361              |
| FDIC indemnification asset  | 33,143                | 71,313               |
| Covered other real estate owned   | 40,343                | 51,642               |
| Other assets  | 596,095               | 613,453              |
| Goodwill  | 251,808               | 251,808              |
| Other intangible assets, net  | 38,440                | 44,695               |
| Total assets  | \$ 13,532,800         | \$ 12,738,062        |
| Liabilities and Stockholders' Equity  |                       |                      |
| Deposits:   |                       |                      |
| Noninterest-bearing   | \$ 2,279,633          | \$ 2,199,483         |
| Interest-bearing  | 5,383,814             | 4,864,328            |
| Total deposits  | 7,663,447             | 7,063,811            |

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|  |               |               |
|--|---------------|---------------|
| Broker-dealer and clearing organization payables   | 1,517,698     | 1,347,128     |
| Short-term borrowings  | 1,477,201     | 1,417,289     |
| Securities sold, not yet purchased, at fair value  | 173,509       | 153,889       |
| Notes payable  | 300,196       | 317,912       |
| Junior subordinated debentures   | 67,012        | 67,012        |
| Other liabilities  | 424,381       | 496,501       |
| Total liabilities  | 11,623,444    | 10,863,542    |
| Commitments and contingencies (see Notes 12 and 13)  |               |               |
| Stockholders' equity:  |               |               |
| Hilltop stockholders' equity:  |               |               |
| Common stock, \$0.01 par value, 125,000,000 shares authorized; 95,904,322 and 98,543,774 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively | 959           | 985           |
| Additional paid-in capital   | 1,525,169     | 1,572,877     |
| Accumulated other comprehensive income   | 2,585         | 485           |
| Retained earnings  | 376,873       | 295,568       |
| Deferred compensation employee stock trust, net  | 840           | 903           |
| Employee stock trust (12,066 and 15,492 shares, at cost, respectively)   | (241)         | (309)         |
| Total Hilltop stockholders' equity   | 1,906,185     | 1,870,509     |
| Noncontrolling interests   | 3,171         | 4,011         |
| Total stockholders' equity   | 1,909,356     | 1,874,520     |
| Total liabilities and stockholders' equity   | \$ 13,532,800 | \$ 12,738,062 |

See accompanying notes.

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## HILLTOP HOLDINGS INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(Unaudited)

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|-----------|------------------------------------|------------|
|  | 2017                                | 2016      | 2017                               | 2016       |
| Interest income:   |                                     |           |                                    |            |
| Loans, including fees  | \$ 102,546                          | \$ 97,590 | \$ 306,330                         | \$ 287,591 |
| Securities borrowed  | 11,404                              | 9,037     | 29,054                             | 22,952     |
| Securities:  |                                     |           |                                    |            |
| Taxable  | 11,157                              | 5,935     | 27,723                             | 19,136     |
| Tax-exempt   | 1,471                               | 1,518     | 4,090                              | 4,692      |
| Other  | 2,366                               | 1,183     | 6,294                              | 3,248      |
| Total interest income  | 128,944                             | 115,263   | 373,491                            | 337,619    |
| Interest expense:  |                                     |           |                                    |            |
| Deposits   | 6,841                               | 3,996     | 16,995                             | 11,872     |
| Securities loaned  | 8,935                               | 6,954     | 22,756                             | 17,857     |
| Short-term borrowings  | 4,567                               | 1,497     | 9,633                              | 3,974      |
| Notes payable  | 2,680                               | 2,793     | 8,320                              | 7,993      |
| Junior subordinated debentures                                       | 774                                 | 673       | 2,229                              | 1,973      |
| Other  | 167                                 | 180       | 502                                | 543        |
| Total interest expense   | 23,964                              | 16,093    | 60,435                             | 44,212     |
| Net interest income  | 104,980                             | 99,170    | 313,056                            | 293,407    |
| Provision for loan losses  | 1,260                               | 3,990     | 8,818                              | 36,273     |
| Net interest income after provision for loan losses                  | 103,720                             | 95,180    | 304,238                            | 257,134    |
| Noninterest income:  |                                     |           |                                    |            |
| Net realized gains on securities                                     | —                                   | —         | 14                                 | —          |
| Net gains from sale of loans and other mortgage<br>production income | 138,498                             | 175,412   | 416,336                            | 469,721    |
| Mortgage loan origination fees                                       | 25,256                              | 26,807    | 70,788                             | 71,417     |
| Securities commissions and fees                                      | 38,735                              | 39,722    | 115,596                            | 118,481    |
| Investment and securities advisory fees and<br>commissions           | 25,620                              | 31,129    | 73,359                             | 84,302     |
| Net insurance premiums earned  | 34,493                              | 38,747    | 106,653                            | 117,201    |
| Other  | 35,875                              | 42,641    | 131,862                            | 116,716    |
| Total noninterest income   | 298,477                             | 354,458   | 914,608                            | 977,838    |
| Noninterest expense:   |                                     |           |                                    |            |

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|  |           |           |            |            |
|--|-----------|-----------|------------|------------|
| Employees' compensation and benefits                     | 209,747   | 225,194   | 611,352    | 625,353    |
| Occupancy and equipment, net                             | 29,073    | 27,460    | 84,285     | 82,264     |
| Loss and loss adjustment expenses                        | 31,234    | 16,055    | 86,118     | 75,225     |
| Policy acquisition and other underwriting expenses       | 10,917    | 11,064    | 33,397     | 33,632     |
| Other  | 72,871    | 84,360    | 225,433    | 240,213    |
| Total noninterest expense                                | 353,842   | 364,133   | 1,040,585  | 1,056,687  |
| Income before income taxes                               | 48,355    | 85,505    | 178,261    | 178,285    |
| Income tax expense                                       | 18,003    | 33,017    | 58,792     | 65,879     |
| Net income   | 30,352    | 52,488    | 119,469    | 112,406    |
| Less: Net income attributable to noncontrolling interest | 146       | 556       | 353        | 1,833      |
| Income attributable to Hilltop                           | \$ 30,206 | \$ 51,932 | \$ 119,116 | \$ 110,573 |
| Earnings per common share:                               |           |           |            |            |
| Basic  | \$ 0.31   | \$ 0.53   | \$ 1.22    | \$ 1.12    |
| Diluted  | \$ 0.31   | \$ 0.53   | \$ 1.22    | \$ 1.12    |
| Cash dividends declared per common share                 | \$ 0.06   | \$ —      | \$ 0.18    | \$ —       |
| Weighted average share information:                      |           |           |            |            |
| Basic  | 96,096    | 98,490    | 97,554     | 98,367     |
| Diluted  | 96,306    | 98,625    | 97,803     | 98,573     |

See accompanying notes.



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## HILLTOP HOLDINGS INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|-----------|------------------------------------|------------|
|   | 2017                                | 2016      | 2017                               | 2016       |
| Net income  | \$ 30,352                           | \$ 52,488 | \$ 119,469                         | \$ 112,406 |
| Other comprehensive income:   |                                     |           |                                    |            |
| Net unrealized gains (losses) on securities available for sale, net of tax of \$263, \$(420), \$1,190 and \$3,004, respectively | 473                                 | (743)     | 2,109                              | 5,410      |
| Reclassification adjustment for gains (losses) included in net income, net of tax of \$0, \$0, \$(5) and \$0, respectively      | —                                   | —         | (9)                                | —          |
| Comprehensive income  | 30,825                              | 51,745    | 121,569                            | 117,816    |
| Less: comprehensive income attributable to noncontrolling interest  | 146                                 | 556       | 353                                | 1,833      |
| Comprehensive income applicable to Hilltop  | \$ 30,679                           | \$ 51,189 | \$ 121,216                         | \$ 115,983 |

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

| Common Stock |        | Additional   | Accumulated   | Retained   | Deferred     | Employee    |             | Total         |                |
|--------------|--------|--------------|---------------|------------|--------------|-------------|-------------|---------------|----------------|
| Shares       | Amount | Paid-in      | Other         | Earnings   | Compensation | Stock Trust | Stock Trust | Hilltop       | Noncontrolling |
|              |        | Capital      | Comprehensive | Net        | Employee     | Shares      | Amount      | Stockholders' | Interest       |
|              |        |              | Income        | Earnings   | Stock        |             |             | Equity        |                |
|              |        |              |               |            | Trust,       |             |             |               |                |
|              |        |              |               |            | Net          |             |             |               |                |
| 98,896       | \$ 989 | \$ 1,577,270 | \$ 2,629      | \$ 155,475 | \$ 1,034     | 22          | \$ (443)    | \$ 1,736,954  | \$ 1,171       |
| —            | —      | —            | —             | 110,573    | —            | —           | —           | 110,573       | 1,833          |
| —            | —      | —            | 5,410         | —          | —            | —           | —           | 5,410         | —              |
| 538          | 5      | 4,134        | —             | —          | —            | —           | —           | 4,139         | —              |
| —            | —      | 7,274        | —             | —          | —            | —           | —           | 7,274         | —              |
| 17           | —      | 325          | —             | —          | —            | —           | —           | 325           | —              |
| (94)         | (1)    | (2,710)      | —             | —          | —            | —           | —           | (2,711)       | —              |
| (816)        | (8)    | (16,268)     | —             | —          | —            | —           | —           | (16,276)      | —              |
| —            | —      | —            | —             | —          | (134)        | (7)         | 134         | —             | —              |
| —            | —      | —            | —             | —          | —            | —           | —           | —             | 676            |

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|         |        |              |          |            |        |     |          |              |          |
|---------|--------|--------------|----------|------------|--------|-----|----------|--------------|----------|
| 98,541  | \$ 985 | \$ 1,570,025 | \$ 8,039 | \$ 266,048 | \$ 900 | 15  | \$ (309) | \$ 1,845,688 | \$ 3,680 |
| 98,544  | \$ 985 | \$ 1,572,877 | \$ 485   | \$ 295,568 | \$ 903 | 15  | \$ (309) | \$ 1,870,509 | \$ 4,011 |
| —       | —      | —            | —        | 119,116    | —      | —   | —        | 119,116      | 353      |
| —       | —      | —            | 2,100    | —          | —      | —   | —        | 2,100        | —        |
| —       | —      | 8,396        | —        | —          | —      | —   | —        | 8,396        | —        |
| 12      | —      | 327          | —        | —          | —      | —   | —        | 327          | —        |
| 264     | 3      | (2,433)      | —        | —          | —      | —   | —        | (2,430)      | —        |
| (2,916) | (29)   | (53,998)     | —        | (20,427)   | —      | —   | —        | (74,454)     | —        |
| —       | —      | —            | —        | (17,384)   | —      | —   | —        | (17,384)     | —        |
| —       | —      | —            | —        | —          | (63)   | (3) | 68       | 5            | —        |
| —       | —      | —            | —        | —          | —      | —   | —        | —            | (1,193)  |
| 95,904  | \$ 959 | \$ 1,525,169 | \$ 2,585 | \$ 376,873 | \$ 840 | 12  | \$ (241) | \$ 1,906,185 | \$ 3,171 |

See accompanying notes.

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## HILLTOP HOLDINGS INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

|   | Nine Months Ended September 30, |              |
|---|---------------------------------|--------------|
|   | 2017                            | 2016         |
| Operating Activities  |                                 |              |
| Net income  | \$ 119,469                      | \$ 112,406   |
| Adjustments to reconcile net income to net cash used in operating activities:             |                                 |              |
| Provision for loan losses   | 8,818                           | 36,273       |
| Depreciation, amortization and accretion, net   | (11,300)                        | (37,616)     |
| Net realized gains on securities  | (14)                            | —            |
| Deferred income taxes   | 6,013                           | 4,878        |
| Other, net  | 8,540                           | 11,661       |
| Net change in securities purchased under agreements to resell                             | (45,224)                        | (32,624)     |
| Net change in assets segregated for regulatory purposes                                   | (26,343)                        | (15,227)     |
| Net change in trading securities  | (410,877)                       | (187,958)    |
| Net change in broker-dealer and clearing organization receivables                         | (157,908)                       | 149,674      |
| Net change in FDIC indemnification asset  | 24,637                          | 18,486       |
| Net change in other assets  | (35,967)                        | (50,760)     |
| Net change in broker-dealer and clearing organization payables                            | 223,043                         | (117,398)    |
| Net change in other liabilities   | (100,970)                       | (1,612)      |
| Net change in securities sold, not yet purchased  | 19,620                          | 34,589       |
| Proceeds from sale of mortgage servicing rights asset                                     | 17,499                          | 7,586        |
| Net gains from sales of loans   | (416,336)                       | (469,721)    |
| Loans originated for sale   | (11,251,438)                    | (11,995,553) |
| Proceeds from loans sold  | 11,520,363                      | 12,292,342   |
| Net cash used in operating activities   | (508,375)                       | (240,574)    |
| Investing Activities  |                                 |              |
| Proceeds from maturities and principal reductions of securities held to maturity          | 42,185                          | 141,485      |
| Proceeds from sales, maturities and principal reductions of securities available for sale | 248,578                         | 367,307      |
| Purchases of securities held to maturity  | (58,831)                        | (175,781)    |
| Purchases of securities available for sale  | (415,282)                       | (250,896)    |
| Net change in loans   | (206,362)                       | (465,542)    |
| Purchases of premises and equipment and other assets                                      | (20,093)                        | (31,119)     |
| Proceeds from sales of premises and equipment and other real estate owned                 | 27,333                          | 58,490       |
| Net cash received from (paid for) Federal Home Loan Bank and Federal Reserve Bank stock   | 14,540                          | (6,807)      |

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|  |            |            |
|--|------------|------------|
| Net cash used in investing activities                    | (367,932)  | (362,863)  |
| <b>Financing Activities</b>                              |            |            |
| Net change in deposits                                   | 547,163    | 108,834    |
| Net change in short-term borrowings                      | 59,912     | 317,649    |
| Proceeds from notes payable                              | 285,806    | 208,794    |
| Payments on notes payable                                | (303,472)  | (134,052)  |
| Proceeds from issuance of common stock                   | —          | 4,139      |
| Payments to repurchase common stock                      | (27,388)   | —          |
| Dividends paid on common stock                           | (17,384)   | —          |
| Net cash distributed (to) from noncontrolling interest   | (1,193)    | 676        |
| Taxes paid on employee stock awards netting activity     | (2,431)    | (2,406)    |
| Other, net   | (501)      | (704)      |
| Net cash provided by financing activities                | 540,512    | 502,930    |
| <br>   |            |            |
| Net change in cash and cash equivalents                  | (335,795)  | (100,507)  |
| Cash and cash equivalents, beginning of period           | 690,764    | 669,445    |
| Cash and cash equivalents, end of period                 | \$ 354,969 | \$ 568,938 |
| <br>   |            |            |
| <b>Supplemental Disclosures of Cash Flow Information</b> |            |            |
| Cash paid for interest                                   | \$ 57,504  | \$ 42,399  |
| Cash paid for income taxes, net of refunds               | \$ 69,863  | \$ 53,899  |
| <b>Supplemental Schedule of Non-Cash Activities</b>      |            |            |
| Conversion of loans to other real estate owned           | \$ 8,319   | \$ 14,894  |
| Additions to mortgage servicing rights                   | \$ 8,429   | \$ 20,309  |

See accompanying notes.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting and Reporting Policies

Nature of Operations

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

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

Basis of Presentation

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

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

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

PrimeLending owns a 100% membership interest in PrimeLending Ventures Management, LLC (“Ventures Management”), 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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

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

2. Recently Issued Accounting Standards



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

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

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

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

In January 2016, FASB issued ASU 2016-01 related to financial instruments. This amendment requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The amendment also impacts financial liabilities under the Fair Value Option and the presentation and disclosure requirements for financial instruments and modifies the required process used to evaluate deferred tax assets on available for sale securities. The amendment is effective for annual periods, and interim periods within those annual

periods, beginning after December 15, 2017. Upon adoption, the Company will reclassify all equity investments out of trading and available for sale securities, with all subsequent changes in fair value recognized in net income. Additionally, the disclosure of the fair value of the loan portfolio will be presented using an exit price method instead of the current discounted cash flow method. The Company continues to evaluate the impact of ASU 2016-01 on other aspects of its consolidated financial statements.

In July 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 by one year, to clarify the principles for recognizing revenue from contracts with customers. The FASB has subsequently issued several amendments to the standard, including clarification of principal versus agent considerations, narrow scope improvements and other technical corrections. The amendments outline a single comprehensive model for entities to depict the transfer of goods or services to customers in amounts that reflect the payment to which a company expects to be entitled in exchange for those goods or services. The amendments also require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017 and may be adopted using either a full retrospective transition method or a modified, cumulative-effect approach

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

wherein the guidance is applied only to existing contracts as of the date of initial application and to new contracts entered into thereafter. The Company does not intend to adopt the provisions of the amendment early and expects to adopt using the cumulative-effect approach. The Company has gathered an inventory of contracts with customers and performed an in-depth assessment. The preliminary assessment suggests that the revenue recognition policies within the Company's broker-dealer segment will be affected when adopted. Specifically, the new guidance may require certain advisory and underwriting revenues and expenses to be recorded on a gross basis while the current guidance requires recognizing these revenues net of the related expenses. The Company is still interpreting certain aspects of this new accounting guidance to address certain implementation issues, specifically the impact of any changes to the accounting for mutual fund fees and insurance product sales commissions received throughout the life of the contract. The Company will continue to evaluate the impact on its future consolidated financial statements of both current and newly issued guidance associated with the amendment.

### 3. Fair Value Measurements

#### Fair Value Measurements and Disclosures

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

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

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities that the Company can access at the measurement date.
- Level 2 Inputs: Observable inputs other than Level 1 prices. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, yield curves, prepayment speeds, default rates, credit risks and loss severities), and inputs that are derived from or corroborated by market data, among others.
- Level 3 Inputs: Unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities. Level 3 inputs include pricing models and discounted cash flow techniques, among others.

#### Fair Value Option

The Company has elected to measure substantially all of PrimeLending's mortgage loans held for sale and retained mortgage servicing rights ("MSR") asset at fair value, under the provisions of the Fair Value Option. The Company elected to apply the provisions of the Fair Value Option to these items so that it would have the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. At September 30, 2017 and December 31, 2016, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was \$1.86 billion and \$1.75 billion, respectively, and the unpaid principal balance of those loans was \$1.79 billion and \$1.71 billion, respectively. The interest component of fair value is reported as interest income on loans in the accompanying consolidated statements of operations.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

|                                    | Level 1  | Level 2    | Level 3 | Total      |
|------------------------------------|----------|------------|---------|------------|
| September 30, 2017                 | Inputs   | Inputs     | Inputs  | Fair Value |
| Trading securities                 | \$ 3,526 | \$ 672,885 | \$ —    | \$ 676,411 |
| Available for sale securities      | 20,983   | 744,559    | —       | 765,542    |
| Loans held for sale                | —        | 1,828,275  | 31,545  | 1,859,820  |
| Derivative assets                  | —        | 55,563     | —       | 55,563     |
| MSR asset                          | —        | —          | 47,766  | 47,766     |
| Securities sold, not yet purchased | 85,471   | 88,038     | —       | 173,509    |
| Derivative liabilities             | —        | 17,500     | —       | 17,500     |

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

|   | Balance at<br>Beginning of<br>Period | Purchases/<br>Additions | Sales/<br>Reductions | Total Gains or Losses<br>(Realized or Unrealized) |   | Balance at<br>End of Period |
|---|--------------------------------------|-------------------------|----------------------|---|---|-----------------------------|
|   |                                      |                         |                      | Included in<br>Net Income                         | Included in Other<br>Comprehensive<br>Income (Loss) |                             |
| Three months<br>ended September 30,<br>2017 |                                      |                         |                      |   |   |                             |
| Loans held for sale                         | \$ 30,037                            | \$ 8,881                | \$ (5,685)           | \$ (1,688)  | \$ —  | \$ 31,545                   |
| MSR asset                                   | 43,580                               | 5,939                   | —                    | (1,753)   | —   | 47,766                      |
| Total                                       | \$ 73,617                            | \$ 14,820               | \$ (5,685)           | \$ (3,441)  | \$ —  | \$ 79,311                   |
| Nine months ended<br>September 30, 2017     |                                      |                         |                      |   |   |                             |
| Loans held for sale                         | \$ 35,801                            | \$ 25,384               | \$ (23,108)          | \$ (6,532)  | \$ —  | \$ 31,545                   |
| MSR asset                                   | 61,968                               | 8,429                   | (17,499)             | (5,132)   | —   | 47,766                      |
| Total                                       | \$ 97,769                            | \$ 33,813               | \$ (40,607)          | \$ (11,664)                                       | \$ —  | \$ 79,311                   |
| Three months<br>ended September 30,<br>2016 |                                      |                         |                      |   |   |                             |
| Trading securities                          | \$ 1                                 | \$ —                    | \$ —                 | \$ (1)  | \$ —  | \$ —                        |
| Loans held for sale                         | 45,645                               | 8,066                   | (8,686)              | (2,448)   | —   | 42,577                      |
| MSR asset                                   | 33,491                               | 10,416                  | —                    | (156)   | —   | 43,751                      |
| Total                                       | \$ 79,137                            | \$ 18,482               | \$ (8,686)           | \$ (2,605)  | \$ —  | \$ 86,328                   |
| Nine months ended<br>September 30, 2016     |                                      |                         |                      |   |   |                             |
| Trading securities                          | \$ 1                                 | \$ —                    | \$ —                 | \$ (1)  | \$ —  | \$ —                        |
| Loans held for sale                         | 25,880                               | 51,105                  | (23,817)             | (10,591)  | —   | 42,577                      |
| MSR asset                                   | 52,285                               | 20,309                  | (7,586)              | (21,257)  | —   | 43,751                      |
| Total                                       | \$ 78,166                            | \$ 71,414               | \$ (31,403)          | \$ (31,849)                                       | \$ —  | \$ 86,328                   |

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

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

| Financial instrument | Valuation Technique                       | Unobservable Inputs      | Range<br>(Weighted-Average) |
|----------------------|---|--------------------------|-----------------------------|
| Loans held for sale  | Discounted cash flows / Market comparable | Projected price          | 90 - 95 % ( 95 %)           |
| MSR asset            | Discounted cash flows                     | Constant prepayment rate | 10.85 %                     |
|                      |   | Discount rate            | 11.07 %                     |

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

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

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



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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

|                     | Three Months Ended September 30, 2017 |                                |                                   | Three Months Ended September 30, 2016 |                                |                                   |
|---------------------|---------------------------------------|--------------------------------|-----------------------------------|---------------------------------------|--------------------------------|-----------------------------------|
|                     | Net<br>Gains<br>(Losses)              | Other<br>Noninterest<br>Income | Total<br>Changes in<br>Fair Value | Net<br>Gains (Losses)                 | Other<br>Noninterest<br>Income | Total<br>Changes in<br>Fair Value |
| Loans held for sale | \$ (4,443)                            | \$ —                           | \$ (4,443)                        | \$ 73                                 | \$ —                           | \$ 73                             |
| MSR asset           | (1,753)                               | —                              | (1,753)                           | (156)                                 | —                              | (156)                             |

  

|                     | Nine Months Ended September 30, 2017 |                                |                                   | Nine Months Ended September 30, 2016 |                                |                                   |
|---------------------|--------------------------------------|--------------------------------|-----------------------------------|--------------------------------------|--------------------------------|-----------------------------------|
|                     | Net<br>Gains<br>(Losses)             | Other<br>Noninterest<br>Income | Total<br>Changes in<br>Fair Value | Net<br>Gains (Losses)                | Other<br>Noninterest<br>Income | Total<br>Changes in<br>Fair Value |
| Loans held for sale | \$ 26,650                            | \$ —                           | \$ 26,650                         | \$ 16,003                            | \$ —                           | \$ 16,003                         |
| MSR asset           | (5,132)                              | —                              | (5,132)                           | (21,257)                             | —                              | (21,257)                          |

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

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

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

|                                     | PCI Loans     |   |             |   |        |   |
|-------------------------------------|---------------|---|-------------|---|--------|---|
|                                     | PlainsCapital |   | FNB         |   | SWS    |   |
|                                     | Merger        |   | Transaction |   | Merger |   |
| Weighted average default rate       | 64            | % | 45          | % | 59     | % |
| Weighted average loss severity rate | 66            | % | 18          | % | 29     | % |
| Weighted average prepayment speed   | 0             | % | 8           | % | 0      | % |

At September 30, 2017, the resulting weighted average expected loss on PCI loans associated with the PlainsCapital Merger, FNB Transaction and SWS Merger was 43%, 8% and 17%, respectively.

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

Other Real Estate Owned — The Company determines fair value primarily using independent appraisals of other real estate owned (“OREO”) properties. The resulting fair value measurements are classified as Level 2 or Level 3 inputs, depending upon the extent to which unobservable inputs determine the fair value measurement. The Company considers a number of factors in determining the extent to which specific fair value measurements utilize unobservable inputs, including, but not limited to, the inherent subjectivity in appraisals, the length of time elapsed since the receipt of independent market price or appraised value, and current market conditions. At September 30, 2017, the most significant

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

unobservable input used in the determination of fair value of OREO was a discount to independent appraisals for estimated holding periods of OREO properties. Level 3 inputs were used to determine the initial fair value at acquisition of a large group of smaller balance properties that were acquired in the FNB Transaction. In the FNB Transaction, the Bank acquired OREO of \$135.2 million, all of which is covered by FDIC loss-share agreements. At September 30, 2017 and December 31, 2016, the estimated fair value of covered OREO was \$40.3 million and \$51.6 million, respectively, and the underlying fair value measurements utilized Level 2 and Level 3 inputs. The fair value of non-covered OREO at September 30, 2017 and December 31, 2016 was \$4.8 million and \$4.5 million, respectively, and is included in other assets within the consolidated balance sheets. During the reported periods, all fair value measurements for non-covered OREO subsequent to initial recognition utilized Level 2 inputs.

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

| September 30,<br>2017                     | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total<br>Fair Value | Total Gains (Losses) for the<br>Three Months Ended |          | Total Gains (Losses) for the<br>Nine Months Ended |          |
|---|-------------------|-------------------|-------------------|---------------------|--|----------|---|----------|
|   |                   |                   |                   |                     | September 30,<br>2017                              | 2016     | September 30,<br>2017                             | 2016     |
| Non-covered<br>impaired<br>loans          | \$ —              | \$ —              | \$ 42,953         | \$ 42,953           | \$ 793   | \$ 1,149 | \$ 323  | \$ 1,284 |
| Covered<br>impaired<br>loans              | —                 | —                 | 58,490            | 58,490              | (787)  | 725      | (1,764)   | 815      |
| Non-covered<br>other real<br>estate owned | —                 | 3,512             | —                 | 3,512               | (135)  | (427)    | (258)   | (439)    |
| Covered other<br>real estate<br>owned     | —                 | 6,969             | —                 | 6,969               | (388)  | (2,552)  | (2,523)   | (14,284) |

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

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).

| September 30, 2017                                  | Carrying Amount | Estimated Fair Value |                |                | Total      |
|---|-----------------|----------------------|----------------|----------------|------------|
|   |                 | Level 1 Inputs       | Level 2 Inputs | Level 3 Inputs |            |
| <b>Financial assets:</b>                            |                 |                      |                |                |            |
| Cash and cash equivalents                           | \$ 354,969      | \$ 354,969           | \$ —           | \$ —           | \$ 354,969 |
| Securities purchased under agreements to resell     | 134,654         | —                    | 134,654        | —              | 134,654    |
| Assets segregated for regulatory purposes           | 207,336         | 207,336              | —              | —              | 207,336    |
| Held to maturity securities                         | 368,031         | —                    | 364,122        | —              | 364,122    |
| Loans held for sale                                 | 79,501          | —                    | 79,501         | —              | 79,501     |
| Non-covered loans, net                              | 6,090,034       | —                    | 485,604        | 5,802,891      | 6,288,495  |
| Covered loans, net                                  | 188,269         | —                    | —              | 284,424        | 284,424    |
| Broker-dealer and clearing organization receivables | 1,672,123       | —                    | 1,672,123      | —              | 1,672,123  |
| FDIC indemnification asset                          | 33,143          | —                    | —              | 22,866         | 22,866     |
| Other assets  | 64,907          | —                    | 59,300         | 5,607          | 64,907     |
| <b>Financial liabilities:</b>                       |                 |                      |                |                |            |
| Deposits  | 7,663,447       | —                    | 7,662,392      | —              | 7,662,392  |
| Broker-dealer and clearing organization payables    | 1,517,698       | —                    | 1,517,698      | —              | 1,517,698  |
| Short-term borrowings                               | 1,477,201       | —                    | 1,477,201      | —              | 1,477,201  |
| Debt  | 367,208         | —                    | 364,731        | —              | 364,731    |
| Other liabilities                                   | 6,630           | —                    | 6,630          | —              | 6,630      |

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

| December 31, 2016                                      | Carrying<br>Amount | Estimated Fair Value |                   |                   | Total      |
|--|--------------------|----------------------|-------------------|-------------------|------------|
|  |                    | Level 1<br>Inputs    | Level 2<br>Inputs | Level 3<br>Inputs |            |
| Financial assets:                                      |                    |                      |                   |                   |            |
| Cash and cash equivalents                              | \$ 690,764         | \$ 690,764           | \$ —              | \$ —              | \$ 690,764 |
| Securities purchased under<br>agreements to resell     | 89,430             | —                    | 89,430            | —                 | 89,430     |
| Assets segregated for regulatory<br>purposes           | 180,993            | 180,993              | —                 | —                 | 180,993    |
| Held to maturity securities                            | 351,831            | —                    | 345,088           | —                 | 345,088    |
| Loans held for sale                                    | 46,965             | —                    | 46,965            | —                 | 46,965     |
| Non-covered loans, net                                 | 5,789,313          | —                    | 502,077           | 5,459,975         | 5,962,052  |
| Covered loans, net                                     | 255,714            | —                    | —                 | 367,444           | 367,444    |
| Broker-dealer and clearing<br>organization receivables | 1,497,741          | —                    | 1,497,741         | —                 | 1,497,741  |
| FDIC indemnification asset                             | 71,313             | —                    | —                 | 60,173            | 60,173     |
| Other assets   | 62,904             | —                    | 58,697            | 4,207             | 62,904     |
| Financial liabilities:                                 |                    |                      |                   |                   |            |
| Deposits   | 7,063,811          | —                    | 7,058,837         | —                 | 7,058,837  |
| Broker-dealer and clearing<br>organization payables    | 1,347,128          | —                    | 1,347,128         | —                 | 1,347,128  |
| Short-term borrowings                                  | 1,417,289          | —                    | 1,417,289         | —                 | 1,417,289  |
| Debt   | 384,924            | —                    | 378,822           | —                 | 378,822    |
| Other liabilities                                      | 3,708              | —                    | 3,708             | —                 | 3,708      |

## 4. Securities

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

|  | September<br>30,<br>2017 | December<br>31,<br>2016 |
|--|--------------------------|-------------------------|
| U.S. Treasury securities               | \$ 200                   | \$ 5,940                |
| U.S. government agencies:              |                          |                         |
| Bonds                                  | 53,275                   | 36,303                  |
| Residential mortgage-backed securities | 407,275                  | 2,539                   |
| Commercial mortgage-backed securities  | 9,599                    | 15,171                  |
| Collateralized mortgage obligations    | 1,098                    | 5,607                   |
| Corporate debt securities              | 77,435                   | 60,699                  |
| States and political subdivisions      | 90,144                   | 89,946                  |
| Unit investment trusts                 | 31,626                   | 41,409                  |
| Private-label securitized product      | 2,398                    | 4,292                   |
| Other                                  | 3,361                    | 3,628                   |
| Totals                                 | \$ 676,411               | \$ 265,534              |

The Hilltop Broker-Dealers enter into transactions that represent commitments to purchase and deliver securities at prevailing future market prices to facilitate customer transactions and satisfy such commitments. Accordingly, the Hilltop Broker-Dealers' ultimate obligations may exceed the amount recognized in the financial statements. These securities, which are carried at fair value and reported as securities sold, not yet purchased in the consolidated balance sheets, had a value of \$173.5 million and \$153.9 million at September 30, 2017 and December 31, 2016, respectively.

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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).

| September 30, 2017                     | Available for Sale |                  |                   | Fair Value |
|--|--------------------|------------------|-------------------|------------|
|  | Amortized Cost     | Unrealized Gains | Unrealized Losses |            |
| U.S. Treasury securities               | \$ 22,751          | \$ 168           | \$ (39)           | \$ 22,880  |
| U.S. government agencies:              |                    |                  |                   |            |
| Bonds                                  | 100,289            | 851              | (133)             | 101,007    |
| Residential mortgage-backed securities | 247,272            | 940              | (2,304)           | 245,908    |
| Commercial mortgage-backed securities  | 12,091             | 78               | (24)              | 12,145     |
| Collateralized mortgage obligations    | 222,187            | 203              | (2,656)           | 219,734    |
| Corporate debt securities              | 72,266             | 2,489            | (2)               | 74,753     |
| States and political subdivisions      | 66,173             | 1,493            | (39)              | 67,627     |
| Commercial mortgage-backed securities  | 499                | 6                | —                 | 505        |
| Equity securities                      | 19,456             | 1,532            | (5)               | 20,983     |
| Totals                                 | \$ 762,984         | \$ 7,760         | \$ (5,202)        | \$ 765,542 |

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

Held to Maturity

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| September 30, 2017                     | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair Value |
|--|-------------------|---------------------|----------------------|------------|
| U.S. government agencies:              |                   |                     |                      |            |
| Bonds                                  | \$ 40,515         | \$ 28               | \$ (891)             | \$ 39,652  |
| Residential mortgage-backed securities | 16,973            | 198                 | —                    | 17,171     |
| Commercial mortgage-backed securities  | 71,613            | 404                 | (510)                | 71,507     |
| Collateralized mortgage obligations    | 183,926           | 152                 | (2,550)              | 181,528    |
| States and political subdivisions      | 55,004            | 289                 | (1,029)              | 54,264     |
| Totals                                 | \$ 368,031        | \$ 1,071            | \$ (4,980)           | \$ 364,122 |

| December 31, 2016                      | Held to Maturity  |                     |                      | Fair Value |
|--|-------------------|---------------------|----------------------|------------|
|  | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses |            |
| U.S. government agencies:              |                   |                     |                      |            |
| Bonds                                  | \$ 40,513         | \$ —                | \$ (1,287)           | \$ 39,226  |
| Residential mortgage-backed securities | 19,606            | 13                  | (6)                  | 19,613     |
| Commercial mortgage-backed securities  | 31,767            | 102                 | (593)                | 31,276     |
| Collateralized mortgage obligations    | 217,954           | 128                 | (3,372)              | 214,710    |
| States and political subdivisions      | 41,991            | 70                  | (1,798)              | 40,263     |
| Totals                                 | \$ 351,831        | \$ 313              | \$ (7,056)           | \$ 345,088 |



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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

|   | September 30, 2017      |            |                      | December 31, 2016       |            |                      |
|---|-------------------------|------------|----------------------|-------------------------|------------|----------------------|
|   | Number of<br>Securities | Fair Value | Unrealized<br>Losses | Number of<br>Securities | Fair Value | Unrealized<br>Losses |
| Available for Sale                          |                         |            |                      |                         |            |                      |
| U.S. treasury securities:                   |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | 6                       | \$ 17,354  | \$ 37                | 7                       | \$ 21,694  | \$ 44                |
| Unrealized loss for twelve months or longer | 1                       | 399        | 2                    | —                       | —          | —                    |
|   | 7                       | 17,753     | 39                   | 7                       | 21,694     | 44                   |
| U.S. government agencies:                   |                         |            |                      |                         |            |                      |
| Bonds:                                      |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | 10                      | 77,870     | 133                  | 1                       | 14,908     | 67                   |
| Unrealized loss for twelve months or longer | —                       | —          | —                    | —                       | —          | —                    |
|   | 10                      | 77,870     | 133                  | 1                       | 14,908     | 67                   |
| Residential mortgage-backed securities:     |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | 9                       | 76,966     | 557                  | 12                      | 109,398    | 2,941                |
| Unrealized loss for twelve months or longer | 8                       | 67,899     | 1,747                | —                       | —          | —                    |
|   | 17                      | 144,865    | 2,304                | 12                      | 109,398    | 2,941                |
| Commercial mortgage-backed securities:      |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | 1                       | 5,076      | 24                   | 2                       | 7,127      | 58                   |
| Unrealized loss for twelve months or longer | —                       | —          | —                    | —                       | —          | —                    |
|   | 1                       | 5,076      | 24                   | 2                       | 7,127      | 58                   |
| Collateralized mortgage obligations:        |                         |            |                      |                         |            |                      |
|   | 13                      | 96,857     | 440                  | 11                      | 91,144     | 2,340                |

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|   |    |            |          |    |            |          |
|---|----|------------|----------|----|------------|----------|
| Unrealized loss for less than twelve months |    |            |          |    |            |          |
| Unrealized loss for twelve months or longer | 14 | 60,719     | 2,216    | 8  | 19,320     | 866      |
|   | 27 | 157,576    | 2,656    | 19 | 110,464    | 3,206    |
| Corporate debt securities:                  |    |            |          |    |            |          |
| Unrealized loss for less than twelve months | 1  | 1,996      | 2        | 3  | 5,899      | 91       |
| Unrealized loss for twelve months or longer | —  | —          | —        | —  | —          | —        |
|   | 1  | 1,996      | 2        | 3  | 5,899      | 91       |
| States and political subdivisions:          |    |            |          |    |            |          |
| Unrealized loss for less than twelve months | 11 | 5,714      | 20       | 32 | 17,549     | 322      |
| Unrealized loss for twelve months or longer | 8  | 2,374      | 19       | 1  | 450        | 14       |
|   | 19 | 8,088      | 39       | 33 | 17,999     | 336      |
| Equity securities:                          |    |            |          |    |            |          |
| Unrealized loss for less than twelve months | 1  | 181        | —        | —  | —          | —        |
| Unrealized loss for twelve months or longer | 2  | 6,900      | 5        | 2  | 11,107     | 343      |
|   | 3  | 7,081      | 5        | 2  | 11,107     | 343      |
| Total available for sale:                   |    |            |          |    |            |          |
| Unrealized loss for less than twelve months | 52 | 282,014    | 1,213    | 68 | 267,719    | 5,863    |
| Unrealized loss for twelve months or longer | 33 | 138,291    | 3,989    | 11 | 30,877     | 1,223    |
|   | 85 | \$ 420,305 | \$ 5,202 | 79 | \$ 298,596 | \$ 7,086 |

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

|   | September 30, 2017      |            | Unrealized<br>Losses | December 31, 2016       |            | Unrealized<br>Losses |
|---|-------------------------|------------|----------------------|-------------------------|------------|----------------------|
|   | Number of<br>Securities | Fair Value |                      | Number of<br>Securities | Fair Value |                      |
| Held to Maturity                            |                         |            |                      |                         |            |                      |
| U.S. government agencies:                   |                         |            |                      |                         |            |                      |
| Bonds:                                      |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | —                       | \$ —       | \$ —                 | 4                       | \$ 33,225  | \$ 1,287             |
| Unrealized loss for twelve months or longer | 3                       | 32,124     | 891                  | —                       | —          | —                    |
|   | 3                       | 32,124     | 891                  | 4                       | 33,225     | 1,287                |
| Residential mortgage-backed securities:     |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | —                       | —          | —                    | 2                       | 13,178     | 6                    |
| Unrealized loss for twelve months or longer | —                       | —          | —                    | —                       | —          | —                    |
|   | —                       | —          | —                    | 2                       | 13,178     | 6                    |
| Commercial mortgage-backed securities:      |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | 3                       | 13,805     | 130                  | 5                       | 18,891     | 588                  |
| Unrealized loss for twelve months or longer | 2                       | 12,823     | 380                  | 1                       | 1,401      | 5                    |
|   | 5                       | 26,628     | 510                  | 6                       | 20,292     | 593                  |
| Collateralized mortgage obligations:        |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | 12                      | 100,054    | 1,066                | 19                      | 187,669    | 3,372                |
| Unrealized loss for twelve months or longer | 5                       | 57,570     | 1,484                | —                       | —          | —                    |
|   | 17                      | 157,624    | 2,550                | 19                      | 187,669    | 3,372                |
| States and political subdivisions:          |                         |            |                      |                         |            |                      |
| Unrealized loss for less than twelve months | 36                      | 17,311     | 188                  | 71                      | 29,862     | 1,790                |
| Unrealized loss for twelve months or longer | 40                      | 15,723     | 841                  | 1                       | 462        | 8                    |

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|   |     |            |          |     |            |          |
|---|-----|------------|----------|-----|------------|----------|
|   | 76  | 33,034     | 1,029    | 72  | 30,324     | 1,798    |
| Total held to maturity:                     |     |            |          |     |            |          |
| Unrealized loss for less than twelve months | 51  | 131,170    | 1,384    | 101 | 282,825    | 7,043    |
| Unrealized loss for twelve months or longer | 50  | 118,240    | 3,596    | 2   | 1,863      | 13       |
|   | 101 | \$ 249,410 | \$ 4,980 | 103 | \$ 284,688 | \$ 7,056 |

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

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

|  | Available for Sale Amortized |            | Held to Maturity Amortized |            |
|--|------------------------------|------------|----------------------------|------------|
|  | Cost                         | Fair Value | Cost                       | Fair Value |
| Due in one year or less                | \$ 108,593                   | \$ 108,958 | \$ 4,947                   | \$ 4,954   |
| Due after one year through five years  | 86,378                       | 88,189     | 2,850                      | 2,884      |
| Due after five years through ten years | 40,798                       | 42,418     | 26,721                     | 26,253     |
| Due after ten years                    | 25,710                       | 26,702     | 61,001                     | 59,825     |
|  | 261,479                      | 266,267    | 95,519                     | 93,916     |
| Residential mortgage-backed securities | 247,272                      | 245,908    | 16,973                     | 17,171     |
| Collateralized mortgage obligations    | 222,187                      | 219,734    | 183,926                    | 181,528    |
| Commercial mortgage-backed securities  | 12,590                       | 12,650     | 71,613                     | 71,507     |
|  | \$ 743,528                   | \$ 744,559 | \$ 368,031                 | \$ 364,122 |

The Company realized net gains of \$5.8 million and \$6.0 million from its trading securities portfolio during the three months ended September 30, 2017 and 2016, respectively, and net gains from its trading securities portfolio of \$18.7 million and \$17.5 million during the nine months ended September 30, 2017 and 2016, respectively. In addition, the

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Hilltop Broker-Dealers realized net gains from trading activities primarily associated with the structured finance business of \$21.8 million and \$33.7 million during the three months ended September 30, 2017 and 2016, respectively, and \$38.8 million and \$63.0 million during the nine months ended September 30, 2017 and 2016, respectively. All such realized net gains are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of \$600.6 million and \$695.1 million (with a fair value of \$597.1 million and \$688.1 million, respectively) at September 30, 2017 and December 31, 2016, respectively, were pledged to secure public and trust deposits, federal funds purchased and securities sold under agreements to repurchase, and for other purposes as required or permitted by law. Substantially all of these pledged securities were included in our available for sale and held to maturity securities portfolios at September 30, 2017 and December 31, 2016.

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

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

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

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

|  | September<br>30,<br>2017 | December 31,<br>2016 |
|--|--------------------------|----------------------|
|--|--------------------------|----------------------|

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|   |              |              |
|---|--------------|--------------|
| Commercial and industrial                 | \$ 1,735,468 | \$ 1,696,453 |
| Real estate                               | 2,944,155    | 2,816,767    |
| Construction and land development         | 941,628      | 786,850      |
| Consumer                                  | 41,958       | 41,352       |
| Broker-dealer (1)                         | 485,604      | 502,077      |
|   | 6,148,813    | 5,843,499    |
| Allowance for non-covered loan losses     | (58,779)     | (54,186)     |
| Total non-covered loans, net of allowance | \$ 6,090,034 | \$ 5,789,313 |

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

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

|                     | September<br>30,<br>2017 | December<br>31,<br>2016 |
|---------------------|--------------------------|-------------------------|
| Carrying amount     | \$ 37,937                | \$ 51,432               |
| Outstanding balance | 52,096                   | 67,988                  |

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

|   | Three Months Ended |           | Nine Months Ended |           |
|---|--------------------|-----------|-------------------|-----------|
|   | September 30,      |           | September 30,     |           |
|   | 2017               | 2016      | 2017              | 2016      |
| Balance, beginning of period                            | \$ 9,793           | \$ 15,229 | \$ 13,116         | \$ 17,744 |
| Reclassifications from nonaccretable difference, net(1) | 277                | 708       | 854               | 4,655     |
| Disposals of loans                                      | (603)              | —         | (664)             | —         |
| Accretion   | (1,851)            | (1,884)   | (5,690)           | (8,346)   |
| Balance, end of period                                  | \$ 7,616           | \$ 14,053 | \$ 7,616          | \$ 14,053 |

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

The remaining nonaccretable difference for non-covered PCI loans was \$20.2 million and \$22.8 million at September 30, 2017 and December 31, 2016, respectively.

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

|                            | Unpaid<br>Contractual<br>Principal Balance | Recorded<br>Investment with<br>No Allowance | Recorded<br>Investment with<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance |
|----------------------------|--|---|--|---------------------------------|----------------------|
| September 30, 2017         |  |   |  |                                 |                      |
| PCI                        |  |   |  |                                 |                      |
| Commercial and industrial: |  |   |  |                                 |                      |
| Secured                    | \$ 19,390                                  | \$ 3,556                                    | \$ 2,676                                 | \$ 6,232                        | \$ 111               |
| Unsecured                  | —  | —   | —  | —                               | —                    |

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|  |            |           |           |           |          |
|--|------------|-----------|-----------|-----------|----------|
| Real estate:                                       |            |           |           |           |          |
| Secured by commercial properties                   | 28,362     | 6,548     | 13,388    | 19,936    | 1,422    |
| Secured by residential properties                  | 12,964     | 7,703     | 2,315     | 10,018    | 284      |
| Construction and land development:                 |            |           |           |           |          |
| Residential construction loans                     | —          | —         | —         | —         | —        |
| Commercial construction loans and land development | 3,462      | 477       | 1,111     | 1,588     | 237      |
| Consumer   | 2,588      | 19        | 144       | 163       | 44       |
| Broker-dealer                                      | —          | —         | —         | —         | —        |
|  | 66,766     | 18,303    | 19,634    | 37,937    | 2,098    |
| Non-PCI  |            |           |           |           |          |
| Commercial and industrial:                         |            |           |           |           |          |
| Secured  | 21,218     | 17,844    | —         | 17,844    | —        |
| Unsecured  | 745        | 708       | —         | 708       | —        |
| Real estate:                                       |            |           |           |           |          |
| Secured by commercial properties                   | 15,402     | 11,380    | 3,386     | 14,766    | 846      |
| Secured by residential properties                  | 1,536      | 1,151     | —         | 1,151     | —        |
| Construction and land development:                 |            |           |           |           |          |
| Residential construction loans                     | 15         | —         | —         | —         | —        |
| Commercial construction loans and land development | 659        | —         | 626       | 626       | 112      |
| Consumer   | 167        | 63        | —         | 63        | —        |
| Broker-dealer                                      | —          | —         | —         | —         | —        |
|  | 39,742     | 31,146    | 4,012     | 35,158    | 958      |
|  | \$ 106,508 | \$ 49,449 | \$ 23,646 | \$ 73,095 | \$ 3,056 |



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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2017                                | 2016      | 2017                               | 2016      |
| Commercial and industrial:                         |                                     |           |                                    |           |
| Secured  | \$ 20,452                           | \$ 25,338 | \$ 18,717                          | \$ 25,903 |
| Unsecured  | 713                                 | 38        | 817                                | 38        |
| Real estate:                                       |                                     |           |                                    |           |
| Secured by commercial properties                   | 35,458                              | 34,491    | 36,606                             | 37,329    |
| Secured by residential properties                  | 11,412                              | 11,746    | 11,387                             | 12,179    |
| Construction and land development:                 |                                     |           |                                    |           |
| Residential construction loans                     | —                                   | —         | 14                                 | 111       |
| Commercial construction loans and land development | 2,590                               | 4,161     | 3,204                              | 4,692     |
| Consumer   | 324                                 | 412       | 382                                | 583       |
| Broker-dealer                                      | —                                   | —         | —                                  | —         |
|  | \$ 70,949                           | \$ 76,186 | \$ 71,127                          | \$ 80,835 |

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

|  | September<br>30,<br>2017 | December<br>31,<br>2016 |
|--|--------------------------|-------------------------|
| Commercial and industrial:                         |                          |                         |
| Secured  | \$ 20,726                | \$ 8,590                |
| Unsecured  | 708                      | 925                     |
| Real estate:                                       |                          |                         |
| Secured by commercial properties                   | 14,766                   | 11,034                  |
| Secured by residential properties                  | 1,608                    | 1,197                   |
| Construction and land development:                 |                          |                         |
| Residential construction loans                     | —                        | 28                      |
| Commercial construction loans and land development | 626                      | 727                     |
| Consumer   | 63                       | 244                     |
| Broker-dealer                                      | —                        | —                       |
|  | \$ 38,497                | \$ 22,745               |

At September 30, 2017 and December 31, 2016, non-covered non-accrual loans included non-covered PCI loans of \$3.3 million and \$5.0 million, respectively, for which discount accretion has been suspended because the extent and timing of cash flows from these non-covered PCI loans can no longer be reasonably estimated. In addition to the non-covered non-accrual loans in the table above, \$1.6 million and \$1.7 million of real estate loans secured by residential properties and classified as held for sale were in non-accrual status at September 30, 2017 and December 31, 2016, respectively.

Interest income, including recoveries and cash payments, recorded on non-covered impaired loans was nominal during the three months ended September 30, 2017 and \$0.1 million during the three months ended September 30, 2016. Interest income, including recoveries and cash payments, recorded on non-covered impaired loans was \$0.3 million during both the nine months ended September 30, 2017 and 2016, respectively. Except as noted above, non-covered PCI loans are considered to be performing due to the application of the accretion method.

The Bank classifies loan modifications as TDRs when it concludes that it has both granted a concession to a debtor and that the debtor is experiencing financial difficulties. Loan modifications are typically structured to create affordable payments for the debtor and can be achieved in a variety of ways. The Bank modifies loans by reducing

interest rates and/or lengthening loan amortization schedules. The Bank may also reconfigure a single loan into two or more loans (“A/B Note”). The typical A/B Note restructure results in a “bad” loan which is charged off and a “good” loan or loans, the terms of which comply with the Bank’s customary underwriting policies. The debt charged off on the “bad” loan is not forgiven to the debtor.

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

There were no TDRs granted during the three months ended September 30, 2017 and 2016, respectively. Information regarding TDRs granted during the nine months ended September 30, 2017 and 2016, respectively, is shown in the following table (dollars in thousands). At September 30, 2017 and December 31, 2016, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

|   | Nine Months Ended September 30,<br>2017 |                         |                                   | Nine Months Ended September 30,<br>2016 |                         |                                   |
|---|---|-------------------------|-----------------------------------|---|-------------------------|-----------------------------------|
|   | Number<br>of<br>Loans                   | Balance at<br>Extension | Balance<br>at<br>End of<br>Period | Number<br>of<br>Loans                   | Balance at<br>Extension | Balance<br>at<br>End of<br>Period |
| Commercial and industrial:                            |   |                         |                                   |   |                         |                                   |
| Secured   | 1                                       | \$ 1,357                | \$ 1,235                          | 1                                       | \$ 1,196                | \$ 944                            |
| Unsecured   | —                                       | —                       | —                                 | —                                       | —                       | —                                 |
| Real estate:  |   |                         |                                   |   |                         |                                   |
| Secured by commercial properties                      | 1                                       | 1,481                   | 1,385                             | —                                       | —                       | —                                 |
| Secured by residential properties                     | —                                       | —                       | —                                 | —                                       | —                       | —                                 |
| Construction and land<br>development:                 |   |                         |                                   |   |                         |                                   |
| Residential construction loans                        | —                                       | —                       | —                                 | —                                       | —                       | —                                 |
| Commercial construction loans<br>and land development | 1                                       | 655                     | 626                               | —                                       | —                       | —                                 |
| Consumer  | —                                       | —                       | —                                 | —                                       | —                       | —                                 |
| Broker-dealer   | —                                       | —                       | —                                 | —                                       | —                       | —                                 |
|   | 3                                       | \$ 3,493                | \$ 3,246                          | 1                                       | \$ 1,196                | \$ 944                            |

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

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

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|   | Twelve Months Preceding<br>September 30, 2017 |                         |                                   | Twelve Months Preceding<br>September 30, 2016 |                         |                                   |
|---|---|-------------------------|-----------------------------------|---|-------------------------|-----------------------------------|
|   | Number<br>of<br>Loans                         | Balance at<br>Extension | Balance<br>at<br>End of<br>Period | Number<br>of<br>Loans                         | Balance at<br>Extension | Balance<br>at<br>End of<br>Period |
| Commercial and industrial:                            |   |                         |                                   |   |                         |                                   |
| Secured   | —   | \$ —                    | \$ —                              | 1   | \$ 1,196                | \$ 944                            |
| Unsecured   | —   | —                       | —                                 | —   | —                       | —                                 |
| Real estate:  |   |                         |                                   |   |                         |                                   |
| Secured by commercial properties                      | 1   | 1,481                   | 1,385                             | —   | —                       | —                                 |
| Secured by residential properties                     | —   | —                       | —                                 | —   | —                       | —                                 |
| Construction and land<br>development:                 |   |                         |                                   |   |                         |                                   |
| Residential construction loans                        | —   | —                       | —                                 | —   | —                       | —                                 |
| Commercial construction loans<br>and land development | —   | —                       | —                                 | —   | —                       | —                                 |
| Consumer  | —   | —                       | —                                 | —   | —                       | —                                 |
| Broker-dealer   | —   | —                       | —                                 | —   | —                       | —                                 |
|   | 1   | \$ 1,481                | \$ 1,385                          | 1   | \$ 1,196                | \$ 944                            |

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| September 30,<br>2017                                       | Loans Past Due<br>30-59 Days | Loans Past Due<br>60-89 Days | Loans Past Due<br>90 Days or More<br>Past Due | Total<br>Loans | Current<br>Loans | PCI<br>Loans | Total<br>Loans | Accruing<br>(Non-PCI)<br>Past Due<br>90 Days |
|---|------------------------------|------------------------------|---|----------------|------------------|--------------|----------------|--|
| Commercial<br>and industrial:                               |                              |                              |   |                |                  |              |                |  |
| Secured   | \$ 9,180                     | \$ 348                       | \$ 5,441                                      | \$ 14,969      | \$ 1,587,935     | \$ 6,232     | \$ 1,609,136   | \$ 125                                       |
| Unsecured   | 1,843                        | 11                           | —   | 1,854          | 124,478          | —            | 126,332        | —  |
| Real estate:  |                              |                              |   |                |                  |              |                |  |
| Secured by<br>commercial<br>properties                      | 13,017                       | —                            | 5,361   | 18,378         | 2,151,678        | 19,936       | 2,189,992      | —  |
| Secured by<br>residential<br>properties                     | 1,168                        | 582                          | 541   | 2,291          | 741,854          | 10,018       | 754,163        | —  |
| Construction<br>and land<br>development:                    |                              |                              |   |                |                  |              |                |  |
| Residential<br>construction<br>loans                        | 232                          | 945                          | —   | 1,177          | 172,302          | —            | 173,479        | —  |
| Commercial<br>construction<br>loans and land<br>development | 510                          | —                            | —   | 510            | 766,051          | 1,588        | 768,149        | —  |
| Consumer  | 58                           | 107                          | 28  | 193            | 41,602           | 163          | 41,958         | —  |
| Broker-dealer   | —                            | —                            | —   | —              | 485,604          | —            | 485,604        | —  |
|   | \$ 26,008                    | \$ 1,993                     | \$ 11,371                                     | \$ 39,372      | \$ 6,071,504     | \$ 37,937    | \$ 6,148,813   | \$ 125                                       |

| December 31,<br>2016 | Loans Past Due<br>30-59 Days | Loans Past Due<br>60-89 Days | Loans Past Due<br>90 Days or More<br>Past Due | Total<br>Loans | Current<br>Loans | PCI<br>Loans | Total<br>Loans | Accruing Loan<br>(Non-PCI)<br>Past Due<br>90 Days or More |
|----------------------|------------------------------|------------------------------|---|----------------|------------------|--------------|----------------|---|
|----------------------|------------------------------|------------------------------|---|----------------|------------------|--------------|----------------|---|

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

In addition to the non-covered loans shown in the tables above, \$45.0 million and \$44.4 million of loans included in loans held for sale (with an aggregate unpaid principal balance of \$45.6 million and \$44.9 million, respectively) were 90 days past due and accruing interest at September 30, 2017 and December 31, 2016, respectively. These loans are guaranteed by U.S. government agencies and include loans that are subject to repurchase, or have been repurchased, by PrimeLending.

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

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

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





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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

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

| September 30, 2017                                 | Pass         | Special Mention | Substandard | PCI       | Total        |
|--|--------------|-----------------|-------------|-----------|--------------|
| Commercial and industrial:                         |              |                 |             |           |              |
| Secured  | \$ 1,532,920 | \$ 19,964       | \$ 50,020   | \$ 6,232  | \$ 1,609,136 |
| Unsecured  | 124,113      | 996             | 1,223       | —         | 126,332      |
| Real estate:                                       |              |                 |             |           |              |
| Secured by commercial properties                   | 2,125,077    | 4,808           | 40,171      | 19,936    | 2,189,992    |
| Secured by residential properties                  | 737,712      | 3,263           | 3,170       | 10,018    | 754,163      |
| Construction and land development:                 |              |                 |             |           |              |
| Residential construction loans                     | 173,479      | —               | —           | —         | 173,479      |
| Commercial construction loans and land development | 763,142      | 2,652           | 767         | 1,588     | 768,149      |
| Consumer   | 41,700       | —               | 95          | 163       | 41,958       |
| Broker-dealer                                      | 485,604      | —               | —           | —         | 485,604      |
|  | \$ 5,983,747 | \$ 31,683       | \$ 95,446   | \$ 37,937 | \$ 6,148,813 |

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| December 31, 2016                                  | Pass         | Special Mention | Substandard | PCI       | Total        |
|--|--------------|-----------------|-------------|-----------|--------------|
| Commercial and industrial:                         |              |                 |             |           |              |
| Secured  | \$ 1,531,895 | \$ 72           | \$ 56,473   | \$ 8,672  | \$ 1,597,112 |
| Unsecured  | 97,646       | —               | 1,695       | —         | 99,341       |
| Real estate:                                       |              |                 |             |           |              |
| Secured by commercial properties                   | 1,888,231    | 3,693           | 34,661      | 28,510    | 1,955,095    |
| Secured by residential properties                  | 846,420      | —               | 4,763       | 10,489    | 861,672      |
| Construction and land development:                 |              |                 |             |           |              |
| Residential construction loans                     | 128,624      | —               | 28          | —         | 128,652      |
| Commercial construction loans and land development | 653,808      | —               | 923         | 3,467     | 658,198      |
| Consumer   | 40,789       | 6               | 263         | 294       | 41,352       |
| Broker-dealer                                      | 502,077      | —               | —           | —         | 502,077      |
|  | \$ 5,689,490 | \$ 3,771        | \$ 98,806   | \$ 51,432 | \$ 5,843,499 |

Allowance for Loan Losses

The allowance for both originated and acquired loans is subject to regulatory examinations, 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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Contingencies Topics of the ASC is described in detail in Note 5 to the consolidated financial statements included in the Company's 2016 Form 10-K.

During 2016, the Bank discovered irregularities with respect to a non-covered loan that is currently in default. As a result, the Bank increased its provision for loan losses and recorded a \$24.5 million charge-off during the second quarter of 2016, representing the entire outstanding principal balance of the loan. During the second quarter of 2017, the Bank recorded other noninterest income of \$15.0 million from coverage provided by an insurance policy for forgery.

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

| Three Months Ended<br>September 30, 2017         | Commercial and |             | Construction and |          |               | Total     |
|--|----------------|-------------|------------------|----------|---------------|-----------|
|  | Industrial     | Real Estate | Land Development | Consumer | Broker-Dealer |           |
| Balance, beginning of period                     | \$ 21,834      | \$ 28,734   | \$ 7,645         | \$ 524   | \$ 471        | \$ 59,208 |
| Provision charged to (recapture from) operations | 2,165          | (1,278)     | 144              | (147)    | (405)         | 479       |
| Loans charged off                                | (1,264)        | (5)         | (3)              | (33)     | —             | (1,305)   |
| Recoveries on charged off loans                  | 280            | 88          | 4                | 25       | —             | 397       |
| Balance, end of period                           | \$ 23,015      | \$ 27,539   | \$ 7,790         | \$ 369   | \$ 66         | \$ 58,779 |

| Nine Months Ended<br>September 30, 2017          | Commercial and |             | Construction and |          |               | Total     |
|--|----------------|-------------|------------------|----------|---------------|-----------|
|  | Industrial     | Real Estate | Land Development | Consumer | Broker-Dealer |           |
| Balance, beginning of period                     | \$ 21,369      | \$ 25,236   | \$ 7,002         | \$ 424   | \$ 155        | \$ 54,186 |
| Provision charged to (recapture from) operations | 3,376          | 2,424       | 796              | 74       | (89)          | 6,581     |
| Loans charged off                                | (3,070)        | (305)       | (13)             | (194)    | —             | (3,582)   |

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|                                 |           |           |          |        |       |           |
|---------------------------------|-----------|-----------|----------|--------|-------|-----------|
| Recoveries on charged off loans | 1,340     | 184       | 5        | 65     | —     | 1,594     |
| Balance, end of period          | \$ 23,015 | \$ 27,539 | \$ 7,790 | \$ 369 | \$ 66 | \$ 58,779 |

| Three Months Ended<br>September 30, 2016         | Commercial and |             | Construction and |          |               | Total     |
|--|----------------|-------------|------------------|----------|---------------|-----------|
|  | Industrial     | Real Estate | Land Development | Consumer | Broker-Dealer |           |
| Balance, beginning of period                     | \$ 20,720      | \$ 23,302   | \$ 6,288         | \$ 325   | \$ 378        | \$ 51,013 |
| Provision charged to (recapture from) operations | 3,973          | (116)       | 823              | 228      | (189)         | 4,719     |
| Loans charged off                                | (3,550)        | (1)         | —                | (67)     | —             | (3,618)   |
| Recoveries on charged off loans                  | 295            | 196         | —                | 20       | —             | 511       |
| Balance, end of period                           | \$ 21,438      | \$ 23,381   | \$ 7,111         | \$ 506   | \$ 189        | \$ 52,625 |

| Nine Months Ended<br>September 30, 2016          | Commercial and |             | Construction and |          |               | Total     |
|--|----------------|-------------|------------------|----------|---------------|-----------|
|  | Industrial     | Real Estate | Land Development | Consumer | Broker-Dealer |           |
| Balance, beginning of period                     | \$ 19,845      | \$ 18,983   | \$ 6,064         | \$ 314   | \$ 209        | \$ 45,415 |
| Provision charged to (recapture from) operations | 30,494         | 5,333       | 1,047            | 243      | (19)          | 37,098    |
| Loans charged off                                | (30,333)       | (1,299)     | —                | (155)    | (1)           | (31,788)  |
| Recoveries on charged off loans                  | 1,432          | 364         | —                | 104      | —             | 1,900     |
| Balance, end of period                           | \$ 21,438      | \$ 23,381   | \$ 7,111         | \$ 506   | \$ 189        | \$ 52,625 |

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

| September 30, 2017<br>Loans individually evaluated for impairment | Commercial and |             | Construction and |          |               | Total     |
|---|----------------|-------------|------------------|----------|---------------|-----------|
|   | Industrial     | Real Estate | Land Development | Consumer | Broker-Dealer |           |
|   | \$ 17,311      | \$ 13,722   | \$ 626           | \$ —     | \$ —          | \$ 31,659 |

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|   |              |              |            |           |            |              |
|---|--------------|--------------|------------|-----------|------------|--------------|
| Loans collectively evaluated for impairment | 1,711,925    | 2,900,479    | 939,414    | 41,795    | 485,604    | 6,079,217    |
| PCI Loans                                   | 6,232        | 29,954       | 1,588      | 163       | —          | 37,937       |
|   | \$ 1,735,468 | \$ 2,944,155 | \$ 941,628 | \$ 41,958 | \$ 485,604 | \$ 6,148,813 |

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

| December 31,<br>2016                        | Commercial and |              | Construction and |           |               | Total        |
|---|----------------|--------------|------------------|-----------|---------------|--------------|
|   | Industrial     | Real Estate  | Land Development | Consumer  | Broker-Dealer |              |
| Loans individually evaluated for impairment | \$ 4,508       | \$ 9,704     | \$ 727           | \$ 205    | \$ —          | \$ 15,144    |
| Loans collectively evaluated for impairment | 1,683,273      | 2,768,064    | 782,656          | 40,853    | 502,077       | 5,776,923    |
| PCI Loans                                   | 8,672          | 38,999       | 3,467            | 294       | —             | 51,432       |
|   | \$ 1,696,453   | \$ 2,816,767 | \$ 786,850       | \$ 41,352 | \$ 502,077    | \$ 5,843,499 |

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

| September 30, 2017                          | Commercial and |             | Construction and |          |               | Total     |
|---|----------------|-------------|------------------|----------|---------------|-----------|
|   | Industrial     | Real Estate | Land Development | Consumer | Broker-Dealer |           |
| Loans individually evaluated for impairment | \$ —           | \$ 846      | \$ 112           | \$ —     | \$ —          | \$ 958    |
| Loans collectively evaluated for impairment | 22,904         | 24,987      | 7,441            | 325      | 66            | 55,723    |
| PCI Loans                                   | 111            | 1,706       | 237              | 44       | —             | 2,098     |
|   | \$ 23,015      | \$ 27,539   | \$ 7,790         | \$ 369   | \$ 66         | \$ 58,779 |

| December 31, 2016                           | Commercial and |             | Construction and |          |               | Total  |
|---|----------------|-------------|------------------|----------|---------------|--------|
|   | Industrial     | Real Estate | Land Development | Consumer | Broker-Dealer |        |
| Loans individually evaluated for impairment | \$ 115         | \$ —        | \$ 167           | \$ —     | \$ —          | \$ 282 |
| Loans collectively evaluated for impairment | 20,697         | 23,129      | 6,458            | 368      | 155           | 50,807 |
| PCI Loans                                   | 557            | 2,107       | 377              | 56       | —             | 3,097  |

|           |           |          |        |        |           |
|-----------|-----------|----------|--------|--------|-----------|
| \$ 21,369 | \$ 25,236 | \$ 7,002 | \$ 424 | \$ 155 | \$ 54,186 |
|-----------|-----------|----------|--------|--------|-----------|

## 6. Covered Assets and Indemnification Asset

The Bank acquired certain assets and assumed certain liabilities of FNB in connection with an FDIC-assisted transaction on September 13, 2013 (the “Bank Closing Date”). As part of the Purchase and Assumption Agreement by and among the FDIC (as receiver of FNB), the Bank and the FDIC (the “P&A Agreement”), the Bank and the FDIC entered into loss-share agreements covering future losses incurred on certain acquired loans and OREO. The Company refers to acquired commercial and single family residential loan portfolios and OREO that are subject to the loss-share agreements as “covered loans” and “covered OREO”, respectively, and these assets are presented as separate line items in the Company’s consolidated balance sheets. Collectively, covered loans and covered OREO are referred to as “covered assets”. Pursuant to the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets: (i) 80% of net losses on the first \$240.4 million of net losses incurred; (ii) 0% of net losses in excess of \$240.4 million up to and including \$365.7 million of net losses incurred; and (iii) 80% of net losses in excess of \$365.7 million of net losses incurred. Net losses are defined as book value losses plus certain defined expenses incurred in the resolution of assets, less subsequent recoveries. Under the loss-share agreement for commercial assets, the amount of subsequent recoveries that are reimbursable to the FDIC for a particular asset is limited to book value losses and expenses actually billed plus any book value charge-offs incurred prior to the Bank Closing Date. There is no limit on the amount of subsequent recoveries reimbursable to the FDIC under the loss-share agreement for single family residential assets. The loss-share agreements for commercial and single family residential assets are in effect for five years and ten years, respectively, from the Bank Closing Date, and the loss recovery provisions to the FDIC are in effect for eight years and ten years, respectively, from the Bank Closing Date. The asset arising from the loss-share agreements, referred to as the “FDIC Indemnification Asset,” is measured separately from the covered loan portfolio because the agreements are not contractually embedded in the covered loans and are not transferable should the Bank choose to dispose of the covered loans.

In accordance with the loss-share agreements, the Bank may be required to make a “true-up” payment to the FDIC approximately ten years following the Bank Closing Date if its actual net realized losses over the life of the loss-share agreements are less than the FDIC’s initial estimate of losses on covered assets. The “true-up” payment is calculated using a defined formula set forth in the P&A Agreement. At September 30, 2017, the Bank has recorded a related “true-up” payment accrual of \$16.1 million based on the current estimate of aggregate realized losses on covered assets over the life of the loss-share agreements.



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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Covered Loans and Allowance for Covered Loan Losses

Loans acquired in the FNB Transaction that are subject to a loss-share agreement are referred to as “covered loans” and reported separately in the consolidated balance sheets. Covered loans are reported exclusive of the cash flow reimbursements that may be received from the FDIC.

The Bank’s portfolio of acquired covered loans had a fair value of \$1.1 billion as of the Bank Closing Date, with no carryover of any allowance for loan losses. Acquired covered loans were preliminarily segregated between those considered to be PCI loans and those without credit impairment at acquisition.

In connection with the FNB Transaction, the Bank acquired loans both with and without evidence of credit quality deterioration since origination. The Company’s accounting policies for acquired covered loans, including covered PCI loans, are consistent with the accounting policies for acquired non-covered loans, as described in Note 5 to the consolidated financial statements. The Company has established under its PCI accounting policy a framework to aggregate certain acquired covered loans into various loan pools based on a minimum of two layers of common risk characteristics for the purpose of determining their respective fair values as of their acquisition dates, and for applying the subsequent recognition and measurement provisions for income accretion and impairment testing.

The following table presents the carrying value of the covered loans summarized by portfolio segment (in thousands).

|                                       | September<br>30,<br>2017 | December<br>31,<br>2016 |
|---------------------------------------|--------------------------|-------------------------|
| Commercial and industrial             | \$ 1,242                 | \$ 2,697                |
| Real estate                           | 186,777                  | 244,469                 |
| Construction and land development     | 2,391                    | 8,961                   |
|                                       | 190,410                  | 256,127                 |
| Allowance for covered loans           | (2,141)                  | (413)                   |
| Total covered loans, net of allowance | \$ 188,269               | \$ 255,714              |

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

|                     | September<br>30,<br>2017 | December<br>31,<br>2016 |
|---------------------|--------------------------|-------------------------|
| Carrying amount     | \$ 90,583                | \$ 133,754              |
| Outstanding balance | 190,352                  | 266,098                 |

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

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2017                                | 2016       | 2017                               | 2016       |
| Balance, beginning of period                            | \$ 128,307                          | \$ 157,604 | \$ 143,731                         | \$ 176,719 |
| Reclassifications from nonaccretable difference, net(1) | 4,096                               | 6,954      | 27,120                             | 25,397     |
| Transfer of loans to covered OREO(2)                    | (77)                                | (250)      | (857)                              | (421)      |
| Accretion   | (10,040)                            | (17,460)   | (47,708)                           | (54,847)   |
| Balance, end of period                                  | \$ 122,286                          | \$ 146,848 | \$ 122,286                         | \$ 146,848 |

- (1) Reclassifications from nonaccretable difference are primarily due to net increases in expected cash flows in the quarterly recasts, but may also include the reclassification and immediate income recognition of nonaccretable difference due to the favorable resolution of loans accounted for individually. Reclassifications to nonaccretable difference occur when accruing loans are moved to non-accrual and expected cash flows are no longer predictable and the accretable yield is eliminated.
- (2) Transfer of loans to covered OREO is the difference between the value removed from the pool and the expected cash flows for the loan.

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

The remaining nonaccretable difference for covered PCI loans was \$53.1 million and \$94.5 million at September 30, 2017 and December 31, 2016, respectively. During the three and nine months ended September 30, 2017 and 2016, a combination of factors affecting the inputs to the Bank's quarterly recast process led to the reclassifications from nonaccretable difference to accretable yield. These transfers resulted from revised cash flows that reflect better-than-expected performance of the covered PCI loan portfolio as a result of the Bank's strategic decision to dedicate resources to the liquidation of covered loans during the noted periods.

Covered impaired loans include non-accrual loans, TDRs, PCI loans and partially charged-off loans. The amounts shown in the following tables include Pooled Loans, as well as loans accounted for on an individual basis. For Pooled Loans, the recorded investment with allowance and the related allowance consider impairment measured at the pool level.

Covered impaired loans, segregated between those considered to be PCI loans and those without credit impairment at acquisition, are summarized by class in the following tables (in thousands).

| September 30, 2017                                 | Unpaid<br>Contractual<br>Principal Balance | Recorded<br>Investment with<br>No Allowance | Recorded<br>Investment with<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance |
|--|--|---|--|---------------------------------|----------------------|
| <b>PCI</b>   |  |   |  |                                 |                      |
| Commercial and industrial:                         |  |   |  |                                 |                      |
| Secured  | \$ 4,010                                   | \$ —  | \$ 240                                   | \$ 240                          | \$ 46                |
| Unsecured  | 6,324                                      | —   | 41                                       | 41                              | 29                   |
| Real estate:                                       |  |   |  |                                 |                      |
| Secured by commercial properties                   |  |   |  |                                 |                      |
|  | 90,640                                     | 1,484                                       | 24,214                                   | 25,698                          | 1,368                |
| Secured by residential properties                  |  |   |  |                                 |                      |
|  | 129,275                                    | 47,295                                      | 17,023                                   | 64,318                          | 384                  |
| Construction and land development:                 |  |   |  |                                 |                      |
| Residential construction loans                     |  |   |  |                                 |                      |
|  | 694  | —   | —  | —                               | —                    |
| Commercial construction loans and land development |  |   |  |                                 |                      |
|  | 11,940                                     | —   | 286                                      | 286                             | 281                  |
|  | 242,883                                    | 48,779                                      | 41,804                                   | 90,583                          | 2,108                |
| <b>Non-PCI</b>                                     |  |   |  |                                 |                      |
| Commercial and industrial:                         |  |   |  |                                 |                      |
| Secured  | 43   | 44  | —  | 44                              | —                    |
| Unsecured  | —  | —   | —  | —                               | —                    |

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Real estate:

Secured by commercial properties

— — — — —

Secured by residential properties

4,695 3,929 — 3,929 —

Construction and land development:

Residential construction loans

— — — — —

Commercial construction loans and land development

19 13 — 13 —

4,757 3,986 — 3,986 —

\$ 247,640 \$ 52,765 \$ 41,804 \$ 94,569 \$ 2,108

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

| December 31, 2016                                     | Unpaid<br>Contractual<br>Principal Balance | Recorded<br>Investment with<br>No Allowance | Recorded<br>Investment with<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance |
|---|--|---|--|---------------------------------|----------------------|
| PCI   |  |   |  |                                 |                      |
| Commercial and industrial:                            |  |   |  |                                 |                      |
| Secured   | \$ 10,579                                  | \$ 1,024                                    | \$ 189                                   | \$ 1,213                        | \$ 13                |
| Unsecured   | 3,259                                      | 299   | —  | 299                             | —                    |
| Real estate:  |  |   |  |                                 |                      |
| Secured by commercial<br>properties                   | 143,934                                    | 26,415                                      | 26,222                                   | 52,637                          | 271                  |
| Secured by residential<br>properties                  | 148,384                                    | 73,240                                      | 1,161                                    | 74,401                          | 60                   |
| Construction and land<br>development:                 |  |   |  |                                 |                      |
| Residential construction loans                        | 766  | —   | —  | —                               | —                    |
| Commercial construction loans<br>and land development | 23,522                                     | 5,204                                       | —  | 5,204                           | —                    |
|   | 330,444                                    | 106,182                                     | 27,572                                   | 133,754                         | 344                  |
| Non-PCI   |  |   |  |                                 |                      |
| Commercial and industrial:                            |  |   |  |                                 |                      |
| Secured   | 52   | 52  | —  | 52                              | —                    |
| Unsecured   | —  | —   | —  | —                               | —                    |
| Real estate:  |  |   |  |                                 |                      |
| Secured by commercial<br>properties                   | 396  | 310   | —  | 310                             | —                    |
| Secured by residential<br>properties                  | 4,175                                      | 3,537                                       | —  | 3,537                           | —                    |
| Construction and land<br>development:                 |  |   |  |                                 |                      |
| Residential construction loans                        | —  | —   | —  | —                               | —                    |
| Commercial construction loans<br>and land development | 24   | 20  | —  | 20                              | —                    |
|   | 4,647                                      | 3,919                                       | —  | 3,919                           | —                    |
|   | \$ 335,091                                 | \$ 110,101                                  | \$ 27,572                                | \$ 137,673                      | \$ 344               |

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

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|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2017                                | 2016       | 2017                               | 2016       |
| Commercial and industrial:                         |                                     |            |                                    |            |
| Secured  | \$ 396                              | \$ 3,286   | \$ 775                             | \$ 4,299   |
| Unsecured  | 105                                 | 1,331      | 170                                | 1,511      |
| Real estate:                                       |                                     |            |                                    |            |
| Secured by commercial properties                   | 28,110                              | 76,693     | 39,323                             | 82,477     |
| Secured by residential properties                  | 68,843                              | 84,129     | 73,093                             | 91,424     |
| Construction and land development:                 |                                     |            |                                    |            |
| Residential construction loans                     | —                                   | —          | —                                  | 331        |
| Commercial construction loans and land development | 1,384                               | 10,568     | 2,762                              | 15,269     |
|  | \$ 98,838                           | \$ 176,007 | \$ 116,123                         | \$ 195,311 |

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

|  | September<br>30,<br>2017 | December<br>31,<br>2016 |
|--|--------------------------|-------------------------|
| Commercial and industrial:                         |                          |                         |
| Secured  | \$ 44                    | \$ 52                   |
| Unsecured  | —                        | —                       |
| Real estate:                                       |                          |                         |
| Secured by commercial properties                   | —                        | 730                     |
| Secured by residential properties                  | 3,438                    | 3,035                   |
| Construction and land development:                 |                          |                         |
| Residential construction loans                     | —                        | —                       |
| Commercial construction loans and land development | 299                      | 19                      |
|  | \$ 3,781                 | \$ 3,836                |

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

At September 30, 2017 and December 31, 2016, covered non-accrual loans included covered PCI loans of \$0.3 million and \$0.4 million, respectively, for which discount accretion had been suspended because the extent and timing of cash flows from these covered PCI loans could no longer be reasonably estimated.

Interest income, including recoveries and cash payments, recorded on covered impaired loans was \$0.9 million and \$1.2 million during the three and nine months ended September 30, 2017, respectively, while interest income recorded on covered impaired loans during the three and nine months ended September 30, 2016 was nominal. Except as noted above, covered PCI loans are considered to be performing due to the application of the accretion method.

The Bank classifies loan modifications of covered loans as TDRs in a manner consistent with that of non-covered loans as discussed in Note 5 to the consolidated financial statements. The Bank did not grant any TDRs during the three and nine months ended September 30, 2017 and 2016. Pooled Loans are not in the scope of the disclosure requirements for TDRs. At September 30, 2017 and December 31, 2016, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

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

|   | Twelve Months Preceding<br>September 30, 2017 |                            |                                   | Twelve Months Preceding<br>September 30, 2016 |                            |                                   |
|---|---|----------------------------|-----------------------------------|---|----------------------------|-----------------------------------|
|   | Number<br>of<br>Loans                         | Balance<br>at<br>Extension | Balance<br>at<br>End of<br>Period | Number<br>of<br>Loans                         | Balance<br>at<br>Extension | Balance<br>at<br>End of<br>Period |
| Commercial and industrial:                            |   |                            |                                   |   |                            |                                   |
| Secured   | —   | \$ —                       | \$ —                              | —   | \$ —                       | \$ —                              |
| Unsecured   | —   | —                          | —                                 | —   | —                          | —                                 |
| Real estate:  |   |                            |                                   |   |                            |                                   |
| Secured by commercial properties                      | —   | —                          | —                                 | —   | —                          | —                                 |
| Secured by residential properties                     | —   | —                          | —                                 | 2   | 204                        | 197                               |
| Construction and land development:                    |   |                            |                                   |   |                            |                                   |
| Residential construction loans                        | —   | —                          | —                                 | —   | —                          | —                                 |
| Commercial construction loans and<br>land development | —   | —                          | —                                 | —   | —                          | —                                 |

— \$ — \$ — 2 \$ 204 \$ 197

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

| September 30, 2017                                 | Loans Past Due 30 Days | Loans Past Due 60 Days | Loans Past Due 90 Days or More | Total Past Due Loans | Current Loans | PCI Loans | Total Loans | Accruing Loans (Non-PCI) Past Due 90 Days or More |
|--|------------------------|------------------------|--------------------------------|----------------------|---------------|-----------|-------------|---|
| Commercial and industrial:                         |                        |                        |                                |                      |               |           |             |   |
| Secured  | \$ —                   | \$ —                   | \$ 43                          | \$ 43                | \$ 918        | \$ 240    | \$ 1,201    | \$ —  |
| Unsecured  | —                      | —                      | —                              | —                    | —             | 41        | 41          | —   |
| Real estate:                                       |                        |                        |                                |                      |               |           |             |   |
| Secured by commercial properties                   | 71                     | —                      | —                              | 71                   | 12,724        | 25,698    | 38,493      | —   |
| Secured by residential properties                  | 3,945                  | 2,296                  | 1,440                          | 7,681                | 76,285        | 64,318    | 148,284     | —   |
| Construction and land development:                 |                        |                        |                                |                      |               |           |             |   |
| Residential construction loans                     | —                      | —                      | —                              | —                    | —             | —         | —           | —   |
| Commercial construction loans and land development | 8                      | —                      | —                              | 8                    | 2,097         | 286       | 2,391       | —   |
|  | \$ 4,024               | \$ 2,296               | \$ 1,483                       | \$ 7,803             | \$ 92,024     | \$ 90,583 | \$ 190,410  | \$ —  |



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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

| December 31,<br>2016                               | Loans Past Due |            |            |                   | Current<br>Loans | PCI<br>Loans | Total<br>Loans | Accruing Loans<br>(Non-PCI) Past<br>90 Days or More |
|--|----------------|------------|------------|-------------------|------------------|--------------|----------------|---|
|  | 30<br>Days     | 60<br>Days | 90<br>Days | Total<br>Past Due |                  |              |                |   |
| Commercial and industrial:                         |                |            |            |                   |                  |              |                |   |
| Secured  | \$ —           | \$ 6       | \$ 96      | \$ 102            | \$ 1,083         | \$ 1,213     | \$ 2,398       | \$ 44   |
| Unsecured  | —              | —          | —          | —                 | —                | 299          | 299            | —   |
| Real estate:                                       |                |            |            |                   |                  |              |                |   |
| Secured by commercial properties                   | 96             | 229        | —          | 325               | 19,132           | 52,637       | 72,094         | —   |
| Secured by residential properties                  | 3,511          | 1,345      | 1,479      | 6,335             | 91,639           | 74,401       | 172,375        | 129   |
| Construction and land development:                 |                |            |            |                   |                  |              |                |   |
| Residential construction loans                     | —              | —          | —          | —                 | —                | —            | —              | —   |
| Commercial construction loans and land development | 15             | —          | —          | 15                | 3,742            | 5,204        | 8,961          | —   |
|  | \$ 3,622       | \$ 1,580   | \$ 1,575   | \$ 6,777          | \$ 115,596       | \$ 133,754   | \$ 256,127     | \$ 173  |

The Bank assigns a risk grade to each of its covered loans in a manner consistent with the existing loan review program and risk grading matrix used for non-covered loans, as described in Note 5 to the consolidated financial statements. The following tables present the internal risk grades of covered loans in the portfolio by class (in thousands).

| September 30, 2017               | Pass   | Special Mention | Substandard | PCI    | Total    |
|----------------------------------|--------|-----------------|-------------|--------|----------|
| Commercial and industrial:       |        |                 |             |        |          |
| Secured                          | \$ 464 | \$ —            | \$ 497      | \$ 240 | \$ 1,201 |
| Unsecured                        | —      | —               | —           | 41     | 41       |
| Real estate:                     |        |                 |             |        |          |
| Secured by commercial properties | 11,832 | —               | 963         | 25,698 | 38,493   |

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|  |           |        |          |           |            |
|--|-----------|--------|----------|-----------|------------|
| Secured by residential properties                  | 75,322    | 438    | 8,206    | 64,318    | 148,284    |
| Construction and land development:                 |           |        |          |           |            |
| Residential construction loans                     | —         | —      | —        | —         | —          |
| Commercial construction loans and land development | 1,863     | —      | 242      | 286       | 2,391      |
|  | \$ 89,481 | \$ 438 | \$ 9,908 | \$ 90,583 | \$ 190,410 |

| December 31, 2016                                  | Pass       | Special Mention | Substandard | PCI        | Total      |
|--|------------|-----------------|-------------|------------|------------|
| Commercial and industrial:                         |            |                 |             |            |            |
| Secured  | \$ 592     | \$ —            | \$ 593      | \$ 1,213   | \$ 2,398   |
| Unsecured  | —          | —               | —           | 299        | 299        |
| Real estate:                                       |            |                 |             |            |            |
| Secured by commercial properties                   | 17,996     | —               | 1,461       | 52,637     | 72,094     |
| Secured by residential properties                  | 90,563     | 461             | 6,950       | 74,401     | 172,375    |
| Construction and land development:                 |            |                 |             |            |            |
| Residential construction loans                     | —          | —               | —           | —          | —          |
| Commercial construction loans and land development | 2,281      | —               | 1,476       | 5,204      | 8,961      |
|  | \$ 111,432 | \$ 461          | \$ 10,480   | \$ 133,754 | \$ 256,127 |

The Bank's impairment methodology for covered loans is consistent with the methodology for non-covered loans, and is discussed in detail in Notes 5 and 6 to the consolidated financial statements included in the Company's 2016 Form 10-K.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

|   | Commercial and<br>Industrial | Real Estate | Construction and<br>Land Development | Total    |
|---|------------------------------|-------------|--------------------------------------|----------|
| Three months ended September 30, 2017               |                              |             |                                      |          |
| Balance, beginning of period                        | \$ 47                        | \$ 684      | \$ 628                               | \$ 1,359 |
| Provision charged to (recapture from)<br>operations | 34                           | 1,093       | (346)                                | 781      |
| Loans charged off                                   | —                            | —           | —                                    | —        |
| Recoveries on charged off loans                     | —                            | —           | 1                                    | 1        |
| Balance, end of period                              | \$ 81                        | \$ 1,777    | \$ 283                               | \$ 2,141 |

|                                      | Commercial and<br>Industrial | Real Estate | Construction and<br>Land Development | Total    |
|--------------------------------------|------------------------------|-------------|--------------------------------------|----------|
| Nine months ended September 30, 2017 |                              |             |                                      |          |
| Balance, beginning of period         | \$ 35                        | \$ 378      | \$ —                                 | \$ 413   |
| Provision charged to operations      | 46                           | 1,915       | 276                                  | 2,237    |
| Loans charged off                    | (6)                          | (521)       | —                                    | (527)    |
| Recoveries on charged off loans      | 6                            | 5           | 7                                    | 18       |
| Balance, end of period               | \$ 81                        | \$ 1,777    | \$ 283                               | \$ 2,141 |

|   | Commercial and<br>Industrial | Real Estate | Construction and<br>Land Development | Total    |
|---|------------------------------|-------------|--------------------------------------|----------|
| Three months ended September 30, 2016               |                              |             |                                      |          |
| Balance, beginning of period                        | \$ 55                        | \$ 1,400    | \$ —                                 | \$ 1,455 |
| Provision charged to (recapture from)<br>operations | 162                          | (888)       | (3)                                  | (729)    |
| Loans charged off                                   | —                            | —           | —                                    | —        |
| Recoveries on charged off loans                     | —                            | —           | 3                                    | 3        |
| Balance, end of period                              | \$ 217                       | \$ 512      | \$ —                                 | \$ 729   |

|   | Commercial and<br>Industrial | Real Estate | Construction and<br>Land Development | Total    |
|---|------------------------------|-------------|--------------------------------------|----------|
| Nine months ended September 30, 2016                |                              |             |                                      |          |
| Balance, beginning of period                        | \$ 758                       | \$ 774      | \$ —                                 | \$ 1,532 |
| Provision charged to (recapture from)<br>operations | (535)                        | (237)       | (53)                                 | (825)    |
| Loans charged off                                   | (6)                          | (42)        | (51)                                 | (99)     |

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|                                 |        |        |      |        |
|---------------------------------|--------|--------|------|--------|
| Recoveries on charged off loans | —      | 17     | 104  | 121    |
| Balance, end of period          | \$ 217 | \$ 512 | \$ — | \$ 729 |

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

| September 30, 2017                          | Commercial and Industrial | Real Estate | Construction and Land Development | Total      |
|---|---------------------------|-------------|-----------------------------------|------------|
| Loans individually evaluated for impairment | \$ —                      | \$ —        | \$ —                              | \$ —       |
| Loans collectively evaluated for impairment | 961                       | 96,761      | 2,105                             | 99,827     |
| PCI Loans                                   | 281                       | 90,016      | 286                               | 90,583     |
|   | \$ 1,242                  | \$ 186,777  | \$ 2,391                          | \$ 190,410 |

| December 31, 2016                           | Commercial and Industrial | Real Estate | Construction and Land Development | Total      |
|---|---------------------------|-------------|-----------------------------------|------------|
| Loans individually evaluated for impairment | \$ —                      | \$ —        | \$ —                              | \$ —       |
| Loans collectively evaluated for impairment | 1,185                     | 117,431     | 3,757                             | 122,373    |
| PCI Loans                                   | 1,512                     | 127,038     | 5,204                             | 133,754    |
|   | \$ 2,697                  | \$ 244,469  | \$ 8,961                          | \$ 256,127 |

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

| September 30, 2017                          | Commercial and Industrial | Real Estate | Construction and Land Development | Total    |
|---|---------------------------|-------------|-----------------------------------|----------|
| Loans individually evaluated for impairment | \$ —                      | \$ —        | \$ —                              | \$ —     |
| Loans collectively evaluated for impairment | 6                         | 25          | 2                                 | 33       |
| PCI Loans                                   | 75                        | 1,752       | 281                               | 2,108    |
|   | \$ 81                     | \$ 1,777    | \$ 283                            | \$ 2,141 |



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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

| December 31, 2016                           | Commercial and<br>Industrial | Real Estate | Construction and<br>Land Development | Total  |
|---|------------------------------|-------------|--------------------------------------|--------|
| Loans individually evaluated for impairment | \$ —                         | \$ —        | \$ —                                 | \$ —   |
| Loans collectively evaluated for impairment | 22                           | 47          | —                                    | 69     |
| PCI Loans                                   | 13                           | 331         | —                                    | 344    |
|   | \$ 35                        | \$ 378      | \$ —                                 | \$ 413 |

## Covered Other Real Estate Owned

A summary of the activity in covered OREO is as follows (in thousands).

|                                     | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                     | 2017                                | 2016      | 2017                               | 2016      |
| Balance, beginning of period        | \$ 42,304                           | \$ 67,634 | \$ 51,642                          | \$ 99,090 |
| Additions to covered OREO           | 1,039                               | 2,422     | 6,166                              | 11,703    |
| Dispositions of covered OREO        | (2,612)                             | (5,516)   | (14,942)                           | (34,521)  |
| Valuation adjustments in the period | (388)                               | (2,552)   | (2,523)                            | (14,284)  |
| Balance, end of period              | \$ 40,343                           | \$ 61,988 | \$ 40,343                          | \$ 61,988 |

During the three and nine months ended September 30, 2017 and 2016, the Bank wrote down certain covered OREO assets to fair value to reflect new appraisals on certain OREO acquired in the FNB Transaction and OREO acquired from the foreclosure on certain FNB loans acquired in the FNB Transaction. Although the Bank recorded a fair value discount on the acquired assets upon acquisition, in some cases additional downward valuations were required. The majority of the downward valuations recorded during the three and nine months ended September 30, 2017 and 2016 were related to covered assets subject to the loss-share agreements with the FDIC.

These additional downward valuation adjustments reflect changes to the assumptions regarding the fair value of the OREO, including in some cases the intended use of the OREO due to the availability of more information, as well as the passage of time. The process of determining fair value is subjective in nature and requires the use of significant estimates and assumptions. Although the Bank makes market-based assumptions when valuing acquired assets, new information may come to light that causes estimates to increase or decrease. When the Bank determines, based on

subsequent information, that its estimates require adjustment, the Bank records the adjustment. The accounting for such adjustments requires that the decreases to the initially recorded fair value be recorded at the time such new information is received, while increases to fair value are recorded when the asset is subsequently sold.

FDIC Indemnification Asset

A summary of the activity in the FDIC Indemnification Asset is as follows (in thousands).

|   | Three Months Ended |           | Nine Months Ended |           |
|---|--------------------|-----------|-------------------|-----------|
|   | September 30,      |           | September 30,     |           |
|   | 2017               | 2016      | 2017              | 2016      |
| Balance, beginning of period                        | \$ 40,304          | \$ 74,460 | \$ 71,313         | \$ 91,648 |
| FDIC Indemnification Asset accretion (amortization) | (5,348)            | 33        | (13,533)          | 189       |
| Transfers to due from FDIC and other                | (1,813)            | (1,142)   | (24,637)          | (18,486)  |
| Balance, end of period                              | \$ 33,143          | \$ 73,351 | \$ 33,143         | \$ 73,351 |

As of September 30, 2017, the Bank had billed and collected \$145.5 million from the FDIC, which represented reimbursable covered losses and expenses through June 30, 2017.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

## 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 |              | Nine Months Ended |           |
|--|--------------------|--------------|-------------------|-----------|
|  | September 30,      |              | September 30,     |           |
|  | 2017               | 2016         | 2017              | 2016      |
| Balance, beginning of period                         | \$ 43,580          | \$ 33,491    | \$ 61,968         | \$ 52,285 |
| Additions  | 5,939              | 10,416       | 8,429             | 20,309    |
| Sales  | —                  | —            | (17,499)          | (7,586)   |
| Changes in fair value:                               |                    |              |                   |           |
| Due to changes in model inputs or assumptions (1)    | (550)              | 1,413        | (1,757)           | (16,923)  |
| Due to customer payoffs                              | (1,203)            | (1,569)      | (3,375)           | (4,334)   |
| Balance, end of period                               | \$ 47,766          | \$ 43,751    | \$ 47,766         | \$ 43,751 |
|  | September          | December     |                   |           |
|  | 30,                | 31,          |                   |           |
|  | 2017               | 2016         |                   |           |
| Mortgage loans serviced for others                   | \$ 4,175,195       | \$ 5,480,943 |                   |           |
| MSR asset as a percentage of serviced mortgage loans | 1.14               | %            | 1.13              | %         |

(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.

|   | September 30, |   | December 31, |   |
|---|---------------|---|--------------|---|
|   | 2017          |   | 2016         |   |
| Weighted average constant prepayment rate | 10.85         | % | 10.47        | % |
| Weighted average discount rate            | 11.07         | % | 10.95        | % |
| Weighted average life (in years)          | 6.9           |   | 6.9          |   |



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).

|                              | September<br>30,<br>2017 | December<br>31,<br>2016 |
|------------------------------|--------------------------|-------------------------|
| Constant prepayment rate:    |                          |                         |
| Impact of 10% adverse change | \$ (1,747)               | \$ (2,297)              |
| Impact of 20% adverse change | (3,441)                  | (4,471)                 |
| Discount rate:               |                          |                         |
| Impact of 10% adverse change | (1,889)                  | (2,539)                 |
| Impact of 20% adverse change | (3,630)                  | (4,882)                 |

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 \$4.2 million and \$5.7 million during the three months ended September 30, 2017 and 2016, respectively, and \$15.7 million and \$17.3 million during the nine months ended September 30, 2017 and 2016, respectively, were included in other noninterest income within the consolidated statements of operations.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

## 8. Deposits

Deposits are summarized as follows (in thousands).

|                            | September<br>30,<br>2017 | December 31,<br>2016 |
|----------------------------|--------------------------|----------------------|
| Noninterest-bearing demand | \$ 2,279,633             | \$ 2,199,483         |
| Interest-bearing:          |                          |                      |
| NOW accounts               | 1,004,410                | 1,252,832            |
| Money market               | 2,215,455                | 1,626,218            |
| Brokered - money market    | 109,788                  | 125,272              |
| Demand                     | 419,303                  | 384,847              |
| Savings                    | 210,316                  | 279,911              |
| Time                       | 1,293,877                | 1,145,859            |
| Brokered - time            | 130,665                  | 49,389               |
|                            | \$ 7,663,447             | \$ 7,063,811         |

## 9. Short-term Borrowings

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

|  | September<br>30,<br>2017 | December 31,<br>2016 |
|--|--------------------------|----------------------|
| Federal funds purchased                        | \$ 72,000                | \$ 87,125            |
| Securities sold under agreements to repurchase | 611,701                  | 195,164              |
| Federal Home Loan Bank                         | 650,000                  | 1,000,000            |
| Short-term bank loans                          | 143,500                  | 135,000              |
|  | \$ 1,477,201             | \$ 1,417,289         |

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.

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

|  | Nine Months Ended |   |            |   |
|--|-------------------|---|------------|---|
|  | September 30,     |   | 2016       |   |
|  | 2017              |   |            |   |
| Average balance during the period                      | \$ 549,425        |   | \$ 351,430 |   |
| Average interest rate during the period                | 0.98              | % | 0.55       | % |
|  | September         |   | December   |   |
|  | 30,               |   | 31,        |   |
|  | 2017              |   | 2016       |   |
| Average interest rate at end of period                 | 1.10              | % | 0.42       | % |
| Securities underlying the agreements at end of period: |                   |   |            |   |
| Carrying value   | \$ 621,429        |   | \$ 209,877 |   |
| Estimated fair value                                   | \$ 648,517        |   | \$ 206,641 |   |

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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).

|   | Nine Months Ended September 30, |   |            |   |
|---|---------------------------------|---|------------|---|
|   | 2017                            |   | 2016       |   |
| Average balance during the period       | \$ 435,531                      |   | \$ 303,011 |   |
| Average interest rate during the period | 1.05                            | % | 0.45       | % |
|   |                                 |   |            |   |
|   |                                 |   | December   |   |
|   | September 30,                   |   | 31,        |   |
|   | 2017                            |   | 2016       |   |
| Average interest rate at end of period  | 1.22                            | % | 0.55       | % |

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 September 30, 2017 and December 31, 2016 was 2.08% and 1.59%, respectively.

## 10. Notes Payable

Notes payable consisted of the following (in thousands).

|   | September<br>30,<br>2017 | December<br>31,<br>2016 |
|---|--------------------------|-------------------------|
| Senior Notes due April 2025, net of discount of \$1,581 and \$1,689, respectively                                   | \$ 148,419               | \$ 148,311              |
| FHLB notes, net of premium of \$469 and \$627, respectively, with maturities ranging from October 2017 to June 2030 | 98,073                   | 102,596                 |
| Insurance company note payable due March 2035, paid off in June 2017  | —                        | 20,000                  |

|  |            |            |
|--|------------|------------|
| 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, 2017 | 3,000      | 3,000      |
| Ventures Management line of credit due January 2018    | 23,204     | 16,505     |
|  | \$ 300,196 | \$ 317,912 |

## 11. Income Taxes

The Company applies an estimated annual effective rate to interim period pre-tax income to calculate the income tax provision for the quarter in accordance with the principal method prescribed by the accounting guidance established for computing income taxes in interim periods. The Company's effective tax rate was 37.2% and 38.6% during the three months ended September 30, 2017 and 2016, respectively, and 33.0% and 37.0% during the nine months ended September 30, 2017 and 2016, respectively. The effective tax rate during the three months ended September 30, 2017 was higher than the statutory rate primarily due to state income taxes. The effective tax rate during the nine months ended September 30, 2017 was lower than the statutory rate primarily due to the gain recorded in the resolution of the SWS matter as discussed in Note 12 to the consolidated financial statements, as the SWS Merger was a tax-free reorganization under Section 368(a) of the Internal Revenue Code. The effective tax rates during the three and nine months ended September 30, 2016 were slightly higher than the statutory rate primarily due to non-deductible transaction costs associated with the SWS Merger, offset by the recognition of excess tax benefits on share-based payment awards.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

12. Commitments and Contingencies

Legal Matters

The Company is subject to loss contingencies related to litigation, claims, investigations and legal and administrative cases and proceedings arising in the ordinary course of business. The Company evaluates these contingencies based on information currently available, including advice of counsel. The Company establishes accruals for those matters when a loss contingency is considered probable and the related amount is reasonably estimable. Any accruals are periodically reviewed and may be adjusted as circumstances change. A portion of the Company's exposure with respect to loss contingencies may be offset by applicable insurance coverage. In determining the amounts of any accruals or estimates of possible loss contingencies, the Company does not take into account the availability of insurance coverage, other than that provided by reinsurers in the insurance segment.

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

Following completion of Hilltop's acquisition of SWS, several purported holders of shares of SWS common stock (the "Petitioners") filed petitions in the Court of Chancery of the State of Delaware (the "Court") seeking appraisal for their shares pursuant to Section 262 of the Delaware General Corporation Law. These petitions were consolidated as *In re SWS Group, Inc., C.A. No. 10554-VCG*. On May 30, 2017, the Court issued its Memorandum Opinion in the matter. The Court found the "fair value" of the shares of SWS common stock as of the date of the transaction was \$6.38 per share. Accordingly, Hilltop paid cash of \$6.38 per share, plus statutory interest from the effective date of the merger until the date of payment, to the Petitioners and the other stockholders of SWS who properly demanded appraisal rights under Delaware law, collectively representing 7,438,453 shares. Each outstanding share of SWS common stock, other than shares held by Hilltop, in treasury by SWS or by stockholders who properly demanded appraisal rights under Delaware law, was converted into the right to receive 0.2496 shares of Hilltop common stock and \$1.94 in cash, the aggregate value of which was \$6.92 per share of SWS common stock as of the effective date of the merger. The resolution of this matter resulted in 1,856,638 shares of HTH common stock, which had been held in escrow during the pendency of the proceeding, being returned to the Company's pool of authorized but unissued shares

of common stock and a pre-tax net increase to other noninterest income of \$11.6 million during the second quarter of 2017. This change in common stock is reflected in repurchases of common stock within the consolidated statements of stockholders' equity. Certain Petitioners filed an appeal to the Court's Memorandum Opinion. The Company also filed a cross-appeal in the matter and intends to vigorously defend the Petitioners' appeal.

The Company is involved in information-gathering requests and investigations (both formal and informal), as well as reviews, examinations and proceedings (collectively, "Inquiries") by various governmental regulatory agencies, law enforcement authorities and self-regulatory bodies regarding certain of its businesses, business practices and policies, as well as the conduct of persons with whom it does business. Additional Inquiries will arise from time to time. In connection with those Inquiries, the Company receives document requests, subpoenas and other requests for information. The Inquiries, including the Inquiry described below, could develop into administrative, civil or criminal proceedings or enforcement actions that could result in consequences that have a material effect on the Company's consolidated financial position, results of operations or cash flows as a whole. Such consequences could include adverse judgments, findings, settlements, penalties, fines, orders, injunctions, restitution, or alterations in the Company's business practices, and could result in additional expenses and collateral costs, including reputational damage.

As a part of an industry-wide Inquiry, PrimeLending received a subpoena from the Office of Inspector General of the U.S. Department of Housing and Urban Development regarding mortgage-related practices, including those relating to

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

origination practices for loans insured by the Federal Housing Administration (the “FHA”). On August 20, 2014, PrimeLending received a Civil Investigative Demand from the United States Department of Justice (the “DOJ”) related to this Inquiry. According to the Civil Investigative Demand, the DOJ is conducting an investigation to determine whether PrimeLending has violated the False Claims Act in connection with originating and underwriting single-family residential mortgage loans insured by the FHA. The DOJ has advised PrimeLending that, based upon its review of a sample of loans for which an FHA insurance claim was paid by the U.S. Department of Housing and Urban Development (“HUD”), some of the loans do not meet FHA underwriting guidelines. PrimeLending, based upon its own review of the loan sample, does not agree with the sampling methodology and loan analysis employed by the DOJ. Remedies in these proceedings or settlements may include statutory damages, indemnification, fines and/or penalties. Many institutions have settled these matters on terms that included large monetary penalties. PrimeLending has fully cooperated with this Inquiry, continues to discuss this matter with the DOJ and adjusts its indemnification reserve based upon such discussions.

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

Indemnification Liability Reserve

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

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



An additional reserve has been established for probable agency, investor or other party losses that may have been incurred, but not yet reported to the mortgage origination segment based upon a reasonable estimate of such losses. Factors considered in the calculation of this reserve include, but are not limited to, the total volume of loans sold exclusive of specific claimant requests, actual claim settlements and the severity of estimated losses resulting from future claims, and the mortgage origination segment's history of successfully curing defects identified in claim requests. While the mortgage origination segment's sales contracts typically include borrower early payment default repurchase provisions, these provisions have not been a primary driver of claims to date, and therefore, are not a primary factor considered in the calculation of this reserve.

At September 30, 2017 and December 31, 2016, the mortgage origination segment's indemnification liability reserve totaled \$24.7 million and \$18.2 million, respectively. The provision for indemnification losses was \$2.5 million and \$1.3 million during the three months ended September 30, 2017 and 2016, respectively, and \$4.5 million and \$3.5 million during the nine months ended September 30, 2017 and 2016, respectively.

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## Notes to Consolidated Financial Statements (continued)

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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<br>Activity - Origination Loan Balance |           |                   |           |
|---------------------------------|--|-----------|-------------------|-----------|
|                                 | Three Months Ended   |           | Nine Months Ended |           |
|                                 | September 30,  |           | September 30,     |           |
|                                 | 2017   | 2016      | 2017              | 2016      |
| Balance, beginning of period    | \$ 32,554  | \$ 53,876 | \$ 40,669         | \$ 57,298 |
| Claims made                     | 10,618   | 3,339     | 27,647            | 12,893    |
| Claims resolved with no payment | (10,991)   | (4,545)   | (29,079)          | (15,162)  |
| Repurchases                     | (1,326)  | (789)     | (3,014)           | (2,660)   |
| Indemnification payments        | —  | (2,115)   | (5,368)           | (2,603)   |
| Balance, end of period          | \$ 30,855  | \$ 49,766 | \$ 30,855         | \$ 49,766 |

|  | Indemnification Liability Reserve Activity |           |                   |           |
|--|--|-----------|-------------------|-----------|
|  | Three Months Ended                         |           | Nine Months Ended |           |
|  | September 30,                              |           | September 30,     |           |
|  | 2017                                       | 2016      | 2017              | 2016      |
| Balance, beginning of period                     | \$ 22,367                                  | \$ 18,216 | \$ 18,239         | \$ 16,640 |
| Additions for new sales                          | 2,488                                      | 1,348     | 4,480             | 3,471     |
| Repurchases                                      | (158)                                      | (78)      | (283)             | (260)     |
| Early payment defaults                           | (41)                                       | (72)      | (170)             | (205)     |
| Indemnification payments                         | —  | (250)     | (713)             | (482)     |
| Change in reserves for loans sold in prior years | —  | —         | 3,103             | —         |
| Balance, end of period                           | \$ 24,656                                  | \$ 19,164 | \$ 24,656         | \$ 19,164 |

|  | September<br>30,<br>2017 | December<br>31,<br>2016 |
|--|--------------------------|-------------------------|
| Reserve for Indemnification Liability: |                          |                         |
| Specific claims                        | \$ 536                   | \$ 1,661                |
| Incurred but not reported claims       | 24,120                   | 16,578                  |
| Total                                  | \$ 24,656                | \$ 18,239               |

Although management considers the total indemnification liability reserve to be appropriate, there may be changes in the reserve over time to address incurred losses, due to unanticipated adverse changes in the economy and historical loss patterns, discrete events adversely affecting specific borrowers or industries, and/or actions taken by institutions

or investors. The impact of such matters is considered in the reserving process when probable and estimable.

#### Other Contingencies

In connection with the FNB Transaction, the Bank entered into two loss-share agreements with the FDIC that collectively cover \$1.2 billion of loans and OREO acquired in the FNB Transaction. Pursuant to the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets: (i) 80% of net losses on the first \$240.4 million of net losses incurred; (ii) 0% of net losses in excess of \$240.4 million up to and including \$365.7 million of net losses incurred; and (iii) 80% of net losses in excess of \$365.7 million of net losses incurred. Net losses are defined as book value losses plus certain defined expenses incurred in the resolution of assets, less subsequent recoveries. Under the loss-share agreement for commercial assets, the amount of subsequent recoveries that are reimbursable to the FDIC for a particular asset is limited to book value losses and expenses actually billed plus any book value charge-offs incurred prior to the Bank Closing Date. There is no limit on the amount of subsequent recoveries reimbursable to the FDIC under the loss-share agreement for single family residential assets. The loss-share agreements for commercial and single family residential assets are in effect for five years and ten years, respectively, from the Bank Closing Date and the loss recovery provisions to the FDIC are in effect for eight years and ten years, respectively, from the Bank Closing Date. As part of the loss-share agreements, the Bank is subject to annual

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(Unaudited)

FDIC compliance audits. As discussed in Note 6 to the consolidated financial statements, and in accordance with the loss-share agreements, the Bank may be required to make a “true-up” payment to the FDIC approximately ten years following the Bank Closing Date if its actual net realized losses over the life of the loss-share agreements are less than the FDIC’s initial estimate of losses on covered assets. The “true-up” payment is calculated using a defined formula set forth in the P&A Agreement. While the ultimate amount of any “true-up” payment is unknown at this time and will vary based upon the amount of future losses or recoveries within our covered loan portfolio, the Bank has recorded a related “true-up” payment accrual of \$16.1 million at September 30, 2017 based on the current estimate of aggregate realized losses on covered assets over the life of the loss-share agreements. The initial estimate of the FDIC Indemnification Asset at the Bank Closing Date was recorded at the present value of 80% of \$240.4 million. As of September 30, 2017, the Bank projects that the sum of actual plus projected covered losses and reimbursable expenses subject to the loss-share agreements will be less than \$240.4 million. As of September 30, 2017, the Bank had billed \$181.9 million of covered net losses to the FDIC, of which 80%, or \$145.5 million, were reimbursable under the loss-share agreements. As of September 30, 2017, the Bank had received aggregate reimbursements of \$145.5 million from the FDIC, which represented reimbursable covered losses and expenses through June 30, 2017.

13. Financial Instruments with Off-Balance Sheet Risk

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

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

In the aggregate, the Bank had outstanding unused commitments to extend credit of \$2.0 billion at September 30, 2017 and outstanding financial and performance standby letters of credit of \$28.8 million at September 30, 2017.

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

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

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(Unaudited)

## 14. Stock-Based Compensation

Pursuant to the Hilltop Holdings Inc. 2012 Equity Incentive Plan (the “2012 Plan”), the Company may grant nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units (“RSUs”), performance awards, dividend equivalent rights and other awards to employees of the Company, its subsidiaries and outside directors of the Company. In the aggregate, 4,000,000 shares of common stock may be delivered pursuant to awards granted under the 2012 Plan. At September 30, 2017, 1,582,281 shares of common stock remained available for issuance pursuant to the 2012 Plan, including shares that may be delivered pursuant to outstanding awards. Compensation expense related to the 2012 Plan was \$2.8 million and \$2.6 million during the three months ended September 30, 2017 and 2016, respectively, and \$8.7 million and \$7.6 million during the nine months ended September 30, 2017 and 2016, respectively.

During the nine months ended September 30, 2017 and 2016, Hilltop granted 11,959 and 16,506 shares of common stock, respectively, pursuant to the 2012 Plan to certain non-employee members of the Company’s board of directors for services rendered to the Company.

## Restricted Stock Awards and RSUs

The following table summarizes information about nonvested Restricted Stock Award and RSU activity for the nine months ended September 30, 2017 (shares in thousands).

|                                  | Restricted Stock Awards |  | RSUs        |  |
|----------------------------------|-------------------------|--|-------------|--|
|                                  | Outstanding             | Weighted<br>Average<br>Grant<br>Date<br>Fair Value | Outstanding | Weighted<br>Average<br>Grant<br>Date<br>Fair Value |
| Balance,<br>December 31,<br>2016 | 4                       | \$ 19.95   | 1,456       | \$ 19.83   |
| Granted                          | -                       | \$ -   | 439         | \$ 27.08   |
| Vested/Released                  | (4)                     | \$ 19.95   | (345)       | \$ 23.36   |

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|                                   |   |      |       |          |
|-----------------------------------|---|------|-------|----------|
| Forfeited                         | - | \$ - | (68)  | \$ 23.09 |
| Balance,<br>September 30,<br>2017 | - | \$ - | 1,482 | \$ 21.00 |

Vested/Released Restricted Stock Awards and RSUs include an aggregate of 88,681 shares withheld to satisfy employee statutory tax obligations during the nine months ended September 30, 2017.

During the nine months ended September 30, 2017, the Compensation Committee of the board of directors of the Company awarded certain executives and key employees an aggregate of 421,189 RSUs pursuant to the 2012 Plan. At September 30, 2017, 322,493 of these outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 89,439 of these outstanding RSUs will cliff vest based upon the achievement of certain performance goals over a three-year period.

At September 30, 2017, in the aggregate, 1,177,641 of the outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 303,800 outstanding RSUs cliff vest based upon the achievement of certain performance goals over a three-year period. At September 30, 2017, unrecognized compensation expense related to outstanding RSUs of \$16.2 million is expected to be recognized over a weighted average period of 1.42 years.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

15. Regulatory Matters

Banking and Hilltop

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

In order to avoid limitations on capital distributions, including dividend payments, stock repurchases and certain discretionary bonus payments to executive officers, Basel III also implemented a capital conservation buffer, which requires a banking organization to hold a buffer above its minimum risk-based capital requirements. This buffer will help to ensure that banking organizations conserve capital when it is most needed, allowing them to better weather periods of economic stress. The buffer is measured relative to risk-weighted assets. The phase-in of the capital conservation buffer requirements began on January 1, 2016 for Hilltop and the Bank. Based on the actual ratios as shown in the table below, Hilltop and the Bank exceed each of the capital conservation buffer requirements in effect as of September 30, 2017, as well as the fully phased-in requirements through 2019.

The following table shows PlainsCapital's and Hilltop's actual capital amounts and ratios in accordance with Basel III compared to the regulatory minimum capital requirements including conservation buffer in effect at the end of the period and on a fully phased-in basis as if such requirements were currently in effect as measured at September 30, 2017 and December 31, 2016, respectively (dollars in thousands). Based on actual capital amounts and ratios shown in the following table, PlainsCapital's ratios place it in the "well capitalized" (as defined) capital category under regulatory requirements.



|  | Actual<br>Amount | Ratio   | Minimum Capital<br>Requirements<br>Including Conservation<br>Buffer |   |      | Fully<br>Phased<br>In<br>Ratio | To Be Well<br>Capitalized<br>Ratio |   |
|--|------------------|---------|---|---|------|--------------------------------|------------------------------------|---|
|  |                  |         | In Effect at<br>End of<br>Period<br>Ratio                           |   |      |                                |                                    |   |
| September 30, 2017   |                  |         |   |   |      |                                |                                    |   |
| Tier 1 capital (to average assets):                        |                  |         |   |   |      |                                |                                    |   |
| PlainsCapital  | \$ 1,150,229     | 12.18 % | 4.0   | % | 4.0  | %                              | 5.0                                | % |
| Hilltop  | 1,682,910        | 12.87 % | 4.0   | % | 4.0  | %                              | N/A                                |   |
| Common equity Tier 1 capital (to<br>risk-weighted assets): |                  |         |   |   |      |                                |                                    |   |
| PlainsCapital  | 1,150,229        | 14.44 % | 5.75  | % | 7.0  | %                              | 6.5                                | % |
| Hilltop  | 1,633,561        | 17.66 % | 5.75  | % | 7.0  | %                              | N/A                                |   |
| Tier 1 capital (to risk-weighted assets):                  |                  |         |   |   |      |                                |                                    |   |
| PlainsCapital  | 1,150,229        | 14.44 % | 7.25  | % | 8.5  | %                              | 8.0                                | % |
| Hilltop  | 1,682,910        | 18.20 % | 7.25  | % | 8.5  | %                              | N/A                                |   |
| Total capital (to risk-weighted assets):                   |                  |         |   |   |      |                                |                                    |   |
| PlainsCapital  | 1,213,069        | 15.23 % | 9.25  | % | 10.5 | %                              | 10.0                               | % |
| Hilltop  | 1,730,164        | 18.71 % | 9.25  | % | 10.5 | %                              | N/A                                |   |

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

|  | Actual<br>Amount | Ratio   | Minimum Capital<br>Requirements<br>Including Conservation<br>Buffer<br>In Effect at<br>End of<br>Period<br>Ratio | Fully<br>Phased<br>In<br>Ratio | To Be Well<br>Capitalized<br>Ratio |
|--|------------------|---------|--|--------------------------------|------------------------------------|
| December 31, 2016  |                  |         |  |                                |                                    |
| Tier 1 capital (to average assets):                        |                  |         |  |                                |                                    |
| PlainsCapital  | \$ 1,108,484     | 12.35 % | 4.0  | % 4.0                          | % 5.0                              |
| Hilltop  | 1,652,101        | 13.51 % | 4.0  | % 4.0                          | % N/A                              |
| Common equity Tier 1 capital (to<br>risk-weighted assets): |                  |         |  |                                |                                    |
| PlainsCapital  | 1,108,484        | 14.64 % | 5.125  | % 7.0                          | % 6.5                              |
| Hilltop  | 1,602,400        | 18.30 % | 5.125  | % 7.0                          | % N/A                              |
| Tier 1 capital (to risk-weighted assets):                  |                  |         |  |                                |                                    |
| PlainsCapital  | 1,108,484        | 14.64 % | 6.625  | % 8.5                          | % 8.0                              |
| Hilltop  | 1,652,101        | 18.87 % | 6.625  | % 8.5                          | % N/A                              |
| Total capital (to risk-weighted assets):                   |                  |         |  |                                |                                    |
| PlainsCapital  | 1,164,767        | 15.38 % | 8.625  | % 10.5                         | % 10.0                             |
| Hilltop  | 1,693,240        | 19.34 % | 8.625  | % 10.5                         | % N/A                              |

## 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 September 30, 2017, the net capital position of each of the Hilltop Broker-Dealers was as follows (in thousands).

|  | Hilltop<br>Securities | HTS<br>Independent<br>Network |
|--|-----------------------|-------------------------------|
| Net capital  | \$ 181,288            | \$ 3,353                      |
| Less: required net capital                           | 9,679                 | 250                           |
| Excess net capital                                   | \$ 171,609            | \$ 3,103                      |
| Net capital as a percentage of aggregate debit items | 37.5                  | %                             |
| Net capital in excess of 5% aggregate debit items    | \$ 157,089            |                               |

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 September 30, 2017 and December 31, 2016, Hilltop Securities held cash of \$207.3 million and \$181.0 million, respectively, segregated in special reserve bank accounts for the benefit of customers. Hilltop Securities was not required to segregate cash and securities in special reserve accounts for the benefit of proprietary accounts of introducing broker-dealers at September 30, 2017 and December 31, 2016. The fair values of any segregated assets included in special reserve accounts were determined using Level 1 inputs.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Mortgage Origination

As a mortgage originator, PrimeLending and its subsidiaries are subject to minimum net worth and liquidity requirements established by the HUD and the GNMA, as applicable. On an annual basis, PrimeLending and its subsidiaries submit audited financial statements to HUD and GNMA, as applicable, documenting their respective compliance with its minimum net worth and liquidity requirements. As of September 30, 2017, 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.

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

|                                   | September<br>30,<br>2017                    | December<br>31,<br>2016                    |
|-----------------------------------|---|--|
| Capital and surplus:              |   |  |
| National Lloyds Insurance Company | \$ 86,879                                   | \$ 131,328                                 |
| American Summit Insurance Company | 21,831                                      | 30,462                                     |
|                                   | Three Months Ended<br>September 30,<br>2017 | Nine Months Ended<br>September 30,<br>2017 |
| Statutory net income (loss):      | 2016  | 2016                                       |

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|                                   |            |          |             |          |
|-----------------------------------|------------|----------|-------------|----------|
| National Lloyds Insurance Company | \$ (4,147) | \$ 8,146 | \$ (10,663) | \$ 4,507 |
| American Summit Insurance Company | (1,216)    | (357)    | (693)       | 729      |

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 September 30, 2017, 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 September 30, 2017, the Company's insurance subsidiaries' RBC ratio exceeded the level at which regulatory action would be required.

### 16. Stockholders' Equity

#### Dividend Declaration

On October 26, 2017, the Company announced that its board of directors declared a quarterly cash dividend of \$0.06 per common share, payable on November 30, 2017, to all common stockholders of record as of the close of business on November 15, 2017.

#### Stock Repurchase Program

The Company's board of directors reauthorized the stock repurchase program originally approved during the second quarter of 2016 through January 2018, under which the Company may repurchase, in the aggregate, up to \$50.0 million

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

of its outstanding common stock. Under the stock repurchase program, the Company may repurchase shares in open-market purchases or through privately negotiated transactions as permitted under Rule 10b-18 promulgated under the Exchange Act. The extent to which the Company repurchases its shares and the timing of such repurchases depends upon market conditions and other corporate considerations, as determined by Hilltop's management team. During the nine months ended September 30, 2017, the Company paid \$27.4 million to repurchase an aggregate of 1,057,656 shares of common stock at an average price of \$25.87 per share. These shares were returned to the Company's pool of authorized but unissued shares of common stock. The purchases were funded from available cash balances. The Company's accounting treatment and policy regarding stock repurchases is discussed in detail in Note 1 to the consolidated financial statements included in the Company's 2016 Form 10-K.

## 17. Derivative Financial Instruments

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

### Non-Hedging Derivative Instruments and the Fair Value Option

As discussed in Note 3 to the consolidated financial statements, the Company has elected to measure substantially all mortgage loans held for sale at fair value under the provisions of the Fair Value Option. The election provides the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without applying complex hedge accounting provisions. The fair values of PrimeLending's IRLCs, forward commitments, interest rate swaps and swaptions, and U.S. Treasury bond futures and options are recorded in other assets or other liabilities, as appropriate, and changes in the fair values of these derivative instruments are recorded as a component of net gains from sale of loans and other mortgage production income. The fair value of PrimeLending's derivative instruments decreased \$9.9 million during the three months ended September 30, 2017, compared with an increase of \$1.2 million during the three months ended September 30, 2016, while the fair values of PrimeLending's derivatives decreased \$0.4 million and \$13.0 million during the nine months ended September 30, 2017 and 2016,

respectively. Changes in fair value are attributable to changes in the volume of IRLCs, mortgage loans held for sale, commitments to purchase and sell MBSs and MSR assets, and changes in market interest rates. Changes in market interest rates also conversely affect the value of PrimeLending's mortgage loans held for sale and its MSR asset, which are measured at fair value under the Fair Value Option. The effect of the change in market interest rates on PrimeLending's loans held for sale and MSR asset is discussed in Note 3 to the consolidated financial statements. The fair values of the Hilltop Broker-Dealers' and the Bank's derivative instruments are recorded in other assets or other liabilities, as appropriate. The fair values of the Hilltop Broker-Dealers' derivatives decreased \$3.6 million and \$8.5 million during the three months ended September 30, 2017 and 2016, respectively, while the fair values of the Bank's derivatives increased \$49 thousand during the three months ended September 30, 2017, compared with an increase of \$0.3 million during the three months ended September 30, 2016. The fair values of the Hilltop Broker-Dealers' derivatives increased \$12.6 million and \$1.0 million during the nine months ended September 30, 2017 and 2016, respectively, while the fair values of the Bank's derivatives increased \$0.2 million during the nine months ended September 30, 2017, compared with a decrease of \$0.3 million during the nine months ended September 30, 2016. The changes in fair value were recorded as a component of other noninterest income.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

|  | September 30, 2017 |                         | December 31, 2016  |                         |
|--|--------------------|-------------------------|--------------------|-------------------------|
|  | Notional<br>Amount | Estimated<br>Fair Value | Notional<br>Amount | Estimated<br>Fair Value |
| Derivative instruments:                    |                    |                         |                    |                         |
| IRLCs                                      | \$ 1,248,422       | \$ 28,601               | \$ 944,550         | \$ 23,269               |
| Customer-based written options             | 14,930             | 30                      | —                  | —                       |
| Customer-based purchased options           | 14,930             | (30)                    | —                  | —                       |
| Commitments to purchase MBSs               | 3,198,208          | 7,040                   | 3,616,922          | (1,155)                 |
| Commitments to sell MBSs                   | 5,878,986          | 2,517                   | 5,609,250          | (532)                   |
| Interest rate swaps and swaptions          | 28,152             | (95)                    | 32,452             | (283)                   |
| U.S. Treasury bond futures and options (1) | 194,000            | —                       | 297,000            | —                       |

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

PrimeLending had cash collateral advances totaling \$3.7 million to offset net liability derivative positions on its commitments to sell MBSs at September 30, 2017, compared to a payable of \$19.1 million on its net liability derivative position on its commitments to sell MBSs at December 31, 2016. In addition, PrimeLending advanced cash collateral totaling \$3.2 million on its U.S. Treasury bond futures and options at both September 30, 2017 and December 31, 2016. These amounts are included in other assets within the consolidated balance sheets.

## 18. Balance Sheet Offsetting

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

|             |  |
|-------------|--|
| Net Amounts | Gross Amounts Not Offset in<br>the Balance Sheet |
|-------------|--|



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|   | Gross Amounts<br>of Recognized<br>Assets | Gross Amounts<br>Offset in the<br>Balance Sheet | of Assets<br>Presented in the<br>Balance Sheet | Financial<br>Instruments  | Cash<br>Collateral<br>Pledged | Net<br>Amount      |
|---|--|---|--|---------------------------|-------------------------------|--------------------|
| September 30,<br>2017   |  |   |  |                           |                               |                    |
| Securities<br>borrowed:<br>Institutional<br>counterparties              | \$ 1,611,885                             | \$ —  | \$ 1,611,885                                   | \$ (1,554,629)            | \$ —                          | \$ 57,256          |
| Interest rate<br>options:<br>Customer<br>counterparties                 | 30                                       | —   | 30   | —                         | —                             | 30                 |
| Reverse<br>repurchase<br>agreements:<br>Institutional<br>counterparties | 134,654                                  | —   | 134,654  | (134,040)                 | —                             | 614                |
| Forward MBS<br>derivatives:<br>Institutional<br>counterparties          | 11,567<br>\$ 1,758,136                   | (1,170)<br>\$ (1,170)                           | 10,397<br>\$ 1,756,966                         | (7,673)<br>\$ (1,696,342) | —<br>\$ —                     | 2,724<br>\$ 60,624 |
| December 31,<br>2016  |  |   |  |                           |                               |                    |
| Securities<br>borrowed:<br>Institutional<br>counterparties              | \$ 1,436,069                             | \$ —  | \$ 1,436,069                                   | \$ (1,385,664)            | \$ —                          | \$ 50,405          |
| Reverse<br>repurchase<br>agreements:<br>Institutional<br>counterparties | 89,430                                   | —   | 89,430   | (89,369)                  | —                             | 61                 |
| Forward MBS<br>derivatives:<br>Institutional<br>counterparties          | 21,366<br>\$ 1,546,865                   | (3,893)<br>\$ (3,893)                           | 17,473<br>\$ 1,542,972                         | (9,012)<br>\$ (1,484,045) | —<br>\$ —                     | 8,461<br>\$ 58,927 |

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

|                                       | Gross Amounts<br>of Recognized<br>Liabilities | Gross Amounts<br>Offset in the<br>Balance Sheet | Net Amounts<br>of Liabilities<br>Presented in the<br>Balance Sheet | Gross Amounts Not Offset in<br>the Balance Sheet<br>Financial<br>Instruments | Cash<br>Collateral<br>Pledged | Net<br>Amount |
|---------------------------------------|---|---|--|--|-------------------------------|---------------|
| September 30, 2017                    |   |   |  |  |                               |               |
| Securities loaned:                    |   |   |  |  |                               |               |
| Institutional<br>counterparties       | \$ 1,447,570                                  | \$ —  | \$ 1,447,570   | \$ (1,393,258)   | \$ —                          | \$ 54,312     |
| Interest rate<br>options:             |   |   |  |  |                               |               |
| Institutional<br>counterparties       | 30  | —   | 30   | —  | —                             | 30            |
| Interest rate swaps<br>and swaptions: |   |   |  |  |                               |               |
| Institutional<br>counterparties       | 118   | (23)  | 95   | (1,149)  | —                             | (1,054)       |
| Repurchase<br>agreements:             |   |   |  |  |                               |               |
| Institutional<br>counterparties       | 476,181                                       | —   | 476,181  | (476,181)  | —                             | —             |
| Customer<br>counterparties            | 135,520                                       | —   | 135,520  | (135,520)  | —                             | —             |
| Forward MBS<br>derivatives:           |   |   |  |  |                               |               |
| Institutional<br>counterparties       | 839   | —   | 839  | (839)  | —                             | —             |
|                                       | \$ 2,060,258                                  | \$ (23)   | \$ 2,060,235   | \$ (2,006,947)   | \$ —                          | \$ 53,288     |
| December 31, 2016                     |   |   |  |  |                               |               |
| Securities loaned:                    |   |   |  |  |                               |               |
| Institutional<br>counterparties       | \$ 1,283,676                                  | \$ —  | \$ 1,283,676   | \$ (1,237,868)   | \$ —                          | \$ 45,808     |
| Interest rate swaps<br>and swaptions: |   |   |  |  |                               |               |
| Institutional<br>counterparties       | 297   | (14)  | 283  | (3,000)  | —                             | (2,717)       |

|                              |              |         |              |                |      |           |
|------------------------------|--------------|---------|--------------|----------------|------|-----------|
| Repurchase agreements:       |              |         |              |                |      |           |
| Institutional counterparties | 39,970       | —       | 39,970       | (39,970)       | —    | —         |
| Customer counterparties      | 155,194      | —       | 155,194      | (155,194)      | —    | —         |
| Forward MBS derivatives:     |              |         |              |                |      |           |
| Institutional counterparties | 19,159       | —       | 19,159       | (19,159)       | —    | —         |
|                              | \$ 1,498,296 | \$ (14) | \$ 1,498,282 | \$ (1,455,191) | \$ — | \$ 43,091 |

### 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 day from the transaction date or involve arrangements with no definite termination date. Securities sold under repurchase agreements are reflected at the amount of cash received in connection with the transactions. The Company may be required to provide additional collateral based on the fair value of the underlying securities, which is monitored on a daily basis.

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

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



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Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following tables present the remaining contractual maturities of repurchase agreement and securities lending transactions accounted for as secured borrowings (in thousands). The Company had no repurchase-to-maturity transactions outstanding at both September 30, 2017 and December 31, 2016.

|  | Remaining Contractual Maturities |                     |               |                               | Total        |
|--|----------------------------------|---------------------|---------------|-------------------------------|--------------|
|  | Overnight<br>and                 | Up to<br>30<br>Days | 30-90<br>Days | Greater<br>Than<br>90<br>Days |              |
| September 30, 2017   | Continuous                       |                     |               |                               |              |
| Repurchase agreement transactions:   |                                  |                     |               |                               |              |
| U.S. Treasury and agency securities  | \$ 186,089                       | \$ —                | \$ —          | \$ —                          | \$ 186,089   |
| Asset-backed securities  | 425,612                          | —                   | —             | —                             | 425,612      |
| Securities lending transactions:   |                                  |                     |               |                               |              |
| Corporate securities   | 15,469                           | —                   | —             | —                             | 15,469       |
| Equity securities  | 1,432,101                        | —                   | —             | —                             | 1,432,101    |
| Total  | \$ 2,059,271                     | \$ —                | \$ —          | \$ —                          | \$ 2,059,271 |
| Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above |                                  |                     |               |                               | \$ 2,059,271 |
| Amount related to agreements not included in offsetting disclosure above   |                                  |                     |               |                               | \$ —         |

|                                     | Remaining Contractual Maturities |                     |               |                               | Total        |
|-------------------------------------|----------------------------------|---------------------|---------------|-------------------------------|--------------|
|                                     | Overnight<br>and                 | Up to<br>30<br>Days | 30-90<br>Days | Greater<br>Than<br>90<br>Days |              |
| December 31, 2016                   | Continuous                       |                     |               |                               |              |
| Repurchase agreement transactions:  |                                  |                     |               |                               |              |
| U.S. Treasury and agency securities | \$ 195,164                       | \$ —                | \$ —          | \$ —                          | \$ 195,164   |
| Securities lending transactions:    |                                  |                     |               |                               |              |
| Corporate securities                | 14,816                           | —                   | —             | —                             | 14,816       |
| Equity securities                   | 1,268,860                        | —                   | —             | —                             | 1,268,860    |
| Total                               | \$ 1,478,840                     | \$ —                | \$ —          | \$ —                          | \$ 1,478,840 |

|  |              |
|--|--------------|
| Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above | \$ 1,478,840 |
| Amount related to agreements not included in offsetting disclosure above   | \$ —         |

19. Broker-Dealer and Clearing Organization Receivables and Payables

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

|                                 | September<br>30,<br>2017 | December 31,<br>2016 |
|---------------------------------|--------------------------|----------------------|
| Receivables:                    |                          |                      |
| Securities borrowed             | \$ 1,611,885             | \$ 1,436,069         |
| Securities failed to deliver    | 25,478                   | 33,834               |
| Trades in process of settlement | 16,545                   | 10,223               |
| Other                           | 18,215                   | 17,615               |
|                                 | \$ 1,672,123             | \$ 1,497,741         |
| Payables:                       |                          |                      |
| Securities loaned               | \$ 1,447,570             | \$ 1,283,676         |
| Correspondents                  | 27,225                   | 31,040               |
| Securities failed to receive    | 39,312                   | 31,724               |
| Other                           | 3,591                    | 688                  |
|                                 | \$ 1,517,698             | \$ 1,347,128         |

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

20. Reserve for Losses and Loss Adjustment Expenses

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

|  | September<br>30,<br>2017 | December<br>31,<br>2016 |
|--|--------------------------|-------------------------|
| Reserve for unpaid losses and allocated LAE balance, net | \$ 29,849                | \$ 25,203               |
| Reinsurance recoverables on unpaid losses                | 35,297                   | 9,434                   |
| Unallocated LAE  | 1,860                    | 1,189                   |
| Reserve for unpaid losses and LAE balance, gross         | \$ 67,006                | \$ 35,826               |

This increase in the gross reserve for unpaid losses and LAE was primarily due to losses attributable to non-catastrophic weather-related events that occurred in 2017 and Hurricane Harvey which occurred in August and September 2017. See Note 21 for further details regarding the effects of reinsurance.

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

| Year | Nine Months Ended |                            | September 30, 2017 |   |   |
|------|-------------------|----------------------------|--------------------|---|---|
|      | Accident<br>Year  | Paid<br>September 30, 2017 | Incurred           | Total of<br>IBNR<br>Reserves<br>Plus<br>Expected<br>Development<br>on<br>Reported<br>Claims | Cumulative<br>Number of<br>Reported<br>Claims |
| 2012 |                   | \$ 113,037                 | \$ 114,693         | \$ 7  | 16,658  |
| 2013 |                   | 110,483                    | 111,128            | 44  | 15,701  |
| 2014 |                   | 83,044                     | 84,289             | 197   | 13,146  |

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|       |           |  |       |        |
|-------|-----------|--|-------|--------|
| 2015  | 84,986    | 88,028   | 1,231 | 14,997 |
| 2016  | 80,786    | 86,301   | 3,696 | 21,363 |
| 2017  | 61,158    | 78,816   | 5,462 | 18,624 |
| Total | 533,494   | \$ 563,255   |       |        |
|       | 88        | All outstanding reserves prior to 2012,<br>net of reinsurance      |       |        |
|       | \$ 29,849 | Reserve for unpaid losses and allocated<br>LAE, net of reinsurance |       |        |

## 21. Reinsurance Activity

NLC limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risk. Substantial amounts of business are ceded, and these reinsurance contracts do not relieve NLC from its obligations to policyholders. Such reinsurance includes quota share, excess of loss, catastrophe, and other forms of reinsurance on essentially all property and casualty lines of insurance. Net insurance premiums earned, losses and LAE and policy acquisition and other underwriting expenses are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE and unearned insurance premiums ceded to them are reported as assets. Failure of reinsurers to honor their obligations could result in losses to NLC; consequently, allowances are established for amounts deemed uncollectible as NLC evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. At September 30, 2017, total reinsurance recoverables and receivables had a carrying value of \$35.8 million, which is included in other assets within the consolidated balance sheet. There was no allowance for uncollectible accounts at September 30, 2017, based on NLC's quality requirements.



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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

|                               | Three Months Ended September 30, |                |                 |                | Nine Months Ended September 30, |                |                 |                |
|-------------------------------|----------------------------------|----------------|-----------------|----------------|---------------------------------|----------------|-----------------|----------------|
|                               | 2017<br>Written                  | 2017<br>Earned | 2016<br>Written | 2016<br>Earned | 2017<br>Written                 | 2017<br>Earned | 2016<br>Written | 2016<br>Earned |
| Premiums from direct business | \$ 33,909                        | \$ 36,096      | \$ 38,200       | \$ 39,839      | \$ 107,497                      | \$ 110,048     | \$ 119,955      | \$ 120,902     |
| Reinsurance assumed           | 3,200                            | 2,993          | 2,927           | 2,798          | 9,427                           | 8,721          | 8,752           | 8,180          |
| Reinsurance ceded             | (4,028)                          | (4,596)        | (4,038)         | (3,890)        | (10,215)                        | (12,116)       | (11,783)        | (11,881)       |
| Net premiums                  | \$ 33,081                        | \$ 34,493      | \$ 37,089       | \$ 38,747      | \$ 106,709                      | \$ 106,653     | \$ 116,924      | \$ 117,201     |

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

|                           | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                           | 2017                                | 2016      | 2017                               | 2016      |
| Losses and LAE incurred   | \$ 67,152                           | \$ 19,953 | \$ 122,806                         | \$ 98,903 |
| Reinsurance recoverables  | (35,918)                            | (3,898)   | (36,688)                           | (23,678)  |
| Net loss and LAE incurred | \$ 31,234                           | \$ 16,055 | \$ 86,118                          | \$ 75,225 |

## Catastrophic coverage

At September 30, 2017, NLC had catastrophic excess of loss reinsurance coverage of losses per event in excess of \$8 million retention by NLIC and \$1.5 million retention by ASIC. ASIC maintained an underlying layer of coverage, providing \$6.5 million in excess of its \$1.5 million retention to bridge to the primary program. The reinsurance 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 September 30, 2017, total retention for any one catastrophe that affects both NLIC and ASIC was limited to \$8 million in the

aggregate.

Effective January 1, 2017, NLC renewed its underlying excess of loss contract that provides \$10 million aggregate coverage in excess of NLC's per event retention and aggregate retention for sub-catastrophic events. NLC retains no participation beyond the first \$1 million, which is consistent with 2016.

During August and September 2017, NLC experienced losses related to Hurricane Harvey in excess of retention. As of September 30, 2017, the total gross losses and LAE incurred associated with Hurricane Harvey was \$19.0 million. However, because the losses exceeded retention, net exposure to NLC was \$3.9 million retention and \$1.5 million in reinstatement premiums.

## 22. Segment and Related Information

The Company currently has four reportable business segments that are organized primarily by the core products offered to the segments' respective customers. These segments reflect the manner in which operations are managed and the criteria used by the Company's chief operating decision maker function to evaluate segment performance, develop strategy and allocate resources. The chief operating decision maker function consists of the Company's President and Co-Chief Executive Officer and the Company's Vice Chairman and Co-Chief Executive Officer.

The banking segment includes the operations of the Bank, the broker-dealer segment includes the operations of Securities Holdings, the mortgage origination segment is composed of PrimeLending, and the insurance segment is composed of NLC.

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, and management and administrative services to support the overall operations of the Company including, but not limited to, certain executive management, corporate relations, legal, finance and acquisition costs.

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

| Three<br>Months<br>Ended<br>September<br>30, 2017 | Mortgage  |               |             |            |             | All Other and | Hilltop      |
|---|-----------|---------------|-------------|------------|-------------|---------------|--------------|
|   | Banking   | Broker-Dealer | Origination | Insurance  | Corporate   | Eliminations  | Consolidated |
| Net interest<br>income<br>(expense)               | \$ 89,322 | \$ 12,215     | \$ 94       | \$ 864     | \$ (2,589)  | \$ 5,074      | \$ 104,980   |
| Provision<br>for loan<br>losses                   | 1,665     | (405)         | —           | —          | —           | —             | 1,260        |
| Noninterest<br>income                             | 11,414    | 91,418        | 163,758     | 36,839     | 182         | (5,134)       | 298,477      |
| Noninterest<br>expense                            | 62,750    | 83,836        | 151,056     | 47,015     | 9,325       | (140)         | 353,842      |
| Income<br>(loss)<br>before<br>income<br>taxes     | \$ 36,321 | \$ 20,202     | \$ 12,796   | \$ (9,312) | \$ (11,732) | \$ 80         | \$ 48,355    |

| Nine<br>Months<br>Ended<br>September<br>30, 2017 | Mortgage   |               |             |           |            | All Other and | Hilltop      |
|--|------------|---------------|-------------|-----------|------------|---------------|--------------|
|  | Banking    | Broker-Dealer | Origination | Insurance | Corporate  | Eliminations  | Consolidated |
| Net interest<br>income<br>(expense)              | \$ 273,595 | \$ 31,052     | \$ (791)    | \$ 1,982  | \$ (7,413) | \$ 14,631     | \$ 313,056   |
| Provision<br>for loan<br>losses                  | 8,907      | (89)          | —           | —         | —          | —             | 8,818        |
| Noninterest<br>income                            | 49,323     | 266,779       | 487,033     | 113,562   | 12,792     | (14,881)      | 914,608      |

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|                                   |            |           |           |             |             |        |            |
|-----------------------------------|------------|-----------|-----------|-------------|-------------|--------|------------|
| Noninterest expense               | 186,075    | 252,395   | 444,263   | 133,444     | 25,010      | (602)  | 1,040,585  |
| Income (loss) before income taxes | \$ 127,936 | \$ 45,525 | \$ 41,979 | \$ (17,900) | \$ (19,631) | \$ 352 | \$ 178,261 |

| Three Months Ended September 30, 2016 | Mortgage  |               |             |           |             | All Other and Hilltop |              |
|---------------------------------------|-----------|---------------|-------------|-----------|-------------|-----------------------|--------------|
|                                       | Banking   | Broker-Dealer | Origination | Insurance | Corporate   | Eliminations          | Consolidated |
| Net interest income (expense)         | \$ 90,549 | \$ 7,823      | \$ (3,076)  | \$ 716    | \$ (1,854)  | \$ 5,012              | \$ 99,170    |
| Provision for loan losses             | 4,179     | (189)         | —           | —         | —           | —                     | 3,990        |
| Noninterest income                    | 12,711    | 103,511       | 202,560     | 41,170    | —           | (5,494)               | 354,458      |
| Noninterest expense                   | 61,536    | 94,094        | 168,303     | 30,415    | 10,041      | (256)                 | 364,133      |
| Income (loss) before income taxes     | \$ 37,545 | \$ 17,429     | \$ 31,181   | \$ 11,471 | \$ (11,895) | \$ (226)              | \$ 85,505    |

| Nine Months Ended September 30, 2016 | Mortgage   |               |             |           |             | All Other and Hilltop |              |
|--------------------------------------|------------|---------------|-------------|-----------|-------------|-----------------------|--------------|
|                                      | Banking    | Broker-Dealer | Origination | Insurance | Corporate   | Eliminations          | Consolidated |
| Net interest income (expense)        | \$ 268,682 | \$ 22,314     | \$ (7,941)  | \$ 2,213  | \$ (5,413)  | \$ 13,552             | \$ 293,407   |
| Provision for loan losses            | 36,292     | (19)          | —           | —         | —           | —                     | 36,273       |
| Noninterest income                   | 39,012     | 287,293       | 541,779     | 124,366   | 2           | (14,614)              | 977,838      |
| Noninterest expense                  | 181,016    | 270,135       | 465,463     | 118,506   | 22,373      | (806)                 | 1,056,687    |
|                                      | \$ 90,386  | \$ 39,491     | \$ 68,375   | \$ 8,073  | \$ (27,784) | \$ (256)              | \$ 178,285   |

Income  
(loss)  
before  
income  
taxes

|                       | Banking      | Broker-Dealer | Mortgage<br>Origination | Insurance  | Corporate    | All Other and<br>Eliminations | Hilltop<br>Consolidated |
|-----------------------|--------------|---------------|-------------------------|------------|--------------|-------------------------------|-------------------------|
| September<br>30, 2017 |              |               |                         |            |              |                               |                         |
| Goodwill              | \$ 207,741   | \$ 7,008      | \$ 13,071               | \$ 23,988  | \$ —         | \$ —                          | \$ 251,808              |
| Total<br>assets       | \$ 9,708,778 | \$ 3,432,228  | \$ 2,176,943            | \$ 327,767 | \$ 2,041,901 | \$ (4,154,817)                | \$ 13,532,800           |
| December<br>31, 2016  |              |               |                         |            |              |                               |                         |
| Goodwill              | \$ 207,741   | \$ 7,008      | \$ 13,071               | \$ 23,988  | \$ —         | \$ —                          | \$ 251,808              |
| Total<br>assets       | \$ 9,527,518 | \$ 2,777,849  | \$ 2,042,458            | \$ 347,252 | \$ 2,032,749 | \$ (3,989,764)                | \$ 12,738,060           |

### 23. Earnings per Common Share

Nonvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of earnings per share pursuant to the two-class method prescribed by the Earnings Per Share Topic of the ASC. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Restricted Stock Awards, all of which are vested as of September 30, 2017, were the only instruments issued by Hilltop which qualified as participating securities.

Net earnings, less any preferred dividends accumulated for the period (whether or not declared), is allocated between the common stock and participating securities pursuant to the two-class method. Basic earnings per common share is computed by dividing net earnings available to common stockholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

Diluted earnings per common share is computed in a similar manner, except that first the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares, excluding the participating securities, were issued using the treasury stock method. During the three and nine months ended September 30, 2017, RSUs were the only potentially dilutive non-participating instruments issued by

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Hilltop, while during the three and nine months ended September 30, 2016, stock options and RSUs were potentially dilutive non-participating instruments. 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<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|-----------|------------------------------------|------------|
|   | 2017                                | 2016      | 2017                               | 2016       |
| Basic earnings per share:                             |                                     |           |                                    |            |
| Income attributable to Hilltop                        | \$ 30,206                           | \$ 51,932 | \$ 119,116                         | \$ 110,573 |
| Less: income applicable to participating shares       | —                                   | (5)       | —                                  | (11)       |
| Net earnings available to Hilltop common stockholders | \$ 30,206                           | \$ 51,927 | \$ 119,116                         | \$ 110,562 |
| Weighted average shares outstanding - basic           | 96,096                              | 98,490    | 97,554                             | 98,367     |
| Basic earnings per common share                       | \$ 0.31                             | \$ 0.53   | \$ 1.22                            | \$ 1.12    |
| Diluted earnings per share:                           |                                     |           |                                    |            |
| Income attributable to Hilltop                        | \$ 30,206                           | \$ 51,932 | \$ 119,116                         | \$ 110,573 |
| Weighted average shares outstanding - basic           | 96,096                              | 98,490    | 97,554                             | 98,367     |
| Effect of potentially dilutive securities             | 210                                 | 135       | 249                                | 206        |
| Weighted average shares outstanding - diluted         | 96,306                              | 98,625    | 97,803                             | 98,573     |
| Diluted earnings per common share                     | \$ 0.31                             | \$ 0.53   | \$ 1.22                            | \$ 1.12    |





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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 |                |                |                |                |                |                | September 30, 2017  |                                      |
|--|----------------|----------------|----------------|----------------|----------------|----------------|---|--------------------------------------|
| Nine Months Ended September 30, 2017                                       |                |                |                |                |                |                | Total of Incurred But Not Reported Reserves Plus Development On Reported Claims | Cumulative Number of Reported Claims |
| Accident Year  | 2012 Unaudited | 2013 Unaudited | 2014 Unaudited | 2015 Unaudited | 2016 Unaudited | 2017 Unaudited |   |                                      |
| 2012   | \$ 107,873     | \$ 108,753     | \$ 114,031     | \$ 114,067     | \$ 114,517     | \$ 114,693     | \$ 7  | 16,658                               |
| 2013   |                | 107,793        | 108,951        | 111,006        | 111,011        | 111,128        | 44  | 15,701                               |
| 2014   |                |                | 83,784         | 85,037         | 84,221         | 84,289         | 197   | 13,146                               |
| 2015   |                |                |                | 89,646         | 88,477         | 88,028         | 1,231   | 14,997                               |
| 2016   |                |                |                |                | 84,771         | 86,301         | 3,696   | 21,363                               |
| 2017   |                |                |                |                |                | 78,816         | 5,462   | 18,624                               |
|  |                |                |                |                |                | \$ 563,255     |   |                                      |

| Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance |                |                |                |                |                |                |
|---|----------------|----------------|----------------|----------------|----------------|----------------|
| Nine Months Ended September 30, 2017  |                |                |                |                |                |                |
| Accident Year   | 2012 Unaudited | 2013 Unaudited | 2014 Unaudited | 2015 Unaudited | 2016 Unaudited | 2017 Unaudited |
| 2012  | \$ 89,603      | \$ 101,968     | \$ 107,126     | \$ 110,782     | \$ 112,062     | \$ 113,037     |
| 2013  |                | 94,238         | 104,938        | 108,099        | 109,662        | 110,483        |
| 2014  |                |                | 70,831         | 79,713         | 81,684         | 83,044         |
| 2015  |                |                |                | 71,820         | 82,940         | 84,986         |
| 2016  |                |                |                |                | 71,543         | 80,786         |
| 2017  |                |                |                |                |                | 61,158         |
|   |                |                |                |                | Total          | \$ 533,494     |
|   |                |                |                |                |                | 88             |
|   |                |                |                |                |                | \$ 29,849      |

All outstanding reserves prior to 2012, net of reinsurance

Reserve for unpaid losses and allocated loss adjustment expenses, net of reinsurance



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

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

Unless the context otherwise indicates, all references in this Management’s Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, to the “Company,” “we,” “us,” “our” or “ours” or similar words are to Hilltop Holdings Inc. and its direct and indirect wholly owned subsidiaries, references to “Hilltop” refer solely to Hilltop Holdings Inc., references to “PCC” refer to PlainsCapital Corporation (a wholly owned subsidiary of Hilltop), references to “Securities Holdings” refer to Hilltop Securities Holdings LLC (a wholly owned subsidiary of Hilltop), references to “Hilltop Securities” refer to Hilltop Securities Inc. (a wholly owned subsidiary of Securities Holdings that was formerly known as Southwest Securities, Inc.), references to “HTS Independent Network” refer to Hilltop Securities Independent Network Inc. (a wholly owned subsidiary of Securities Holdings that was formerly known as SWS Financial Services, Inc.), references to the “Bank” refer to PlainsCapital Bank (a wholly owned subsidiary of PCC), references to “FNB” refer to First National Bank, references to “SWS” refer to the former SWS Group, Inc., references to “FSC” refer to First Southwest Company, LLC (a former wholly owned subsidiary of First Southwest Holdings, LLC), 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,” “should,” “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 strategic acquisitions, the costs of integration of the operations acquired in the SWS Merger (as defined below), our revenue, our liquidity and sources of funding, market trends, operations and business, capital levels, mortgage servicing rights (“MSR”) assets, stock repurchases, dividend payments, expectations concerning mortgage loan origination volume and interest rate compression, expected losses on covered loans and related reimbursements from the Federal Deposit Insurance Corporation (“FDIC”), anticipated amortization of the value of the receivable under our loss-share agreements with the FDIC (“FDIC Indemnification Asset”), expected levels of refinancing as a percentage of total loan origination volume, projected losses on mortgage loans originated, loss estimates related to natural disasters, the effects of government regulation applicable to our operations, the appropriateness of 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 and the outcome of litigation are forward-looking statements.

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

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

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

- changes in the interest rate environment;

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- risks associated with concentration in real estate related loans;
- risks associated with merger and acquisition integration;
  
- severe catastrophic events in Texas and other areas of the southern United States;
  
- effectiveness of our data security controls in the face of cyber attacks;
  
- the effects of our indebtedness on our ability to manage our business successfully, including the restrictions imposed by the indenture governing our indebtedness;
- cost and availability of capital;
- changes in state and federal laws, regulations or policies affecting one or more of our business segments, including changes in regulatory fees, deposit insurance premiums, capital requirements and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”);
  
- changes in key management;
  
- competition in our banking, broker-dealer, mortgage origination and insurance segments from other banks and financial institutions as well as investment banking and financial advisory firms, mortgage bankers, asset-based non-bank lenders, government agencies and insurance companies;
  
- legal and regulatory proceedings;
  
- our obligations under loss-share agreements with the FDIC, including the possibility that we may be required to make a “true-up” payment to the FDIC;
  
- failure of our insurance segment reinsurers to pay obligations under reinsurance contracts; and
  
- our ability to use excess capital in an effective manner.

For a more detailed discussion of these and other factors that may affect our business and that could cause the actual results to differ materially from those anticipated in these forward-looking statements, see “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016 (“2016 Form 10-K”), which was filed with the Securities and Exchange Commission (the “SEC”) on February 16, 2017, 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.

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

During the three and nine months ended September 30, 2017, our net income to common stockholders was \$30.2 million, or \$0.31 per diluted share, and \$119.1 million, or \$1.22 per diluted share, respectively. We declared total common dividends of \$0.06 and \$0.18 per share during the three and nine months ended September 30, 2017, respectively, which resulted in dividend payout ratios of 19.09% and 14.74%, respectively. Dividend payout ratio is defined as cash dividends declared per common share divided by basic earnings per common share. We also paid an aggregate of \$27.4 million to repurchase our common stock during the nine months ended September 30, 2017.

We reported \$48.4 million and \$178.3 million of consolidated income before income taxes during the three and nine months ended September 30, 2017, respectively, including the following contributions from our four reportable business segments.

- The banking segment contributed \$36.3 million and \$127.9 million of income before income taxes during the three and nine months ended September 30, 2017, respectively;
- The broker-dealer segment contributed \$20.2 million and \$45.5 million of income before income taxes during the three and nine months ended September 30, 2017, respectively;
- The mortgage origination segment contributed \$12.8 million and \$42.0 million of income before income taxes during the three and nine months ended September 30, 2017, respectively; and
- The insurance segment incurred losses before income taxes of \$9.3 million and \$17.9 million during the three and nine months ended September 30, 2017, respectively.

During August and September 2017, Hurricanes Harvey and Irma affected both the Company and its customers. While we continue to monitor and evaluate the financial impact and exposures related to these hurricanes, all of our businesses are fully operational. The estimated pre-tax earnings impact from these hurricanes on our third quarter operating results was \$9.8 million. Specifically, within our insurance segment, the total loss and loss adjustment expenses (“LAE”) incurred associated with the hurricanes was \$19.6 million. However, since the losses exceeded excess of loss retention coverage, net exposure to the insurance segment was \$4.5 million retention and \$1.5 million in reinstatement premiums. The effect on our broker-dealer segment’s operating results were limited to \$0.3 million associated with waived customer fees. While the mortgage origination and banking segments did not identify any immediate losses based on client interactions and the review of collateral domiciled in the affected areas, each has recorded loss estimates within its third quarter operating results. The mortgage origination segment’s results included a \$1.5 million indemnification liability reserve associated with loss exposures related to funded loans, not yet sold into the secondary markets, as well as loans upon which it owns the mortgage servicing rights. The banking segment has reflected \$2.0 million associated with estimated hurricane loss exposures within the qualitative factors used to determine its allowance for loan losses during the three and nine months ended September 30, 2017. Loan balances in the affected areas represented approximately 12% of total bank loans as of September 30, 2017 and are summarized by portfolio segment in the following table (dollars in millions).

|                                   |        |
|-----------------------------------|--------|
| Commercial and industrial         | \$ 110 |
| Real estate                       | 590    |
| Construction and land development | —      |
| Consumer                          | 1      |
| Broker-dealer                     | —      |
| Total loans in affected areas     | \$ 701 |

Additionally, during the nine months ended September 30, 2017, our consolidated income before taxes included the recognition within corporate of a pre-tax net increase to other noninterest income of \$11.6 million related to the resolution of the appraisal proceedings from the SWS Merger as discussed in detail in Note 12, Commitments and Contingencies.

During the three months ended June 30, 2016, the Bank discovered irregularities with respect to a non-covered loan that is currently in default, including the genuineness of certain underlying documents that supported the loan and the



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operations of the borrower's business. As a result of the payment default and other irregularities, the Bank increased its provision for loan losses and recorded a \$24.5 million charge-off, representing the entire outstanding principal balance of the loan. The banking segment's financial results for the nine months ended September 30, 2016 reflect this charge-off. During the three months ended June 30, 2017, the Bank recorded other noninterest income of \$15.0 million from coverage provided by an insurance policy for forgery. The Bank is actively pursuing legal remedies to recover losses arising from this isolated incident, including litigation against the borrower and guarantors. The Bank cannot currently estimate the amount of any future recoveries or additional expenses related to this charged-off loan.

At September 30, 2017, on a consolidated basis, we had total assets of \$13.5 billion, total deposits of \$7.7 billion, total loans, including loans held for sale, of \$8.2 billion and stockholders' equity of \$1.9 billion.

## Segment Information

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

The banking segment includes the operations of the Bank, which primarily provides business and consumer banking services from offices located throughout Texas and generates revenue from its portfolio of earning assets. The Bank's results of operations are primarily dependent on net interest income, while also deriving revenue from other sources, including service charges on customer deposit accounts and trust fees.

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

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

secondary market.

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

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, and management and administrative services to support the overall operations of the Company including, but not limited to, certain executive management, corporate relations, legal, finance, and acquisition costs.

The elimination of intercompany transactions are included in “All Other and Eliminations.” Additional information concerning our reportable segments is presented in Note 22, Segment and Related Information, in the notes to our consolidated financial statements. The following tables present certain information about the operating results of our reportable segments (in thousands).

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| Three<br>Months<br>Ended<br>September<br>30, 2017 | Mortgage   |               |             |             |             | All Other and Hilltop |              |
|---|------------|---------------|-------------|-------------|-------------|-----------------------|--------------|
|   | Banking    | Broker-Dealer | Origination | Insurance   | Corporate   | Eliminations          | Consolidated |
| Net interest<br>income<br>(expense)               | \$ 89,322  | \$ 12,215     | \$ 94       | \$ 864      | \$ (2,589)  | \$ 5,074              | \$ 104,980   |
| Provision<br>for loan<br>losses                   | 1,665      | (405)         | —           | —           | —           | —                     | 1,260        |
| Noninterest<br>income                             | 11,414     | 91,418        | 163,758     | 36,839      | 182         | (5,134)               | 298,477      |
| Noninterest<br>expense                            | 62,750     | 83,836        | 151,056     | 47,015      | 9,325       | (140)                 | 353,842      |
| Income<br>(loss) before<br>income<br>taxes        | \$ 36,321  | \$ 20,202     | \$ 12,796   | \$ (9,312)  | \$ (11,732) | \$ 80                 | \$ 48,355    |
|   |            |               |             |             |             |                       |              |
| Nine<br>Months<br>Ended<br>September<br>30, 2017  | Mortgage   |               |             |             |             | All Other and Hilltop |              |
|   | Banking    | Broker-Dealer | Origination | Insurance   | Corporate   | Eliminations          | Consolidated |
| Net interest<br>income<br>(expense)               | \$ 273,595 | \$ 31,052     | \$ (791)    | \$ 1,982    | \$ (7,413)  | \$ 14,631             | \$ 313,056   |
| Provision<br>for loan<br>losses                   | 8,907      | (89)          | —           | —           | —           | —                     | 8,818        |
| Noninterest<br>income                             | 49,323     | 266,779       | 487,033     | 113,562     | 12,792      | (14,881)              | 914,608      |
| Noninterest<br>expense                            | 186,075    | 252,395       | 444,263     | 133,444     | 25,010      | (602)                 | 1,040,585    |
| Income<br>(loss)<br>before<br>income<br>taxes     | \$ 127,936 | \$ 45,525     | \$ 41,979   | \$ (17,900) | \$ (19,631) | \$ 352                | \$ 178,261   |

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| Three Months Ended September 30, 2016 | Mortgage  |               |             |           |             | All Other and Hilltop |              |
|---------------------------------------|-----------|---------------|-------------|-----------|-------------|-----------------------|--------------|
|                                       | Banking   | Broker-Dealer | Origination | Insurance | Corporate   | Eliminations          | Consolidated |
| Net interest income (expense)         | \$ 90,549 | \$ 7,823      | \$ (3,076)  | \$ 716    | \$ (1,854)  | \$ 5,012              | \$ 99,170    |
| Provision for loan losses             | 4,179     | (189)         | —           | —         | —           | —                     | 3,990        |
| Noninterest income                    | 12,711    | 103,511       | 202,560     | 41,170    | —           | (5,494)               | 354,458      |
| Noninterest expense                   | 61,536    | 94,094        | 168,303     | 30,415    | 10,041      | (256)                 | 364,133      |
| Income (loss) before income taxes     | \$ 37,545 | \$ 17,429     | \$ 31,181   | \$ 11,471 | \$ (11,895) | \$ (226)              | \$ 85,505    |

| Nine Months Ended September 30, 2016 | Mortgage   |               |             |           |             | All Other and Hilltop |              |
|--------------------------------------|------------|---------------|-------------|-----------|-------------|-----------------------|--------------|
|                                      | Banking    | Broker-Dealer | Origination | Insurance | Corporate   | Eliminations          | Consolidated |
| Net interest income (expense)        | \$ 268,682 | \$ 22,314     | \$ (7,941)  | \$ 2,213  | \$ (5,413)  | \$ 13,552             | \$ 293,407   |
| Provision for loan losses            | 36,292     | (19)          | —           | —         | —           | —                     | 36,273       |
| Noninterest income                   | 39,012     | 287,293       | 541,779     | 124,366   | 2           | (14,614)              | 977,838      |
| Noninterest expense                  | 181,016    | 270,135       | 465,463     | 118,506   | 22,373      | (806)                 | 1,056,687    |
| Income (loss) before income taxes    | \$ 90,386  | \$ 39,491     | \$ 68,375   | \$ 8,073  | \$ (27,784) | \$ (256)              | \$ 178,285   |

How We Generate Revenue

We generate revenue from net interest income and from noninterest income. Net interest income represents the difference between the income earned on our assets, including our loans and investment securities, and our cost of funds, including the interest paid on the deposits and borrowings that are used to support our assets. Net interest income is a significant contributor to our operating results. Fluctuations in interest rates, as well as the amounts and types of interest-earning assets and interest-bearing liabilities we hold, affect net interest income. We generated \$313.1 million and \$293.4 million in net interest income during the nine months ended September 30, 2017 and 2016, respectively. Changes in net interest income primarily included increases within our banking, broker-dealer and mortgage origination segments.

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

- (i) Income from broker-dealer operations. Through Securities Holdings, we provide investment banking and other related financial services. We generated \$189.0 million and \$202.8 million in securities commissions and fees and investment and securities advisory fees and commissions, and \$70.2 million and \$81.0 million in gains from derivative and trading portfolio activities (included within other noninterest income) during the nine months ended September 30, 2017 and 2016, respectively.
- (ii) Income from mortgage operations. Through PrimeLending, we generate noninterest income by originating and selling mortgage loans. During the nine months ended September 30, 2017 and 2016, we generated \$487.1 million and \$541.1 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 \$106.7 million and \$117.2 million in net insurance premiums earned during the nine months ended September 30, 2017 and 2016, respectively.

In the aggregate, we generated \$914.6 million and \$977.8 million in noninterest income during the nine months ended September 30, 2017 and 2016, respectively. This year-over-year decrease in noninterest income was predominantly attributable to decreases in noninterest income in our mortgage origination, broker-dealer and insurance segments,

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partially offset by increases in noninterest income due to the previously mentioned increase in other noninterest income of \$15.0 million within the banking segment and the \$11.6 million within corporate related to the resolution of the appraisal proceedings from the SWS Merger.

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 September 30, 2017 was \$30.2 million, or \$0.31 per diluted share, compared with net income applicable to common stockholders of \$51.9 million, or \$0.53 per diluted share, during the three months ended September 30, 2016. The consolidated operating results during the three months ended September 30, 2017 included the previously mentioned estimated pre-tax earnings impact from the hurricanes of \$9.8 million. Net income applicable to common stockholders during the nine months ended September 30, 2017 was \$119.1 million, or \$1.22 per diluted share, compared with net income applicable to common stockholders of \$110.6 million, or \$1.12 per diluted share, during the nine months ended September 30, 2016. The consolidated operating results during the nine months ended September 30, 2017 included the previously mentioned increase to other noninterest income of \$15.0 million from coverage provided by an insurance policy for forgery related to a single, large loan charged off by the Bank in 2016 and the pre-tax net increase to other noninterest income of \$11.6 million (or \$14.3 million after income tax benefit of \$2.6 million) related to the resolution of the appraisal proceedings from the SWS Merger, partially offset by the hurricane losses noted above. The consolidated operating results during the three and nine months ended September 30, 2016 included the previously mentioned \$24.5 million charge-off of the single, large loan by the Bank.

Our consolidated operating results during the nine months ended September 30, 2017 also included transaction costs related to the acquisition of SWS (the "SWS Merger"), while our consolidated operating results during the nine months ended September 30, 2016 included both transaction costs and integration-related costs associated with employee expenses (such as severance and retention), professional fees (such as consulting and legal) and contractual costs (such as vendor contract termination and lease), incurred as a result of the integration of the operations and systems acquired in the SWS Merger.

During the nine months ended September 30, 2017, we incurred \$1.6 million in pre-tax transaction costs related to the SWS Merger. During the nine months ended September 30, 2016, we incurred transaction costs and integration-related costs related to the SWS Merger totaling \$12.5 million resulting from \$6.7 million in pre-tax transaction costs and pre-tax integration-related costs associated with employee, professional fee and contractual expenses of \$2.9 million, \$2.8 million and \$0.1 million, respectively. Effective as of the close of business on January 22, 2016, we merged FSC and Hilltop Securities into a combined firm operating under the "Hilltop Securities" name. The integration is complete and Hilltop Securities does not expect to incur any additional integration costs in relation to the SWS Merger.

Certain items included in net income for 2017 and 2016 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 FDIC-assisted transaction (the “FNB Transaction”) whereby the Bank acquired certain assets and assumed certain liabilities of FNB, and the SWS Merger (collectively, the “Bank Transactions”). Income before taxes during the three months ended September 30, 2017 included net accretion of \$1.3 million, \$8.1 million and \$0.8 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of \$1.6 million, \$0.1 million and \$0.2 million, respectively. During the three months ended September 30, 2016, income before taxes included net accretion of \$1.9 million, \$12.2 million and \$1.1 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of \$2.0 million, \$0.2 million and \$0.2 million, respectively. Income before taxes during the nine months ended September 30, 2017 included net accretion of \$3.2 million, \$38.5 million and \$2.6 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of \$4.8 million, \$0.5 million and \$0.6 million, respectively. During the nine months ended September 30, 2016, income before taxes included net accretion of \$7.8 million, \$36.2 million and \$3.5 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of \$6.0 million, \$0.6 million and \$0.7 million, respectively.

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In addition, the Bank recorded a “true-up” accrual related to the loss-share agreements with the FDIC and amortization of the FDIC Indemnification Asset, both related to the FNB Transaction, of \$5.5 million and \$15.4 million during the three and nine months ended September 30, 2017, respectively, compared to \$1.4 million and \$5.3 million during the same periods in 2016.

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

|  | Three Months<br>Ended September<br>30,<br>2017 |   | 2016  |   | Nine Months<br>Ended<br>September 30,<br>2017 |   | 2016 |   |
|--|--|---|-------|---|---|---|------|---|
|  | Performance Ratios:                            |   |       |   |   |   |      |   |
| Return on average stockholder's equity               | 6.32   | % | 11.41 | % | 8.44  | % | 8.32 | % |
| Return on average assets                             | 0.90   | % | 1.69  | % | 1.24  | % | 1.24 | % |
| Net interest margin (1) (3) (4)                      | 3.50   | % | 3.65  | % | 3.69  | % | 3.71 | % |
| Net interest margin (taxable equivalent) (2) (3) (4) | 3.52   | % | 3.67  | % | 3.71  | % | 3.74 | % |

- 
- (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 a 35% federal income tax rate. 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 50 basis points during the three months ended September 30, 2017 and 2016, respectively, and 48 basis points and 59 basis points during the nine months ended September 30, 2017 and 2016, respectively.
- (4) Net interest margin and taxable equivalent net interest margin were 37 basis points and 64 basis points greater due to the impact of purchase accounting during the three months ended September 30, 2017 and 2016, respectively, and 56 basis points and 70 basis points greater due to the impact of purchase accounting during the nine months ended September 30, 2017 and 2016, respectively.

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

During the three months ended September 30, 2017, the consolidated taxable equivalent net interest margin of 3.52% was 37 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on



loans of \$1.7 million, \$8.1 million and \$0.8 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$0.4 million. The consolidated taxable equivalent net interest margin during the three months ended September 30, 2016 of 3.67% was 64 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$2.7 million, \$12.2 million and \$1.1 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$0.8 million.

During the nine months ended September 30, 2017, the consolidated taxable equivalent net interest margin of 3.71% was 56 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$4.9 million, \$38.5 million and \$2.4 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$1.6 million. During the nine months ended September 30, 2016, the consolidated taxable equivalent net interest margin of 3.74% was 70 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$10.5 million, \$36.2 million and \$3.2 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$2.5 million.

The FNB Transaction-related accretion of discount on loans of \$38.5 million and \$36.2 million during the nine months ended September 30, 2017 and 2016, respectively, included accretion of approximately \$4 million and \$11 million, respectively, due to better-than-expected resolution of covered purchased credit impaired (“PCI”) loans during the respective periods. The performance of the covered PCI loan portfolio since 2014, which has exceeded our expectations at the time of acquisition, has led to higher yields calculated as a result of the Bank’s quarterly cash flow recast process. The recast process performed during the nine months ended September 30, 2017 and 2016 resulted in the reclassification of \$27.1 million and \$25.4 million, respectively, from nonaccretable difference to accretable yield.

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

|  | Three Months Ended September 30,<br>2017 |                               |                                |   | 2016                              |                               |                                |   |
|--|--|-------------------------------|--------------------------------|---|-----------------------------------|-------------------------------|--------------------------------|---|
|  | Average<br>Outstanding<br>Balance        | Interest<br>Earned or<br>Paid | Annualized<br>Yield or<br>Rate |   | Average<br>Outstanding<br>Balance | Interest<br>Earned or<br>Paid | Annualized<br>Yield or<br>Rate |   |
| <b>Assets</b>  |  |                               |                                |   |                                   |                               |                                |   |
| <b>Interest-earning assets</b>   |  |                               |                                |   |                                   |                               |                                |   |
| Loans, gross (1)   | \$ 8,077,804                             | \$ 102,546                    | 5.01                           | % | \$ 7,315,433                      | \$ 97,590                     | 5.26                           | % |
| Investment securities - taxable  | 1,538,890                                | 11,134                        | 2.88                           | % | 999,394                           | 5,915                         | 2.36                           | % |
| Investment securities - non-taxable (2)                                | 229,089                                  | 2,032                         | 3.54                           | % | 296,013                           | 2,052                         | 2.77                           | % |
| Federal funds sold and securities purchased under agreements to resell | 139,398                                  | —                             | 0.00                           | % | 185,533                           | 52                            | 0.11                           | % |
| Interest-bearing deposits in other financial institutions              | 282,806                                  | 853                           | 1.20                           | % | 478,560                           | 567                           | 0.47                           | % |
| Securities borrowed  | 1,548,039                                | 11,404                        | 2.88                           | % | 1,476,297                         | 9,037                         | 2.44                           | % |
| Other  | 87,281                                   | 1,536                         | 7.00                           | % | 65,858                            | 585                           | 3.54                           | % |
| Interest-earning assets, gross (2)                                     | 11,903,307                               | 129,505                       | 4.30                           | % | 10,817,088                        | 115,798                       | 4.22                           | % |
| Allowance for loan losses  | (61,243)                                 |                               |                                |   | (53,470)                          |                               |                                |   |
| Interest-earning assets, net   | 11,842,064                               |                               |                                |   | 10,763,618                        |                               |                                |   |
| Noninterest-earning assets   | 1,506,552                                |                               |                                |   | 1,588,921                         |                               |                                |   |
| Total assets   | \$ 13,348,616                            |                               |                                |   | \$ 12,352,539                     |                               |                                |   |
| <b>Liabilities and Stockholders' Equity</b>                            |  |                               |                                |   |                                   |                               |                                |   |
| <b>Interest-bearing liabilities</b>                                    |  |                               |                                |   |                                   |                               |                                |   |
| Interest-bearing deposits  | \$ 5,350,959                             | \$ 6,841                      | 0.51                           | % | \$ 4,851,952                      | \$ 3,996                      | 0.33                           | % |

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|  |               |            |      |   |               |           |      |   |
|--|---------------|------------|------|---|---------------|-----------|------|---|
| Securities loaned                          | 1,398,922     | 8,935      | 2.53 | % | 1,390,071     | 6,955     | 1.99 | % |
| Notes payable and other borrowings         | 1,781,498     | 8,188      | 1.81 | % | 1,339,395     | 5,142     | 1.53 | % |
| Total interest-bearing liabilities         | 8,531,379     | 23,964     | 1.11 | % | 7,581,418     | 16,093    | 0.84 | % |
| Noninterest-bearing liabilities            |               |            |      |   |               |           |      |   |
| Noninterest-bearing deposits               | 2,290,151     |            |      |   | 2,251,744     |           |      |   |
| Other liabilities                          | 627,907       |            |      |   | 705,985       |           |      |   |
| Total liabilities                          | 11,449,437    |            |      |   | 10,539,147    |           |      |   |
| Stockholders' equity                       | 1,896,838     |            |      |   | 1,810,266     |           |      |   |
| Noncontrolling interest                    | 2,341         |            |      |   | 3,126         |           |      |   |
| Total liabilities and stockholders' equity | \$ 13,348,616 |            |      |   | \$ 12,352,539 |           |      |   |
| Net interest income (2)                    |               | \$ 105,541 |      |   |               | \$ 99,705 |      |   |
| Net interest spread (2)                    |               |            | 3.19 | % |               |           | 3.38 | % |
| Net interest margin (2)                    |               |            | 3.52 | % |               |           | 3.67 | % |

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|  | Nine Months Ended September 30,<br>2017 |                               |                                |   | 2016                              |                               |                                |   |
|--|---|-------------------------------|--------------------------------|---|-----------------------------------|-------------------------------|--------------------------------|---|
|  | Average<br>Outstanding<br>Balance       | Interest<br>Earned or<br>Paid | Annualized<br>Yield or<br>Rate |   | Average<br>Outstanding<br>Balance | Interest<br>Earned or<br>Paid | Annualized<br>Yield or<br>Rate |   |
| Assets   |   |                               |                                |   |                                   |                               |                                |   |
| Interest-earning assets  |   |                               |                                |   |                                   |                               |                                |   |
| Loans, gross (1)   | \$ 7,659,277                            | \$ 306,330                    | 5.30                           | % | \$ 7,007,669                      | \$ 287,591                    | 5.41                           | % |
| Investment securities - taxable  | 1,343,753                               | 27,654                        | 2.75                           | % | 1,041,245                         | 19,075                        | 2.44                           | % |
| Investment securities - non-taxable (2)                                | 226,977                                 | 5,684                         | 3.34                           | % | 283,033                           | 6,532                         | 3.08                           | % |
| Federal funds sold and securities purchased under agreements to resell | 134,826                                 | 50                            | 0.05                           | % | 152,010                           | 115                           | 0.10                           | % |
| Interest-bearing deposits in other financial institutions              | 386,695                                 | 2,640                         | 0.91                           | % | 431,056                           | 1,524                         | 0.47                           | % |
| Securities borrowed  | 1,516,004                               | 29,054                        | 2.53                           | % | 1,574,084                         | 22,952                        | 1.95                           | % |
| Other  | 86,587                                  | 3,673                         | 5.66                           | % | 63,235                            | 1,671                         | 3.53                           | % |
| Interest-earning assets, gross (2)                                     | 11,354,119                              | 375,085                       | 4.38                           | % | 10,552,332                        | 339,460                       | 4.25                           | % |
| Allowance for loan losses  | (58,303)                                |                               |                                |   | (51,198)                          |                               |                                |   |
| Interest-earning assets, net   | 11,295,816                              |                               |                                |   | 10,501,134                        |                               |                                |   |
| Noninterest-earning assets   | 1,535,649                               |                               |                                |   | 1,593,065                         |                               |                                |   |
| Total assets   | \$ 12,831,465                           |                               |                                |   | \$ 12,094,199                     |                               |                                |   |
| Liabilities and Stockholders' Equity                                   |   |                               |                                |   |                                   |                               |                                |   |
| Interest-bearing liabilities   |   |                               |                                |   |                                   |                               |                                |   |
| Interest-bearing deposits  | \$ 5,144,173                            | \$ 16,995                     | 0.44                           | % | \$ 4,819,336                      | \$ 11,872                     | 0.33                           | % |
| Securities loaned  | 1,383,329                               | 22,756                        | 2.20                           | % | 1,485,463                         | 17,857                        | 1.61                           | % |
| Notes payable and other borrowings                                     | 1,515,767                               | 20,684                        | 1.81                           | % | 1,146,993                         | 14,483                        | 1.69                           | % |
| Total interest-bearing   | 8,043,269                               | 60,435                        | 1.00                           | % | 7,451,792                         | 44,212                        | 0.79                           | % |

|  |               |            |   |               |   |
|--|---------------|------------|---|---------------|---|
| liabilities                                |               |            |   |               |   |
| Noninterest-bearing liabilities            |               |            |   |               |   |
| Noninterest-bearing deposits               | 2,266,361     |            |   | 2,203,011     |   |
| Other liabilities                          | 632,384       |            |   | 663,043       |   |
| Total liabilities                          | 10,942,014    |            |   | 10,317,846    |   |
| Stockholders' equity                       | 1,886,874     |            |   | 1,774,196     |   |
| Noncontrolling interest                    | 2,577         |            |   | 2,157         |   |
| Total liabilities and stockholders' equity | \$ 12,831,465 |            |   | \$ 12,094,199 |   |
| Net interest income                        |               |            |   |               |   |
| (2)  |               | \$ 314,650 |   | \$ 295,248    |   |
| Net interest spread                        |               |            |   |               |   |
| (2)  |               | 3.38       | % | 3.46          | % |
| Net interest margin                        |               |            |   |               |   |
| (2)  |               | 3.71       | % | 3.74          | % |

(1) Average balance includes non-accrual loans.

(2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on a 35% federal income tax rate. The adjustment to interest income was \$0.6 million and \$0.5 million for the three months ended September 30, 2017 and 2016, respectively, and \$1.6 million and \$1.8 million for the nine months ended September 30, 2017 and 2016, 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 \$5.8 million and \$19.6 million during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016. Changes in net interest income were primarily related to increases in the net interest earned on mortgage-backed securities and increases in the average stock borrowing balances in our broker-dealer segment and net volume and yield changes on the loan portfolio within our banking segment as a result of the changes in year-over-year accretion of discount on loans.

The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The consolidated provision for loan losses, substantially all of which related to the banking segment, was \$1.3 million and \$4.0 million during the three months ended September 30, 2017 and 2016, respectively. During the three months ended September 30, 2017, the provision

for loan losses was comprised of charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$1.4 million, partially offset by the recapture of charges on PCI loans of \$0.1 million, compared to charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$6.4 million, partially offset by the recapture of charges on PCI loans of \$2.4 million during the three months ended September 30, 2016. During the nine months ended September 30, 2017 and 2016, the consolidated provision for loan losses, substantially all of which related to the banking segment, was \$8.8 million and \$36.3 million, respectively. The provision for loan losses

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during the nine months ended September 30, 2017 was comprised of charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$7.5 million and charges on PCI loans of \$1.3 million, compared to charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$37.5 million, partially offset by the recapture of charges on PCI loans of \$1.2 million during the nine months ended September 30, 2016. In addition, as previously mentioned, the consolidated provision for loan losses during the nine months ended September 30, 2016 included a \$24.5 million charge-off of a single large loan by the Bank.

Consolidated noninterest income decreased \$56.0 million and \$63.2 million during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016. Consolidated noninterest income during the nine months ended September 30, 2017 included the previously mentioned increase to other noninterest income of \$15.0 million in our banking segment and the pre-tax net increase to other noninterest income of \$11.6 million within corporate related to the resolution of the appraisal proceedings from the SWS Merger. The year-over-year changes in noninterest income, other than the previously mentioned non-recurring items, during the three and nine months ended September 30, 2017, compared with the same periods in 2016, were primarily driven by decreases in noninterest income within each of our operating segments.

Consolidated noninterest expense decreased \$10.3 million and \$16.1 million during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016. The year-over-year decrease in noninterest expense during the three and nine months ended September 30, 2017, compared with the same periods in 2016, primarily included decreases in noninterest expense within our broker-dealer and mortgage origination segments, partially offset by an increase within our banking segment and an increase in our insurance segment due to the effects of hurricanes as well as other weather-related losses experienced during 2017. During the nine months ended September 30, 2017, we incurred pre-tax transaction and integration costs related to the SWS Merger of \$1.6 million, compared with \$12.5 million during the same period in 2016.

Consolidated income tax expense during the three months ended September 30, 2017 and 2016 was \$18.0 million and \$33.0 million, respectively, reflecting effective tax rates of 37.2% and 38.6%, respectively. During the nine months ended September 30, 2017 and 2016, consolidated income tax expense was \$58.8 million and \$65.9 million, respectively, reflecting effective tax rates of 33.0% and 37.0%, respectively. The effective tax rate during the three months ended September 30, 2017 was higher than the statutory rate primarily due to state income taxes. The effective tax rate during the nine months ended September 30, 2017 was lower than the statutory rate primarily due to a nontaxable gain recorded in the resolution of the SWS matter as discussed in Note 12 to the consolidated financial statements, as the SWS Merger was a tax-free reorganization under Section 368(a) of the Internal Revenue Code. The effective tax rates during the three and nine months ended September 30, 2016 were slightly higher than the statutory rate primarily due to non-deductible transaction costs associated with the SWS Merger, offset by the recognition of excess tax benefits on share-based payment awards.

Segment Results

Banking Segment

Income before income taxes in our banking segment during the three months ended September 30, 2017 and 2016 was \$36.3 million and \$37.5 million, respectively, while income before income taxes in our banking segment during the nine months ended September 30, 2017 and 2016 was \$127.9 million and \$90.4 million, respectively. The increase in income before income taxes during the nine months ended September 30, 2017, compared with the same period in 2016, was primarily due to the inclusion of the previously mentioned increase to other noninterest income of \$15.0 million during the nine months ended September 30, 2017 and the \$24.5 million charge-off within the provision for loan losses during the nine months ended September 30, 2016. Income before income taxes during the nine months ended September 30, 2017, compared with the same period in 2016, also increased due to an increase in net interest income associated with net volume and yield changes. See discussion in the Overview for the effect of recent hurricanes on the banking segment's operating results.



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

|  | Three Months    |         | Nine Months     |         |
|--|-----------------|---------|-----------------|---------|
|  | Ended September |         | Ended September |         |
|  | 30,             |         | 30,             |         |
|  | 2017            | 2016    | 2017            | 2016    |
| Performance Ratios:                              |                 |         |                 |         |
| Efficiency ratio (1)                             | 62.29 %         | 59.59 % | 57.62 %         | 58.83 % |
| Return on average assets                         | 0.94 %          | 1.09 %  | 1.17 %          | 0.91 %  |
| Net interest margin (2) (4)                      | 4.03 %          | 4.50 %  | 4.34 %          | 4.69 %  |
| Net interest margin (taxable equivalent) (3) (4) | 4.05 %          | 4.53 %  | 4.36 %          | 4.71 %  |

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- (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 a 35% federal income tax rate. See footnote 2 to the following tables for the taxable equivalent adjustments to interest income.
- (4) Net interest margin and taxable equivalent net interest margin were 51 basis points and 90 basis points greater due to the impact of purchase accounting during the three months ended September 30, 2017 and 2016, respectively, and 77 basis points and 99 basis points greater due to the impact of purchase accounting during the nine months ended September 30, 2017 and 2016, respectively.

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 September 30, 2017, the banking segment's taxable equivalent net interest margin of 4.05% was 51 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$1.7 million, \$8.1 million and \$0.8 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$0.4 million. The banking segment's taxable equivalent net interest margin during the three months ended September 30, 2016 of 4.53% was 90 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$2.7 million, \$12.2 million and \$1.1 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$0.8 million.

During the nine months ended September 30, 2017, the banking segment's taxable equivalent net interest margin of 4.36% was 77 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$4.9 million, \$38.5 million and \$2.4 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$1.6 million. The banking segment's taxable equivalent net interest margin during the nine months ended September 30, 2016 of 4.71% was 99 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of \$10.5 million, \$36.2 million and \$3.2 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of \$2.5 million.

The FNB Transaction-related accretion of discount on loans of \$38.5 million and \$36.2 million during the nine months ended September 30, 2017 and 2016, respectively, included accretion of approximately \$4 million and \$11 million, respectively, due to better-than-expected resolution of covered PCI loans during the respective periods. The performance of the covered PCI loan portfolio since 2014, which has exceeded our expectations at the time of acquisition, has led to higher yields calculated as a result of the Bank's quarterly cash flow recast process. The recast process performed during the nine months ended September 30, 2017 and 2016 resulted in the reclassification of \$27.1 million and \$25.4 million, respectively, from nonaccretable difference to accretable yield.

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

|  | Three Months Ended September 30,<br>2017 |                               |                                |   | 2016                              |                               |                                |   |
|--|--|-------------------------------|--------------------------------|---|-----------------------------------|-------------------------------|--------------------------------|---|
|  | Average<br>Outstanding<br>Balance        | Interest<br>Earned or<br>Paid | Annualized<br>Yield or<br>Rate |   | Average<br>Outstanding<br>Balance | Interest<br>Earned or<br>Paid | Annualized<br>Yield or<br>Rate |   |
| <b>Assets</b>  |  |                               |                                |   |                                   |                               |                                |   |
| <b>Interest-earning assets</b>   |  |                               |                                |   |                                   |                               |                                |   |
| Loans, gross (1)   | \$ 5,806,508                             | \$ 78,769                     | 5.34                           | % | \$ 5,363,523                      | \$ 78,749                     | 5.78                           | % |
| Subsidiary warehouse lines of credit                                   | 1,669,633                                | 15,991                        | 3.75                           | % | 1,363,413                         | 13,235                        | 3.80                           | % |
| Investment securities - taxable  | 877,080                                  | 4,308                         | 1.96                           | % | 680,587                           | 3,121                         | 1.83                           | % |
| Investment securities - non-taxable (2)                                | 125,848                                  | 1,195                         | 3.80                           | % | 137,009                           | 1,245                         | 3.63                           | % |
| Federal funds sold and securities purchased under agreements to resell | 571                                      | —                             | 0.27                           | % | 38,246                            | 52                            | 0.54                           | % |
| Interest-bearing deposits in other financial institutions              | 244,017                                  | 780                           | 1.27                           | % | 389,713                           | 516                           | 0.53                           | % |
| Other  | 72,362                                   | 646                           | 3.57                           | % | 57,839                            | 527                           | 3.65                           | % |
| Interest-earning assets, gross (2)                                     | 8,796,019                                | 101,689                       | 4.55                           | % | 8,030,330                         | 97,445                        | 4.77                           | % |
| Allowance for loan losses  | (61,099)                                 |                               |                                |   | (53,279)                          |                               |                                |   |
| Interest-earning assets, net   | 8,734,920                                |                               |                                |   | 7,977,051                         |                               |                                |   |
| Noninterest-earning assets   | 948,062                                  |                               |                                |   | 1,031,002                         |                               |                                |   |
| Total assets   | \$ 9,682,982                             |                               |                                |   | \$ 9,008,053                      |                               |                                |   |
| <b>Liabilities and Stockholders' Equity</b>                            |  |                               |                                |   |                                   |                               |                                |   |
| <b>Interest-bearing liabilities</b>                                    |  |                               |                                |   |                                   |                               |                                |   |
| Interest-bearing deposits  | \$ 5,056,539                             | \$ 9,479                      | 0.74                           | % | \$ 4,558,000                      | \$ 5,075                      | 0.44                           | % |
|  | 915,818                                  | 2,478                         | 1.06                           | % | 775,175                           | 1,024                         | 0.52                           | % |

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|  |              |           |      |   |              |           |      |   |
|--|--------------|-----------|------|---|--------------|-----------|------|---|
| Notes payable and other borrowings         |              |           |      |   |              |           |      |   |
| Total interest-bearing liabilities (3)     | 5,972,357    | 11,957    | 0.79 | % | 5,333,175    | 6,099     | 0.45 | % |
| Noninterest-bearing liabilities            |              |           |      |   |              |           |      |   |
| Noninterest-bearing deposits               | 2,293,091    |           |      |   | 2,280,750    |           |      |   |
| Other liabilities                          | 49,031       |           |      |   | 70,971       |           |      |   |
| Total liabilities                          | 8,314,479    |           |      |   | 7,684,896    |           |      |   |
| Stockholders' equity                       | 1,368,503    |           |      |   | 1,323,157    |           |      |   |
| Total liabilities and stockholders' equity | \$ 9,682,982 |           |      |   | \$ 9,008,053 |           |      |   |
| Net interest income (2)                    |              | \$ 89,732 |      |   |              | \$ 91,346 |      |   |
| Net interest spread (2)                    |              |           | 3.76 | % |              |           | 4.33 | % |
| Net interest margin (2)                    |              |           | 4.05 | % |              |           | 4.53 | % |

|  | Nine Months Ended September 30, 2017 |                         |                          |   | 2016                        |                         |                          |   |
|--|--------------------------------------|-------------------------|--------------------------|---|-----------------------------|-------------------------|--------------------------|---|
|  | Average Outstanding Balance          | Interest Earned or Paid | Annualized Yield or Rate |   | Average Outstanding Balance | Interest Earned or Paid | Annualized Yield or Rate |   |
| Assets   |                                      |                         |                          |   |                             |                         |                          |   |
| Interest-earning assets  |                                      |                         |                          |   |                             |                         |                          |   |
| Loans, gross (1)   | \$ 5,643,019                         | \$ 243,017              | 5.70                     | % | \$ 5,242,000                | \$ 236,436              | 5.93                     | % |
| Subsidiary warehouse lines of credit                                   | 1,425,476                            | 40,622                  | 3.76                     | % | 1,169,400                   | 34,226                  | 3.85                     | % |
| Investment securities - taxable  | 841,048                              | 12,014                  | 1.90                     | % | 717,097                     | 10,788                  | 2.01                     | % |
| Investment securities - non-taxable (2)                                | 125,310                              | 3,565                   | 3.79                     | % | 138,377                     | 3,798                   | 3.66                     | % |
| Federal funds sold and securities purchased under agreements to resell | 7,808                                | 50                      | 0.86                     | % | 28,266                      | 115                     | 0.54                     | % |
| Interest-bearing deposits in other financial institutions              | 307,624                              | 2,389                   | 1.04                     | % | 341,372                     | 1,371                   | 0.54                     | % |

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|  |              |            |      |   |              |            |      |   |
|--|--------------|------------|------|---|--------------|------------|------|---|
| Other                                      | 71,533       | 1,804      | 3.36 | % | 53,631       | 1,525      | 3.79 | % |
| Interest-earning assets, gross (2)         | 8,421,818    | 303,461    | 4.77 | % | 7,690,143    | 288,259    | 4.94 | % |
| Allowance for loan losses                  | (58,144)     |            |      |   | (50,982)     |            |      |   |
| Interest-earning assets, net               | 8,363,674    |            |      |   | 7,639,161    |            |      |   |
| Noninterest-earning assets                 | 959,370      |            |      |   | 1,046,027    |            |      |   |
| Total assets                               | \$ 9,323,044 |            |      |   | \$ 8,685,188 |            |      |   |
| Liabilities and Stockholders' Equity       |              |            |      |   |              |            |      |   |
| Interest-bearing liabilities               |              |            |      |   |              |            |      |   |
| Interest-bearing deposits                  | \$ 4,863,393 | \$ 23,136  | 0.64 | % | \$ 4,515,661 | \$ 14,764  | 0.44 | % |
| Notes payable and other borrowings         | 796,086      | 5,501      | 0.91 | % | 600,720      | 2,423      | 0.53 | % |
| Total interest-bearing liabilities (3)     | 5,659,479    | 28,637     | 0.67 | % | 5,116,381    | 17,187     | 0.45 | % |
| Noninterest-bearing liabilities            |              |            |      |   |              |            |      |   |
| Noninterest-bearing deposits               | 2,249,786    |            |      |   | 2,220,755    |            |      |   |
| Other liabilities                          | 53,063       |            |      |   | 55,315       |            |      |   |
| Total liabilities                          | 7,962,328    |            |      |   | 7,392,451    |            |      |   |
| Stockholders' equity                       | 1,360,716    |            |      |   | 1,292,737    |            |      |   |
| Total liabilities and stockholders' equity | \$ 9,323,044 |            |      |   | \$ 8,685,188 |            |      |   |
| Net interest income (2)                    |              |            |      |   |              |            |      |   |
|  |              | \$ 274,824 |      |   |              | \$ 271,072 |      |   |
| Net interest spread (2)                    |              |            |      |   |              |            |      |   |
|  |              |            | 4.09 | % |              |            | 4.49 | % |
| Net interest margin (2)                    |              |            |      |   |              |            |      |   |
|  |              |            | 4.36 | % |              |            | 4.71 | % |

(1) Average balance includes non-accrual loans.

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- (2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on a 35% federal income tax rate. The adjustment to interest income was \$0.4 million for both the three months ended September 30, 2017 and 2016 and \$1.2 million and \$1.3 million for the nine months ended September 30, 2017 and 2016, respectively.
- (3) Only considers debt of PlainsCapital without the allocation of interest expense on PCC debt of \$0.4 million and \$1.1 million for the three and nine months ended September 30, 2016, respectively. Interest expense on PCC debt was not allocated to PlainsCapital beginning January 1, 2017.

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

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

|  | Three Months Ended September 30,<br>2017 vs. 2016 |            |          | Nine Months Ended September 30,<br>2017 vs. 2016 |             |          |
|--|---|------------|----------|--|-------------|----------|
|  | Change Due To (1)                                 |            |          | Change Due To (1)                                |             |          |
|  | Volume  | Yield/Rate | Change   | Volume   | Yield/Rate  | Change   |
| Interest income  |   |            |          |  |             |          |
| Loans, gross   | \$ 6,450  | \$ (6,430) | \$ 20    | \$ 17,801  | \$ (11,220) | \$ 6,581 |
| Subsidiary warehouse lines of credit                                   | 2,932   | (176)      | 2,756    | 7,365  | (969)       | 6,396    |
| Investment securities - taxable  | 908   | 279        | 1,187    | 1,860  | (634)       | 1,226    |
| Investment securities - non-taxable (2)                                | (102)   | 52         | (50)     | (358)  | 125         | (233)    |
| Federal funds sold and securities purchased under agreements to resell | (51)  | (1)        | (52)     | (83)   | 18          | (65)     |
| Interest-bearing deposits in other financial institutions              | (194)   | 458        | 264      | (135)  | 1,153       | 1,018    |
| Other  | 133   | (14)       | 119      | 508  | (229)       | 279      |
| Total interest income (2)  | 10,076  | (5,832)    | 4,244    | 26,958   | (11,756)    | 15,202   |
| Interest expense   |   |            |          |  |             |          |
| Deposits   | \$ 557  | \$ 3,847   | \$ 4,404 | \$ 1,136   | \$ 7,236    | \$ 8,372 |
| Notes payable and other borrowings                                     | 184   | 1,270      | 1,454    | 778  | 2,300       | 3,078    |
| Total interest expense   | 741   | 5,117      | 5,858    | 1,914  | 9,536       | 11,450   |

|                         |          |             |            |           |             |          |
|-------------------------|----------|-------------|------------|-----------|-------------|----------|
| Net interest income (2) | \$ 9,335 | \$ (10,949) | \$ (1,614) | \$ 25,044 | \$ (21,292) | \$ 3,752 |
|-------------------------|----------|-------------|------------|-----------|-------------|----------|

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

(2) Annualized taxable equivalent.

Taxable equivalent net interest income decreased \$1.6 million during the three months ended September 30, 2017, compared to the same period in 2016, while taxable equivalent net interest income increased \$3.8 million during the nine months ended September 30, 2017, compared with the same period in 2016. Changes in the yields earned on interest-earning assets decreased taxable equivalent net interest income by \$5.8 million during the three months ended September 30, 2017, compared with the same period in 2016, primarily due to a decrease in accretion of discount on loans of \$5.4 million. Changes in yields earned on interest-earning assets decreased taxable equivalent net interest income by \$11.8 million during the nine months ended September 30, 2017, compared with the same period in 2016, primarily due to a decrease in accretion of discount on loans of \$4.1 million. Accretion of discount on loans is expected to decrease in future periods as loans acquired in the Bank Transactions are repaid, refinanced or renewed. We experienced interest rate margin compression during the three and nine months ended September 30, 2017, which was driven by the rising interest rate environment and the rate floors in effect for a portion of the Bank's loan portfolio, thereby causing yields on our interest-earning assets to rise more slowly than increases in market interest rates. Absent a decline in interest rates, we believe this interest rate compression will continue until the rise in market interest rates is sufficient to allow our loan portfolio to reprice above applicable rate floors. Increases in the volume of interest-earning assets, primarily on the loan portfolio and additional amounts drawn on the subsidiary warehouse lines of credit, increased taxable equivalent net interest income by \$10.1 million and \$27.0 million during the three and nine months ended September 30, 2017,

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respectively, compared with the same periods in 2016. Changes in rates paid on interest-bearing liabilities decreased taxable equivalent net interest income by \$5.1 million and \$9.5 million during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016, due to increases in market interest rates.

The banking segment's noninterest income was \$11.4 million and \$12.7 million during the three months ended September 30, 2017 and 2016, respectively, and \$49.3 million and \$39.0 million during the nine months ended September 30, 2017 and 2016, respectively. Other than the previously mentioned increase to other noninterest income of \$15.0 million, the changes in noninterest income for the nine months ended September 30, 2017 compared to the same period in 2016, were primarily driven by year-over-year decreases in exchange fee income due to the impact of the Durbin amendment, which became applicable to the Bank on July 1, 2016, and intercompany financing charges.

The banking segment's noninterest expenses were \$62.8 million and \$61.5 million during the three months ended September 30, 2017 and 2016, respectively, and \$186.1 million and \$181.0 million during the nine months ended September 30, 2017 and 2016, respectively. The change in noninterest expenses during the nine months ended September 30, 2017, compared to the same period in 2016, included increases in employees' compensation and benefits of \$3.0 million primarily due to increased benefit costs, net expenses associated with covered assets of \$10.1 million, repossession and foreclosure expenses of \$1.1 million, as well as legal expenses associated with the Bank's previously mentioned efforts to recover losses associated with a charged-off loan, partially offset by a year-over-year decrease of \$9.3 million associated with downward valuation adjustments on a significant covered OREO property recorded during the first nine months of 2016, as well as decreases in occupancy expenses associated with closed branches and expenses associated with organizational changes.

Broker-Dealer Segment

Income before income taxes in our broker-dealer segment was \$20.2 million and \$45.5 million during the three and nine months ended September 30, 2017, respectively, and \$17.4 million and \$39.5 million during the three and nine months ended September 30, 2016, respectively. The changes in income before income taxes during the three and nine months ended September 30, 2017, compared with the same periods in 2016, were primarily the result of decreases in pre-tax integration-related costs of \$1.0 million and \$5.8 million, respectively, increases in the federal funds rate during the first nine months of 2017, which led to increases of \$3.7 million and \$8.8 million, respectively, in fees earned on money market and FDIC insured bank deposits, and decreases of \$6.0 million and \$12.2 million, respectively, in investment banking and advisory fees primarily earned on the underwriting of municipal bond transactions and the secondary trading of these and other municipal securities within our public finance and capital markets business lines.

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 paid to it by its clients, in large part upon



the successful completion of the client's transaction. Rapid or significant changes in interest rates could adversely affect the broker-dealer segment's bond trading, sales, underwriting activities and other interest spread-sensitive activities described below. The broker-dealer segment also receives administrative fees for providing money market and FDIC investment alternatives to clients, which tend to be sensitive to short term interest rates. In addition, the profitability of the broker-dealer segment depends, to an extent, on the spread between revenues earned on customer loans and excess customer cash balances, and the interest expense paid on customer cash balances and other borrowings.

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

|  | Three Months Ended<br>September 30, |           |                             | Nine Months Ended<br>September 30, |           |                             |
|--|-------------------------------------|-----------|-----------------------------|------------------------------------|-----------|-----------------------------|
|  | 2017                                | 2016      | Variance<br>2017 vs<br>2016 | 2017                               | 2016      | Variance<br>2017 vs<br>2016 |
| Net interest income:                                   |                                     |           |                             |                                    |           |                             |
| Securities lending                                     | \$ 2,469                            | \$ 2,083  | \$ 386                      | \$ 6,298                           | \$ 5,095  | \$ 1,203                    |
| Other  | 9,746                               | 5,740     | 4,006                       | 24,754                             | 17,219    | 7,535                       |
| Total net interest income                              | 12,215                              | 7,823     | 4,392                       | 31,052                             | 22,314    | 8,738                       |
| Noninterest income:                                    |                                     |           |                             |                                    |           |                             |
| Securities commissions and fees by business line (1):  |                                     |           |                             |                                    |           |                             |
| Capital markets  | 10,711                              | 13,854    | (3,143)                     | 32,369                             | 42,435    | (10,066)                    |
| Retail   | 21,836                              | 19,095    | 2,741                       | 61,153                             | 55,314    | 5,839                       |
| Clearing   | 7,948                               | 6,999     | 949                         | 25,058                             | 20,752    | 4,306                       |
| Other  | 957                                 | 825       | 132                         | 3,293                              | 2,832     | 461                         |
|  | 41,452                              | 40,773    | 679                         | 121,873                            | 121,333   | 540                         |
| Investment banking and advisory fees by business line: |                                     |           |                             |                                    |           |                             |
| Public finance   | 19,911                              | 24,599    | (4,688)                     | 56,599                             | 64,727    | (8,128)                     |
| Capital markets  | 104                                 | 1,366     | (1,262)                     | 611                                | 4,684     | (4,073)                     |
| Retail   | 4,170                               | 3,637     | 533                         | 12,017                             | 10,864    | 1,153                       |
| Structured finance                                     | 1,123                               | 1,292     | (169)                       | 3,265                              | 3,763     | (498)                       |
| Clearing   | 311                                 | 234       | 77                          | 863                                | 265       | 598                         |
| Other  | 1                                   | 1         | —                           | 4                                  | (1)       | 5                           |
|  | 25,620                              | 31,129    | (5,509)                     | 73,359                             | 84,302    | (10,943)                    |
| Other:   |                                     |           |                             |                                    |           |                             |
| Structured finance                                     | 17,731                              | 24,998    | (7,267)                     | 52,197                             | 61,502    | (9,305)                     |
| Capital markets  | 6,285                               | 6,260     | 25                          | 17,982                             | 19,516    | (1,534)                     |
| Other  | 330                                 | 351       | (21)                        | 1,368                              | 640       | 728                         |
|  | 24,346                              | 31,609    | (7,263)                     | 71,547                             | 81,658    | (10,111)                    |
| Total noninterest income                               | 91,418                              | 103,511   | (12,093)                    | 266,779                            | 287,293   | (20,514)                    |
| Net revenue (2)  | 103,633                             | 111,334   | (7,701)                     | 297,831                            | 309,607   | (11,776)                    |
| Noninterest expense (3):                               |                                     |           |                             |                                    |           |                             |
| Compensation and benefits expenses                     | 60,365                              | 68,051    | (7,686)                     | 180,445                            | 189,843   | (9,398)                     |
| Other  | 23,066                              | 25,854    | (2,788)                     | 71,861                             | 80,273    | (8,412)                     |
| Total noninterest expense                              | 83,431                              | 93,905    | (10,474)                    | 252,306                            | 270,116   | (17,810)                    |
| Income before income taxes                             | \$ 20,202                           | \$ 17,429 | \$ 2,773                    | \$ 45,525                          | \$ 39,491 | \$ 6,034                    |

- (1) Securities commissions and fees includes income of \$2.7 million and \$1.1 million during the three months ended September 30, 2017 and 2016, respectively, and \$6.3 million and \$2.9 million during the nine months ended September 30, 2017 and 2016, 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.

The broker-dealer segment had net interest income of \$12.2 million and \$7.8 million during the three months ended September 30, 2017 and 2016, respectively, and \$31.1 million and \$22.3 million during the nine months ended September 30, 2017 and 2016, respectively. In the broker-dealer segment, interest is earned from securities lending activities, interest charged on customer margin loan balances and interest earned on investment securities used to support sales, underwriting and other customer activities. The increases between the three and nine months ended September 30, 2017 and comparable periods in 2016 were primarily due to increases in the net interest earned on mortgage-backed securities and increases in the average stock borrowing balances.

Noninterest income was \$91.4 million and \$103.5 million during the three months ended September 30, 2017 and 2016, respectively, and \$266.8 million and \$287.3 million during the nine months ended September 30, 2017 and 2016, respectively. The decreases in noninterest income between the three and nine months ended September 30, 2017 and comparable periods in 2016 were primarily due to decreases of \$5.5 million and \$10.9 million, respectively, in investment banking and advisory fees and decreases of \$7.3 million and \$10.1 million, respectively in other noninterest income.

Securities commissions and fees increased \$0.7 million and \$0.5 million during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016. The increases during both periods were primarily attributable to fees earned on money market accounts and FDIC insured bank deposits by the clearing and retail businesses resulting from the 51-basis point increase in the federal funds rate during the first nine months of 2017. These increases were partially offset by a reduction in securities commissions and fees earned in the capital markets business on the sale of over-the-counter, municipal and mortgage backed security products.

Investment banking and advisory fees decreased \$5.5 million and \$10.9 million during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016, primarily due to reductions in the number and the aggregate dollar amount of municipal bond transactions and the municipal finance and underwriting fees associated with those and other taxable transactions.

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The decrease in other noninterest income during the three months ended September 30, 2017 compared with the same period in 2016 was primarily due to a decrease of \$7.3 million in income earned from trading gains associated with the structured finance business. The decrease in other noninterest income during the nine months ended September 30, 2017 compared with the same period in 2016 was primarily due to a decrease of \$10.8 million in income earned from trading gains associated with the structured finance and capital markets businesses, partially offset by an increase of \$0.7 million in the value of broker-dealer segment investments held at corporate, including investments held in the broker-dealer segment's deferred compensation plan.

Noninterest expenses were \$83.4 million and \$93.9 million during the three months ended September 30, 2017 and 2016, respectively, and \$252.3 million and \$270.1 million during the nine months ended September 30, 2017 and 2016, respectively. The decrease in noninterest expenses of \$10.5 million during the three months ended September 30, 2017, compared to the same period in 2016, was primarily due to a decrease of \$3.0 million in legal expenses associated with settled litigation and a decrease of \$7.7 million in compensation and benefits expenses, which was in part a product of the integration and merger of FSC and Hilltop Securities and in part due to the decrease in the variable compensation and benefits expense components that are based on each business line's performance. The decrease in noninterest expenses of \$17.8 million during the nine months ended September 30, 2017, compared to the same period in 2016, was primarily due to a decrease in pre-tax integration-related professional costs of \$2.8 million, a decrease of \$6.3 million in legal expenses associated with settled litigation and a decrease of \$9.4 million in compensation and benefits expenses, which was in part a product of the integration and merger of FSC and Hilltop Securities and in part due to the decrease in the variable compensation and benefits expense components that are based on each business lines' performance. During the three months ended September 30, 2016, the broker-dealer segment incurred pre-tax integration-related costs totaling \$1.0 million resulting from employee expenses and professional fees of \$0.8 million and \$0.2 million, respectively. During the nine months ended September 30, 2016, the broker-dealer segment incurred pre-tax integration-related costs totaling \$5.8 million resulting from employee expenses, professional fees and contractual expenses of \$2.9 million, \$2.8 million and \$0.1 million, respectively.

Effective as of January 22, 2016, we merged FSC and Hilltop Securities into a combined firm operating under the "Hilltop Securities" name. The integration is complete and Hilltop Securities does not expect to incur any additional integration costs in relation to the SWS Merger.

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

|   | Three Months Ended September |       | Nine Months Ended September |            |
|---|------------------------------|-------|-----------------------------|------------|
|   | 30,                          |       | 30,                         |            |
|   | 2017                         | 2016  | 2017                        | 2016       |
| Compensation as a % of net revenue                                  | 58.2%                        | 61.1% | 60.6%                       | 61.3%      |
| FDIC insured program balances at PlainsCapital Bank (end of period) |                              |       | \$ 1,300,732                | \$ 950,501 |

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|  |               |               |               |               |
|--|---------------|---------------|---------------|---------------|
| Other FDIC insured program balances (end of period)                |               |               | \$ 1,134,884  | \$ 1,420,496  |
| Customer margin balances (end of period)                           |               |               | \$ 230,303    | \$ 337,751    |
| Customer funds on deposit, including short credits (end of period) |               |               | \$ 419,324    | \$ 403,883    |
| Public finance:  |               |               |               |               |
| Number of issues   | 337           | 447           | 1,129         | 1,358         |
| Aggregate amount of offerings                                      | \$ 20,812,898 | \$ 22,663,624 | \$ 60,650,662 | \$ 65,650,303 |
| Capital markets:   |               |               |               |               |
| Total volumes  | \$ 15,610,712 | \$ 18,196,667 | \$ 50,052,574 | \$ 61,149,636 |
| Net inventory (end of period)                                      |               |               | \$ 492,844    | \$ 221,263    |
| Retail:  |               |               |               |               |
| Retail employee representatives (end of period)                    |               |               | 122           | 119           |
| Independent registered representatives (end of period)             |               |               | 222           | 231           |
| Structured finance:  |               |               |               |               |
| Lock production/TBA volume   | \$ 1,293,493  | \$ 1,663,926  | \$ 4,753,980  | \$ 4,536,631  |
| Clearing:  |               |               |               |               |
| Total tickets (1)  | 302,809       | 348,877       | 967,594       | 1,308,929     |
| Correspondents (end of period)                                     |               |               | 168           | 179           |
| Securities lending:  |               |               |               |               |
| Interest-earning assets - stock borrowed (end of period)           |               |               | \$ 1,611,885  | \$ 1,266,145  |
| Interest-bearing liabilities - stock loaned (end of period)        |               |               | \$ 1,447,570  | \$ 1,150,826  |

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(1) Effective May 2016, a single correspondent began compressing multiple executions when delivering trades for processing, resulting in a decrease in year-over-year ticket count for the broker-dealer segment's clearing business line. This modification did not significantly impact the correspondent's clearing revenues.

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## Mortgage Origination Segment

Income before income taxes in our mortgage origination segment was \$12.8 million and \$31.2 million during the three months ended September 30, 2017 and 2016, respectively, and \$42.0 million and \$68.4 million during the nine months ended September 30, 2017 and 2016, respectively. The decreases in income before income taxes for both periods were primarily due to decreases in noninterest income, partially offset by decreases in noninterest expense and net interest expense. Net interest income of \$0.1 million and net interest expense of \$3.1 million during the three months ended September 30, 2017 and 2016, respectively, and net interest expense of \$0.8 million and \$7.9 million during the nine months ended September 30, 2017 and 2016, respectively, was primarily comprised of interest incurred on a warehouse line of credit held with the Bank as well as related intercompany financing costs, partially offset by interest income earned on loans held for sale. The year-over-year improvement in net interest income (expense) included the effects of increased average hold periods and improved net yields on mortgage loans held for sale.

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. During 2016, refinancing volume was \$4.2 billion, representing 27.1% of total loan origination volume. Due to increases in mortgage interest rates since the fourth quarter of 2016, refinancing volume and refinancing volume as a percentage of total loan origination volume decreased in the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016, and we anticipate that this year-over-year trend will continue for the remainder of 2017. We also anticipate the recent percentage mix of refinancing and purchase volumes relative to total loan origination volume will continue into 2018. We do not anticipate that these recent increases in mortgage interest rates will significantly impact home purchases volume during the remainder of 2017, as changes in mortgage interest rates have historically had a lesser impact on home purchases volume than on refinancing volume.

The mortgage origination segment primarily originates its mortgage loans through a retail channel, with limited lending through its affiliated business relationships (“ABAs”). For the nine months ended September 30, 2017, funded volume through ABAs was less than 5% of the mortgage origination segment’s total loan volume. Currently, PrimeLending owns a 51% membership interest in three ABAs. One of these ABAs is scheduled to be dissolved by the end of 2017 and accounted for less than 1% of total loan volume during the nine months ended September 30, 2017. We expect production within the ABA channel to represent approximately 5% of the total loan volume during 2017.

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

The mortgage  
origination  
segment  
primarily  
originates its  
mortgage  
loans through  
retail  
channel, with  
limited  
lending  
through its  
joint venture  
channel. For  
the nine  
months ended  
September 30,  
2017, joint  
venture funded  
loan volume was  
less than 5%  
of the  
mortgage  
origination  
segments total  
loan volume.  
Currently,  
PrimeLending  
owns a 51%  
membership  
interest in two  
joint ventures.  
We do not  
expect the  
joint venture  
channel to  
produce more  
than 5% of the  
total loan  
volume  
through the  
remainder of  
2017. The  
following

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

|                                     | Three Months Ended September 30, |            |              |            | Nine Months Ended September 30, |            |               |            |
|-------------------------------------|----------------------------------|------------|--------------|------------|---------------------------------|------------|---------------|------------|
|                                     | 2017                             | % of Total | 2016         | % of Total | 2017                            | % of Total | 2016          | % of Total |
| Mortgage loan Originations - units  | 16,904                           |            | 19,330       |            | 46,890                          |            | 50,441        |            |
| Mortgage loan Originations - volume | \$ 3,972,505                     |            | \$ 4,492,553 |            | \$ 10,854,920                   |            | \$ 11,572,132 |            |
| Mortgage loan Originations:         |                                  |            |              |            |                                 |            |               |            |
| Conventional                        | \$ 2,359,220                     | 59.39 %    | \$ 3,003,506 | 66.86 %    | \$ 6,460,144                    | 59.51 %    | \$ 7,431,755  | 64.22 %    |
| Government                          | 952,888                          | 23.99 %    | 1,010,682    | 22.50 %    | 2,629,338                       | 24.22 %    | 2,731,967     | 23.61 %    |
| Jumbo                               | 409,947                          | 10.32 %    | 308,800      | 6.87 %     | 1,064,035                       | 9.80 %     | 924,194       | 7.99 %     |
| Other                               | 250,450                          | 6.30 %     | 169,565      | 3.77 %     | 701,403                         | 6.47 %     | 484,216       | 4.18 %     |
|                                     | \$ 3,972,505                     | 100.00 %   | \$ 4,492,553 | 100.00 %   | \$ 10,854,920                   | 100.00 %   | \$ 11,572,132 | 100.00 %   |
| Home purchases                      | \$ 3,332,441                     | 83.89 %    | \$ 3,191,851 | 71.05 %    | \$ 9,103,707                    | 83.87 %    | \$ 8,504,061  | 73.49 %    |
| Refinancings                        | 640,064                          | 16.11 %    | 1,300,702    | 28.95 %    | 1,751,213                       | 16.13 %    | 3,068,071     | 26.51 %    |
|                                     | \$ 3,972,505                     | 100.00 %   | \$ 4,492,553 | 100.00 %   | \$ 10,854,920                   | 100.00 %   | \$ 11,572,132 | 100.00 %   |
| Texas                               | \$ 819,586                       | 20.63 %    | \$ 984,974   | 21.91 %    | \$ 2,331,162                    | 21.47 %    | \$ 2,516,881  | 21.75 %    |
| California                          | 531,584                          | 13.38 %    | 658,074      | 14.65 %    | 1,375,134                       | 12.67 %    | 1,654,059     | 14.30 %    |
| Florida                             | 222,150                          | 5.59 %     | 219,544      | 4.89 %     | 637,097                         | 5.87 %     | 584,541       | 5.05 %     |
| Ohio                                | 179,538                          | 4.52 %     | 192,950      | 4.29 %     | 490,750                         | 4.52 %     | 493,733       | 4.27 %     |
| Arizona                             | 143,645                          | 3.62 %     | 160,766      | 3.58 %     | 416,327                         | 3.84 %     | 407,736       | 3.52 %     |
| South Carolina                      | 130,967                          | 3.30 %     | 118,550      | 2.64 %     | 357,796                         | 3.30 %     | 327,050       | 2.83 %     |
| Missouri                            | 122,555                          | 3.09 %     | 130,325      | 2.90 %     | 340,099                         | 3.13 %     | 341,770       | 2.95 %     |
| Washington                          | 135,267                          | 3.41 %     | 155,257      | 3.46 %     | 340,075                         | 3.13 %     | 401,879       | 3.47 %     |
| North Carolina                      | 112,273                          | 2.83 %     | 142,315      | 3.17 %     | 337,548                         | 3.11 %     | 392,637       | 3.39 %     |
| Maryland                            | 115,862                          | 2.92 %     | 155,246      | 3.46 %     | 325,432                         | 3.00 %     | 384,273       | 3.32 %     |
| All other states                    | 1,459,078                        | 36.71 %    | 1,574,552    | 35.05 %    | 3,903,500                       | 35.96 %    | 4,067,573     | 35.15 %    |
|                                     | \$ 3,972,505                     | 100.00 %   | \$ 4,492,553 | 100.00 %   | \$ 10,854,920                   | 100.00 %   | \$ 11,572,132 | 100.00 %   |



|                                    |              |              |               |               |
|------------------------------------|--------------|--------------|---------------|---------------|
| Mortgage<br>loan Sales -<br>volume | \$ 4,002,195 | \$ 4,349,794 | \$ 10,662,622 | \$ 11,431,589 |
|------------------------------------|--------------|--------------|---------------|---------------|

Refinancing volume decreased to \$640.1 million during the three months ended September 30, 2017 from \$1.3 billion during the three months ended September 30, 2016 (representing 16.1% and 29.0%, respectively, of total loan origination volume), while refinancing volume decreased to \$1.8 billion during the nine months ended September 30, 2017 from \$3.1 billion during the nine months ended September 30, 2016 (representing 16.1% and 26.5%, respectively, of total loan origination volume). Home purchases volume increased 4.4% to \$3.3 billion during the three months ended September 30, 2017 from \$3.2 billion during the three months ended September 30, 2016, while home purchases volume increased 7.1% to \$9.1 billion during the nine months ended September 30, 2017 from \$8.5 billion during the nine months ended September 30, 2016.

The mortgage origination segment's total loan origination volume during the three and nine months ended September 30, 2017 decreased 11.6% and 6.2%, respectively, compared to the same periods in 2016, while income before income taxes during the three and nine months ended September 30, 2017 decreased 59.0% and 38.6%, respectively, compared to the same periods in 2016. The decrease in income before taxes during the three months ended September 30, 2017 was primarily due a decrease in the change in net fair value of interest rate lock commitments ("IRLCs") and loans held for sale, in addition to a decrease in net gains from sale of loans. These changes were partially offset by a decrease in compensation that varies with the volume of mortgage loan originations ("variable compensation"), a decrease in segment operating costs, a decrease in lender paid closing costs, and an increase in net interest income. The decrease in income before taxes during the nine months ended September 30, 2017 was primarily due to a decrease in net gains from sale of loans, in addition to a decrease in the change in net fair value of interest rate lock commitments and loans held for sale. These changes were partially offset by a decrease in variable compensation, a decrease in lender paid closing costs, and a decrease in net interest expense.

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Noninterest income was \$163.8 million and \$202.6 million during the three months ended September 30, 2017 and 2016, respectively, and \$487.0 million and \$541.8 million during the nine months ended September 30, 2017 and 2016, respectively, and was comprised of the following (in thousands).

|   | Three Months Ended |            | Variance<br>2017 vs<br>2016 | Nine Months Ended |            | Variance<br>2017 vs<br>2016 |
|---|--------------------|------------|-----------------------------|-------------------|------------|-----------------------------|
|   | September 30,      |            |                             | September 30,     |            |                             |
|   | 2017               | 2016       |                             | 2017              | 2016       |                             |
| Net gains from sale of loans                              | \$ 149,958         | \$ 167,238 | \$ (17,280)                 | \$ 392,081        | \$ 432,488 | \$ (40,407)                 |
| Mortgage loan origination fees                            | 25,256             | 26,807     | (1,551)                     | 70,788            | 71,417     | (629)                       |
| Other mortgage production income:                         |                    |            |                             |                   |            |                             |
| Change in net fair value and related derivative activity: |                    |            |                             |                   |            |                             |
| Interest rate lock commitments and loans held for sale    | (14,003)           | 5,147      | (19,150)                    | 10,526            | 26,641     | (16,115)                    |
| Mortgage servicing rights asset                           | (1,631)            | (2,308)    | 677                         | (2,059)           | (6,111)    | 4,052                       |
| Servicing fees  | 4,178              | 5,676      | (1,498)                     | 15,697            | 17,344     | (1,647)                     |
|   | \$ 163,758         | \$ 202,560 | \$ (38,802)                 | \$ 487,033        | \$ 541,779 | \$ (54,746)                 |

Net gains from sale of loans decreased 10.3% and 9.3% during the three and nine months ended September 30, 2017, respectively, compared to the same periods in 2016. Mortgage loan origination fees decreased 5.8% and 0.9% during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016. The decreases in net gains from sale of loans during the three and nine months ended September 30, 2017 were primarily a result of decreases in total loan sales volume of 8.0% and 6.7% during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016, in addition to a slight decrease in average loan sales margin during the same periods. Decreases in mortgage loan origination fees were primarily a result of decreases in total loan origination volume during three and nine months ended September 30, 2017, compared with the same periods in 2016, offset by increases in average mortgage loan origination fees during the same periods.

Noninterest income included a decrease of \$14.0 million and an increase of \$10.5 million during the three and nine months ended September 30, 2017, respectively, compared with increases of \$5.1 million and \$26.6 million during the same periods in 2016, 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 decrease during the three months ended September 30, 2017 was the result of decreases in the total volume and average value of individual IRLCs and mortgage loans. The increase during the nine months ended September 30, 2017 was primarily the result of an increase in the total volume of individual IRLCs and mortgage loans, partially offset by a decrease in the average value of individual IRLCs and mortgage loans. The increases during the three and nine months ended September 30, 2016 were primarily a result of increases in the volume of IRLCs and mortgage loans held during this period, partially

offset by decreases 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 September 30, 2017, the mortgage origination segment retained servicing on approximately 14% of loans sold, compared to 22% during the same period in 2016. During the nine months ended September 30, 2017, the mortgage origination segment retained servicing on approximately 7% of loans sold, compared to 19% during the same period in 2016. 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 \$48.9 million on \$4.3 billion of serviced loan volume at September 30, 2017, compared with a value of \$63.3 million on \$5.6 billion of serviced loan volume at December 31, 2016. 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 various combinations of interest rate swaps, swaptions, forward commitments to sell mortgage-backed securities, and U.S. Treasury bond futures and options, as a means to mitigate interest rate risk associated with its MSR asset. Changes in the net fair value of the MSR asset and the related derivatives associated with normal customer payments, changes in discount rates, prepayment speed assumptions and customer payoffs resulted in net losses of \$1.6 million and \$2.1 million during the three and nine months ended September 30, 2017, respectively, compared to net losses of \$2.3 million and \$6.1 million during the three and nine months ended September 30, 2016, respectively. Additionally, net servicing income was \$1.8 million and \$6.7 million during the three and nine months ended September

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30, 2017, respectively, compared with \$2.3 million and \$7.2 million, respectively, during the same periods in 2016. In March 2017 and May 2016, the mortgage origination segment sold MSR assets of \$17.5 million and \$7.6 million, respectively, which represented \$1.7 billion and \$917.4 million, respectively, of its serviced loan volume at the time.

Noninterest expenses were \$151.1 million and \$168.3 million during the three months ended September 30, 2017 and 2016, respectively, and \$444.3 million and \$465.5 million during the nine months ended September 30, 2017 and 2016, respectively, and were comprised of the following (in thousands).

|                           | Three Months Ended |            |                             | Nine Months Ended |            |                             |
|---------------------------|--------------------|------------|-----------------------------|-------------------|------------|-----------------------------|
|                           | September 30,      |            | Variance<br>2017 vs<br>2016 | September 30,     |            | Variance<br>2017 vs<br>2016 |
|                           | 2017               | 2016       |                             | 2017              | 2016       |                             |
| Variable compensation     | \$ 66,420          | \$ 75,271  | \$ (8,851)                  | \$ 185,203        | \$ 201,564 | \$ (16,361)                 |
| Segment operating costs   | 75,596             | 79,308     | (3,712)                     | 230,453           | 226,522    | 3,931                       |
| Lender paid closing costs | 6,705              | 10,302     | (3,597)                     | 19,594            | 27,216     | (7,622)                     |
| Servicing expense         | 2,335              | 3,422      | (1,087)                     | 9,013             | 10,161     | (1,148)                     |
|                           | \$ 151,056         | \$ 168,303 | \$ (17,247)                 | \$ 444,263        | \$ 465,463 | \$ (21,200)                 |

Employees' compensation and benefits accounted for the majority of noninterest expenses incurred during all periods presented. Variable compensation decreased \$8.9 million and \$16.4 million during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016, and comprised 59.8% and 62.8% of total employees' compensation and benefits expenses during the three months ended September 30, 2017 and 2016, respectively, and 58.4% and 61.7% of total employees' compensation and benefits expenses during the nine months ended September 30, 2017 and 2016, 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.

While total loan origination volume decreased 11.6% and 6.2% for the three and nine months ended September 30, 2017, respectively, compared to the same periods in 2016, the mortgage origination segment's operating costs decreased 4.7% and increased 1.7%, respectively. The change in segment operating costs during the three months ended September 30, 2017, compared to the same period in 2016, was primarily due to a decrease in non-variable salaries and benefits, a decrease in loan related expenses, and a decrease in third party professional fees. The change in segment operating expenses during the nine months ended September 30, 2017, compared to the same period in 2016, was primarily due to an increase in non-variable salaries and benefits and occupancy expense. The increase in non-variable salaries and benefits was primarily the result of an increase in headcount related to loan processing functions. The increase in loan processing headcount was initiated during the second quarter of 2016, primarily to address growth in loan origination volume. This additional headcount has remained in place through the third quarter of 2017 to support anticipated 2017 loan origination volumes. Historically, segment operating costs tend to fluctuate with, but at a lesser magnitude than, loan origination volume, as these costs are comprised of salaries, benefits,

occupancy and administrative costs, which are not normally highly sensitive to changes in loan origination volume.

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

Between January 1, 2008 and September 30, 2017, the mortgage origination segment sold mortgage loans totaling \$97.7 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 2008, it does not anticipate experiencing significant losses in the future on loans originated prior to 2008 as a result of investor claims under these provisions of its sales contracts.

When an agency, investor, or other party claim for indemnification of a loan sold is made, the mortgage origination segment evaluates the claim and determines if the claim can be satisfied through additional documentation or other

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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, 2008 and September 30, 2017 (dollars in thousands).

|  | Original Loan Balance |                       | Loss Recognized |                       |
|--|-----------------------|-----------------------|-----------------|-----------------------|
|  | Amount                | % of<br>Loans<br>Sold | Amount          | % of<br>Loans<br>Sold |
| Claims resolved with no payment  | \$ 205,085            | 0.21%                 | \$ —            | 0.00%                 |
| Claims resolved as a result of a loan repurchase or payment to an investor for losses incurred (1) | 235,810               | 0.24%                 | 16,107          | 0.02%                 |
|  | \$ 440,895            | 0.45%                 | \$ 16,107       | 0.02%                 |

(1) Losses incurred include refunded purchased servicing rights.

At September 30, 2017 and December 31, 2016, the mortgage origination segment's indemnification liability reserve totaled \$24.7 million and \$18.2 million, respectively. The related provision for indemnification losses was \$2.5 million and \$1.3 million during the three months ended September 30, 2017 and 2016, respectively, and \$4.5 million and \$3.5 million during the nine months ended September 30, 2017 and 2016, respectively. The increases to the provision for indemnification losses during both periods were primarily related to a \$1.5 million indemnification liability reserve recorded in connection with 2017 hurricane loss exposures.

### Insurance Segment

Losses before income taxes in our insurance segment were \$9.3 million during the three months ended September 30, 2017 compared with income before income taxes of \$11.5 million during the three months ended September 30, 2016. Losses before income taxes were \$17.9 million during the nine months ended September 30, 2017 compared with income before income taxes of \$8.1 million during the nine months ended September 30, 2016. These year-over-year changes during the three and nine months ended September 30, 2017, compared with the same periods in 2016, were driven primarily by a decline in net insurance premiums earned, loss and LAE effects of Hurricane Harvey, and other non-catastrophic weather-related losses experienced during 2017.

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

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

The noted negative impact on premiums written and earned and the significance of the higher net loss and LAE incurred due to current year weather-related events, including Hurricane Harvey, have had a negative impact on current year operating results. In response, we continue to undertake initiatives to help grow net insurance premiums written and earned, streamline business activities and expenses, mitigate the impact of future significant weather-related events,

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as well as evaluate product offerings and pricing to improve our long-term financial condition and operating results. These initiatives, as well as other assumptions and conditions, will be reflected in the insurance segment's annual impairment evaluation of goodwill and other intangible assets as of October 1, 2017.

The insurance segment's operations resulted in combined ratios of 131.0% and 75.0% during the three months ended September 30, 2017 and 2016, respectively, and 120.2% and 97.8% during the nine months ended September 30, 2017 and 2016, respectively. The increase in the combined ratio during the three months ended September 30, 2017, compared with the same period in 2016, included increases in the loss and LAE ratio and the underwriting expense ratio driven by the reduction in premiums earned and increase in loss and LAE incurred. The increase in the combined ratio during the nine months ended September 30, 2017, compared with the same period in 2016, included increases in the loss and LAE ratio and the underwriting expense ratio as previously discussed. The combined ratio is a measure of overall insurance underwriting profitability, and represents the sum of loss and LAE and underwriting expenses divided by net insurance premiums earned.

Noninterest income of \$36.8 million and \$41.2 million during the three months ended September 30, 2017 and 2016, respectively, included net insurance premiums earned of \$34.5 million and \$38.7 million, respectively, while noninterest income of \$113.6 million and \$124.4 million during the nine months ended September 30, 2017 and 2016, respectively, included net insurance premiums earned of \$106.7 million and \$117.2 million, respectively. The year-over-year decrease in net insurance premiums earned was due to the effect of the decrease in net premiums written.

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

|                           | Three Months Ended<br>September 30, |           | Variance<br>2017 vs<br>2016 | Nine Months Ended<br>September 30, |            | Variance<br>2017 vs<br>2016 |
|---------------------------|-------------------------------------|-----------|-----------------------------|------------------------------------|------------|-----------------------------|
|                           | 2017                                | 2016      |                             | 2017                               | 2016       |                             |
| Direct Insurance Premiums |                                     |           |                             |                                    |            |                             |
| Written:                  |                                     |           |                             |                                    |            |                             |
| Homeowners                | \$ 13,889                           | \$ 16,727 | \$ (2,838)                  | \$ 43,047                          | \$ 50,964  | \$ (7,917)                  |
| Fire                      | 10,618                              | 11,744    | (1,126)                     | 33,254                             | 36,679     | (3,425)                     |
| Mobile Home               | 8,547                               | 8,796     | (249)                       | 28,711                             | 29,576     | (865)                       |
| Commercial                | 785                                 | 856       | (71)                        | 2,338                              | 2,568      | (230)                       |
| Other                     | 70                                  | 77        | (7)                         | 147                                | 168        | (21)                        |
|                           | \$ 33,909                           | \$ 38,200 | \$ (4,291)                  | \$ 107,497                         | \$ 119,955 | \$ (12,458)                 |



The total direct insurance premiums written for our three largest insurance product lines decreased by \$4.2 million and \$12.2 million during the three and nine months ended September 30, 2017, respectively, compared with the same periods in 2016, due primarily to the effects of competitive pressures in our Texas market.

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

|                                   | Three Months Ended<br>September 30, |           | Variance<br>2017 vs<br>2016 | Nine Months Ended<br>September 30, |            | Variance<br>2017 vs<br>2016 |
|-----------------------------------|-------------------------------------|-----------|-----------------------------|------------------------------------|------------|-----------------------------|
|                                   | 2017                                | 2016      |                             | 2017                               | 2016       |                             |
| Net Insurance Premiums<br>Earned: |                                     |           |                             |                                    |            |                             |
| Homeowners                        | \$ 14,117                           | \$ 16,940 | \$ (2,823)                  | \$ 42,709                          | \$ 49,792  | \$ (7,083)                  |
| Fire                              | 10,796                              | 11,909    | (1,113)                     | 32,993                             | 35,838     | (2,845)                     |
| Mobile Home                       | 8,713                               | 8,955     | (242)                       | 28,486                             | 28,897     | (411)                       |
| Commercial                        | 797                                 | 866       | (69)                        | 2,319                              | 2,509      | (190)                       |
| Other                             | 70                                  | 77        | (7)                         | 146                                | 165        | (19)                        |
|                                   | \$ 34,493                           | \$ 38,747 | \$ (4,254)                  | \$ 106,653                         | \$ 117,201 | \$ (10,548)                 |

Net insurance premiums earned during the three and nine months ended September 30, 2017 decreased compared to the same periods in 2016, primarily due to the decrease in net premiums written noted above.

Noninterest expenses of \$47.0 million and \$30.4 million during the three months ended September 30, 2017 and 2016, respectively, and \$133.4 million and \$118.5 million during the nine months ended September 30, 2017 and 2016, respectively, include both loss and LAE expenses and policy acquisition and other underwriting expenses, as well as other noninterest expenses. Loss and LAE are recognized based on formula and case basis estimates for losses reported with respect to direct business, estimates of unreported losses based on past experience and deduction of amounts for reinsurance placed with reinsurers. Loss and LAE during the three months ended September 30, 2017 was \$31.2 million,

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compared with \$16.1 million during the same period in 2016, resulting in loss and LAE ratios of 90.6% and 41.4%, respectively. Loss and LAE during the nine months ended September 30, 2017 was \$86.1 million, compared with \$75.2 million during the same period in 2016, resulting in loss and LAE ratios of 80.7% and 64.2%, respectively. The increase in the loss and LAE ratio during the three months ended September 30, 2017, compared to the same period in 2016, was primarily driven by a 94.5% increase in loss and LAE expense, compared to premiums earned decreasing by 11.0%. The increase in the loss and LAE ratio during the nine months ended September 30, 2017, compared to the same period in 2016, was primarily driven by a 14.5% increase in loss and LAE expense, compared to premiums earned decreasing by 9.0%. The increases in the loss and LAE ratio during the three and nine months ended September 30, 2017 were attributable to non-catastrophic weather-related losses as well as Hurricanes Harvey and Irma. The actual loss related to these hurricanes, excluding reinstatement premium, was \$4.5 million after reinsurance.

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 |           |                 | Nine Months Ended |            |                 |
|---|--------------------|-----------|-----------------|-------------------|------------|-----------------|
|   | September 30,      |           | Variance        | September 30,     |            | Variance        |
|   | 2017               | 2016      | 2017 vs<br>2016 | 2017              | 2016       | 2017 vs<br>2016 |
| Amortization of deferred policy acquisition costs | \$ 8,830           | \$ 9,337  | \$ (507)        | \$ 27,457         | \$ 29,217  | \$ (1,760)      |
| Other underwriting expenses                       | 6,102              | 4,606     | 1,496           | 17,570            | 12,780     | 4,790           |
| Total   | 14,932             | 13,943    | 989             | 45,027            | 41,997     | 3,030           |
| Agency expenses                                   | (989)              | (908)     | (81)            | (2,914)           | (2,672)    | (242)           |
| Total less agency expenses                        | \$ 13,943          | \$ 13,035 | \$ 908          | \$ 42,113         | \$ 39,325  | \$ 2,788        |
| Net insurance premiums earned                     | \$ 34,493          | \$ 38,747 | \$ (4,254)      | \$ 106,653        | \$ 117,201 | \$ (10,548)     |
| Expense ratio                                     | 40.4 %             | 33.6 %    | 6.8 %           | 39.5 %            | 33.6 %     | 5.9 %           |

Corporate includes certain activities not allocated to specific business segments. These activities include holding company financing and investing activities, and management and administrative services to support the overall operations of the Company including, but not limited to, certain executive management, corporate relations, legal, finance, and acquisition costs.

As a holding company, Hilltop's primary investment objectives are to preserve capital and have cash resources available to make acquisitions. Investment and interest income earned was \$0.1 million and \$0.1 million during the three months ended September 30, 2017 and 2016, respectively, and \$0.3 million and \$0.3 million during the nine months ended September 30, 2017 and 2016, respectively. Investment and interest income during the nine months ended September 30, 2016 included \$0.2 million of intercompany interest earned on note receivables held with Securities Holdings that were paid off in January 2016 and March 2016, respectively.

As a result of previously disclosed strategic leadership and organizational changes, certain interest expenses, headcount and related noninterest expenses of PCC, which were previously allocated to the banking and mortgage origination segments, are included within corporate effective January 1, 2017.

Interest expense was \$2.7 million and \$1.9 million during the three months ended September 30, 2017 and 2016, respectively, and \$7.7 million and \$5.7 million during the nine months ended September 30, 2017 and 2016, respectively, and 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"). In addition, interest expense during the three and nine months ended September 30, 2017 of \$0.8 million and \$2.3 million, respectively, on junior subordinated debentures of \$67.0 million issued by PCC (the "Debentures") was included within corporate as a result of the organizational changes noted above. During the three and nine months ended September 30, 2016, interest expense on the Debentures of \$0.7 million and \$2.0 million was reported within our operating segments.

Noninterest income during the three months ended September 30, 2017 was nominal. Noninterest income during the three and nine months ended September 30, 2017 was primarily comprised of the previously mentioned pre-tax net

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increase to other noninterest income of \$11.6 million related to the resolution of the appraisal proceedings from the SWS Merger. Noninterest income during the three and nine months ended September 30, 2016 was nominal.

Noninterest expenses of \$9.3 million and \$10.0 million during the three months ended September 30, 2017 and 2016, respectively, and \$25.0 million and \$22.4 million during the nine months ended September 30, 2017 and 2016, respectively, were primarily comprised of employees' compensation and benefits and professional fees, including corporate governance, legal and transaction costs. During the nine months ended September 30, 2017, compared with the same period in 2016, the change in noninterest expenses primarily included increases associated with the organizational changes noted above related to employees' compensation and benefits costs of \$6.4 million, professional fees of \$3.5 million, and occupancy and equipment expenses of \$2.9 million, partially offset by a decrease of \$5.1 million in transaction-related costs directly attributable to the SWS Merger. Specifically, during the nine months ended September 30, 2017, Hilltop incurred pre-tax transaction costs related to the SWS Merger of \$1.6 million, compared with \$6.7 million during the nine months ended September 30, 2016.

## Financial Condition

The following discussion contains a more detailed analysis of our financial condition at September 30, 2017 as compared with December 31, 2016.

## Securities Portfolio

At September 30, 2017, 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 and held to maturity.

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). However, with the adoption of Accounting Standards Update 2016-01 in January 2018, the Company will reclassify all equity investments out of trading and available for sale securities, with all subsequent changes in fair value recognized in net income. Securities are classified as held to maturity based on the intent and ability of our management, at the time of purchase, to hold such securities to maturity. These securities are carried at amortized cost.



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

|  | September<br>30,<br>2017 | December 31,<br>2016 |
|--|--------------------------|----------------------|
| Trading securities, at fair value              |                          |                      |
| U.S. Treasury securities                       | \$ 200                   | \$ 5,940             |
| U.S. government agencies:                      |                          |                      |
| Bonds  | 53,275                   | 36,303               |
| Residential mortgage-backed securities         | 407,275                  | 2,539                |
| Commercial mortgage-backed securities          | 9,599                    | 15,171               |
| Collateralized mortgage obligations            | 1,098                    | 5,607                |
| Corporate debt securities                      | 77,435                   | 60,699               |
| States and political subdivisions              | 90,144                   | 89,946               |
| Unit investment trusts                         | 31,626                   | 41,409               |
| Private-label securitized product              | 2,398                    | 4,292                |
| Other  | 3,361                    | 3,628                |
|  | 676,411                  | 265,534              |
| Securities available for sale, at fair value   |                          |                      |
| U.S. Treasury securities                       | 22,880                   | 31,801               |
| U.S. government agencies:                      |                          |                      |
| Bonds  | 101,007                  | 122,652              |
| Residential mortgage-backed securities         | 245,908                  | 133,138              |
| Commercial mortgage-backed securities          | 12,145                   | 8,715                |
| Collateralized mortgage obligations            | 219,734                  | 114,702              |
| Corporate debt securities                      | 74,753                   | 79,129               |
| States and political subdivisions              | 67,627                   | 87,515               |
| Commercial mortgage-backed securities          | 505                      | 515                  |
| Equity securities                              | 20,983                   | 19,840               |
|  | 765,542                  | 598,007              |
| Securities held to maturity, at amortized cost |                          |                      |
| U.S. government agencies:                      |                          |                      |
| Bonds  | 40,515                   | 40,513               |
| Residential mortgage-backed securities         | 16,973                   | 19,606               |
| Commercial mortgage-backed securities          | 71,613                   | 31,767               |
| Collateralized mortgage obligations            | 183,926                  | 217,954              |
| States and political subdivisions              | 55,004                   | 41,991               |
|  | 368,031                  | 351,831              |
| Total securities portfolio                     | \$ 1,809,984             | \$ 1,215,372         |

We had a net unrealized gain of \$2.6 million at September 30, 2017, compared with a net unrealized loss of \$0.2 million at December 31, 2016, related to the available for sale investment portfolio, and net unrealized losses associated with the securities held to maturity portfolio of \$3.9 million and \$6.7 million at September 30, 2017

and December 31, 2016, respectively.

#### 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 securities portfolio serves 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 September 30, 2017, the banking segment's securities portfolio of \$1.0 billion was comprised of trading securities of \$10.0 million, available for sale securities of \$624.4 million and held to maturity securities of \$368.0 million.

#### 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

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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 \$666.4 million at September 30, 2017. 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 sheet, had a value of \$173.5 million at September 30, 2017. The Hilltop Broker-Dealers continue to evaluate market opportunities and from time to time will hold residential mortgage-backed securities in firm inventory which is sold to institutional clients and other counterparties.

## 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. The insurance segment invests the premiums it receives from policyholders until they are needed to pay policyholder claims or other expenses. At September 30, 2017, the insurance segment's securities portfolio was comprised of \$141.1 million in available for sale securities and \$5.6 million of other investments included in other assets within the consolidated balance sheet.

## Non-Covered Loan Portfolio

Consolidated non-covered loans held for investment are detailed in the tables below, classified by portfolio segment and segregated between those considered to be 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.

|                                     | Loans, excluding<br>PCI Loans | PCI<br>Loans | Total<br>Loans |
|-------------------------------------|-------------------------------|--------------|----------------|
| September 30, 2017                  |                               |              |                |
| Commercial and industrial           | \$ 1,729,236                  | \$ 6,232     | \$ 1,735,468   |
| Real estate                         | 2,914,201                     | 29,954       | 2,944,155      |
| Construction and land development   | 940,040                       | 1,588        | 941,628        |
| Consumer                            | 41,795                        | 163          | 41,958         |
| Broker-dealer                       | 485,604                       | —            | 485,604        |
| Non-covered loans, gross            | 6,110,876                     | 37,937       | 6,148,813      |
| Allowance for loan losses           | (56,681)                      | (2,098)      | (58,779)       |
| Non-covered loans, net of allowance | \$ 6,054,195                  | \$ 35,839    | \$ 6,090,034   |



| December 31, 2016                   | Loans, excluding<br>PCI Loans | PCI<br>Loans | Total<br>Loans |
|-------------------------------------|-------------------------------|--------------|----------------|
| Commercial and industrial           | \$ 1,687,781                  | \$ 8,672     | \$ 1,696,453   |
| Real estate                         | 2,777,768                     | 38,999       | 2,816,767      |
| Construction and land development   | 783,383                       | 3,467        | 786,850        |
| Consumer                            | 41,058                        | 294          | 41,352         |
| Broker-dealer                       | 502,077                       | —            | 502,077        |
| Non-covered loans, gross            | 5,792,067                     | 51,432       | 5,843,499      |
| Allowance for loan losses           | (51,089)                      | (3,097)      | (54,186)       |
| Non-covered loans, net of allowance | \$ 5,740,978                  | \$ 48,335    | \$ 5,789,313   |

### 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 loan portfolio consists of the non-covered loan portfolio and the covered loan portfolio. The covered loan portfolio consists of loans acquired in the FNB Transaction that are subject to loss-share agreements with the FDIC and is discussed below. The non-covered loan portfolio includes all other loans held by the Bank and is discussed herein.

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The banking segment's total non-covered loans, net of the allowance for non-covered loan losses, were \$7.4 billion and \$6.9 billion at September 30, 2017 and December 31, 2016, respectively. The banking segment's non-covered loan portfolio includes a warehouse line of credit extended to PrimeLending, of which \$1.8 billion and \$1.6 billion was drawn at September 30, 2017 and December 31, 2016, respectively. Effective April 1, 2017, this warehouse line of credit was increased to \$2.2 billion to address seasonal fluctuations in loan origination volumes. Amounts advanced against the warehouse line of credit are eliminated from net loans 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 September 30, 2017, the banking segment had non-covered loan concentrations (loans to borrowers engaged in similar activities) that exceeded 10% of total non-covered loans in its real estate portfolio. The areas of concentration within our non-covered real estate portfolio were non-construction commercial real estate loans, non-construction residential real estate loans, and construction and land development loans, which represented 35.6%, 12.3% and 15.3%, respectively, of the banking segment's total non-covered loans at September 30, 2017. The banking segment's non-covered loan concentrations were within regulatory guidelines at September 30, 2017.

**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 non-covered loans, net of the allowance for non-covered loan losses, were \$485.5 million and \$501.9 million at September 30, 2017 and December 31, 2016, respectively. This decrease was primarily attributable to decreases of \$12.5 million in borrowings in margin accounts and \$3.5 million 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).

|                      | September<br>30,<br>2017 | December 31,<br>2016 |
|----------------------|--------------------------|----------------------|
| Loans held for sale: |                          |                      |

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|                          |              |              |
|--------------------------|--------------|--------------|
| Unpaid principal balance | \$ 1,791,055 | \$ 1,706,383 |
| Fair value adjustment    | 68,765       | 42,115       |
|                          | \$ 1,859,820 | \$ 1,748,498 |
| IRLCs:                   |              |              |
| Unpaid principal balance | \$ 1,248,422 | \$ 944,550   |
| Fair value adjustment    | 28,601       | 23,269       |
|                          | \$ 1,277,023 | \$ 967,819   |

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 September 30, 2017 and December 31, 2016 were \$2.5 billion and \$2.1 billion, respectively, while the related estimated fair values were \$2.7 million and \$8.5 million, respectively.

#### Covered Loan Portfolio

#### Banking Segment

Loans acquired in the FNB Transaction that are subject to loss-share agreements with the FDIC are referred to as “covered loans” and reported separately in our consolidated balance sheets. Under the terms of the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets (including covered loans): (i) 80% of net losses on the first \$240.4 million of net losses incurred; (ii) 0% of net losses in excess of \$240.4 million up to and including \$365.7 million of net losses incurred; and (iii) 80% of net losses in excess

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of \$365.7 million of net losses incurred. Net losses are defined as book value losses plus certain defined expenses incurred in the resolution of assets, less subsequent recoveries. Under the loss-share agreement for commercial assets, the amount of subsequent recoveries that are reimbursable to the FDIC for a particular asset is limited to book value losses and expenses actually billed plus any book value charge-offs incurred prior to September 13, 2013 (the “Bank Closing Date”). There is no limit on the amount of subsequent recoveries reimbursable to the FDIC under the loss-share agreement for single family residential assets. The loss-share agreements for commercial and single family residential assets are in effect for five years and ten years, respectively, and the loss recovery provisions to the FDIC are in effect for eight years and ten years, respectively, from the Bank Closing Date. As part of the loss-share agreements, the Bank is subject to annual FDIC compliance audits. In accordance with the loss-share agreements, the Bank may be required to make a “true-up” payment to the FDIC approximately ten years following the Bank Closing Date if our actual net realized losses over the life of the loss-share agreements are less than the FDIC’s initial estimate of losses on covered assets. The “true-up” payment is calculated using a defined formula set forth in the Purchase and Assumption Agreement by and among the FDIC (as receiver of FNB), the Bank and the FDIC (the “P&A Agreement”). As of September 30, 2017, the Bank projects that the sum of actual plus projected covered losses and reimbursable expenses subject to the loss-share agreements will be less than \$240.4 million. As a result, the Bank has recorded, and expects that it will continue to record, amortization associated with its FDIC Indemnification Asset. As of September 30, 2017, the Bank had billed \$181.9 million of covered net losses to the FDIC, of which 80%, or \$145.5 million, were reimbursable under the loss-share agreements. As of September 30, 2017, the Bank had received aggregate reimbursements of \$145.5 million from the FDIC. While the ultimate amount of any “true-up” payment is unknown at this time and will vary based upon the amount of future losses or recoveries within our covered loan portfolio, the Bank has recorded a related “true-up” payment accrual of \$16.1 million at September 30, 2017 based on the current estimate of aggregate realized losses on covered assets over the life of the loss-share agreements. Additionally, as estimates of realized losses on covered assets change, the value of the FDIC Indemnification Asset will be adjusted and therefore may not be realized. As noted above, if the Bank continues to experience favorable resolutions within its covered assets portfolio and covered losses, the Bank will be required to increase its “true-up” payment accrual and recognize amortization on the FDIC Indemnification Asset.

In connection with the FNB Transaction, the Bank acquired loans both with and without evidence of credit quality deterioration since origination. Based on purchase date valuations, the banking segment’s portfolio of acquired covered loans had a fair value of \$1.1 billion as of the Bank Closing Date, with no carryover of any allowance for loan losses. Unless the banking segment acquires additional loans subject to loss-share agreements with the FDIC, the covered portfolio will continue to decrease as covered loans are liquidated.

Covered loans held for investment are detailed in the table below and classified by portfolio segment (in thousands).

|                                   | Loans, excluding<br>PCI Loans | PCI<br>Loans | Total<br>Loans |
|-----------------------------------|-------------------------------|--------------|----------------|
| September 30, 2017                |                               |              |                |
| Commercial and industrial         | \$ 961                        | \$ 281       | \$ 1,242       |
| Real estate                       | 96,761                        | 90,016       | 186,777        |
| Construction and land development | 2,105                         | 286          | 2,391          |
| Covered loans, gross              | 99,827                        | 90,583       | 190,410        |
| Allowance for loan losses         | (33)                          | (2,108)      | (2,141)        |

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|                                 |           |           |            |
|---------------------------------|-----------|-----------|------------|
| Covered loans, net of allowance | \$ 99,794 | \$ 88,475 | \$ 188,269 |
|---------------------------------|-----------|-----------|------------|

|                                   | Loans, excluding<br>PCI Loans | PCI<br>Loans | Total<br>Loans |
|-----------------------------------|-------------------------------|--------------|----------------|
| December 31, 2016                 |                               |              |                |
| Commercial and industrial         | \$ 1,185                      | \$ 1,512     | \$ 2,697       |
| Real estate                       | 117,431                       | 127,038      | 244,469        |
| Construction and land development | 3,757                         | 5,204        | 8,961          |
| Covered loans, gross              | 122,373                       | 133,754      | 256,127        |
| Allowance for loan losses         | (69)                          | (344)        | (413)          |
| Covered loans, net of allowance   | \$ 122,304                    | \$ 133,410   | \$ 255,714     |

At September 30, 2017, the banking segment had covered loan concentrations (loans to borrowers engaged in similar activities) that exceeded 10% of total covered loans in its real estate portfolio. The areas of concentration within our covered real estate portfolio were non-construction residential real estate loans and non-construction commercial real estate loans, which represented 77.9% and 20.2%, respectively, of the banking segment's total covered loans at

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September 30, 2017. The banking segment's covered loan concentrations were within regulatory guidelines at September 30, 2017.

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 non-covered and covered loan portfolios. 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.

It is management's responsibility to, at the end of each quarter, or more frequently as deemed necessary, analyze the level of the allowance for loan losses to ensure that it is appropriate for the estimated credit losses in the portfolio. Estimated credit losses are the probable current amount of loans that we will be unable to collect given facts and circumstances as of the evaluation date. When management determines that a loan, or portion thereof, is uncollectible, the loan, or portion thereof, is charged-off against the allowance for loan losses, or for acquired loans accounted for in pools, charged against the pool discount. Recoveries on charge-offs of loans acquired in the Bank Transactions that occurred prior to their acquisition represent contractual cash flows not expected to be collected and are recorded as accretion income. Recoveries on acquired loans charged-off subsequent to their acquisition are credited to the allowance for loan loss, except for recoveries on loans accounted for in pools, which are credited to the pool discount.

In connection with the Bank Transactions, we acquired loans both with and without evidence of credit quality deterioration since origination. PCI loans acquired in the PlainsCapital Merger are accounted for on an individual loan basis, while PCI loans acquired in each of the FNB Transaction and the SWS Merger are accounted for in pools as well as on an individual loan basis. We have established under our PCI accounting policy a framework to aggregate certain acquired loans into various loan pools based on a minimum of two layers of common risk characteristics for the purpose of determining their respective fair values as of their acquisition dates, and for applying the subsequent recognition and measurement provisions for income accretion and impairment testing. The common risk characteristics used for the pooling of the FNB and SWS PCI loans are risk grade and loan collateral type. The loans acquired in the Bank Transactions were initially recorded at fair value with no carryover of any allowance for loan losses.

Provisions for loan losses are charged to operations to record the total allowance for loan losses at a level deemed appropriate by the banking segment's management based on such factors as the volume and type of lending it conducted, the amount of non-performing loans and related collateral security, the present level of the allowance for loan losses, the results of recent regulatory examinations, generally accepted accounting principles, general economic conditions and other factors related to the ability to collect loans in its portfolio. The provision for loan losses, primarily attributable to the banking segment, was \$1.3 million and \$4.0 million during the three months ended September 30, 2017 and 2016, respectively, and \$8.8 million and \$36.3 million during the nine months ended September 30, 2017 and 2016, respectively. The significant decrease in the provision for losses during the nine

months ended September 30, 2017, compared with the same period in 2016, was primarily the result of the previously mentioned \$24.5 million charge-off of a single large loan during the second quarter of 2016.

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 non-covered and covered portfolios at September 30, 2017, additional provisions for losses on existing loans may be necessary in the future.

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

|  | Three Months Ended |           | Nine Months Ended |           |      |   |
|--|--------------------|-----------|-------------------|-----------|------|---|
|  | September 30,      |           | September 30,     |           |      |   |
| Non-Covered Portfolio  | 2017               | 2016      | 2017              | 2016      |      |   |
| Balance, beginning of period   | \$ 59,208          | \$ 51,013 | \$ 54,186         | \$ 45,415 |      |   |
| Provisions charged to operations   | 479                | 4,719     | 6,581             | 37,098    |      |   |
| Recoveries of non-covered loans previously charged off:                          |                    |           |                   |           |      |   |
| Commercial and industrial  | 280                | 295       | 1,340             | 1,432     |      |   |
| Real estate  | 88                 | 196       | 184               | 364       |      |   |
| Construction and land development  | 4                  | —         | 5                 | —         |      |   |
| Consumer   | 25                 | 20        | 65                | 104       |      |   |
| Broker-dealer  | —                  | —         | —                 | —         |      |   |
| Total recoveries   | 397                | 511       | 1,594             | 1,900     |      |   |
| Non-covered loans charged off:   |                    |           |                   |           |      |   |
| Commercial and industrial  | 1,264              | 3,550     | 3,070             | 30,333    |      |   |
| Real estate  | 5                  | 1         | 305               | 1,299     |      |   |
| Construction and land development  | 3                  | —         | 13                | —         |      |   |
| Consumer   | 33                 | 67        | 194               | 155       |      |   |
| Broker-dealer  | —                  | —         | —                 | 1         |      |   |
| Total charge-offs  | 1,305              | 3,618     | 3,582             | 31,788    |      |   |
| Net charge-offs  | (908)              | (3,107)   | (1,988)           | (29,888)  |      |   |
| Balance, end of period   | \$ 58,779          | \$ 52,625 | \$ 58,779         | \$ 52,625 |      |   |
| Non-covered allowance for loan losses as a percentage of gross non-covered loans |                    |           | 0.96              | %         | 0.93 | % |

|   | Three Months Ended |          | Nine Months Ended |          |
|---|--------------------|----------|-------------------|----------|
|   | September 30,      |          | September 30,     |          |
| Covered Portfolio                                   | 2017               | 2016     | 2017              | 2016     |
| Balance, beginning of period                        | \$ 1,359           | \$ 1,455 | \$ 413            | \$ 1,532 |
| Provisions charged to (recapture from) operations   | 781                | (729)    | 2,237             | (825)    |
| Recoveries of covered loans previously charged off: |                    |          |                   |          |
| Commercial and industrial                           | —                  | —        | 6                 | —        |
| Real estate   | —                  | —        | 5                 | 17       |
| Construction and land development                   | 1                  | 3        | 7                 | 104      |
| Total recoveries                                    | 1                  | 3        | 18                | 121      |
| Covered loans charged off:                          |                    |          |                   |          |
| Commercial and industrial                           | —                  | —        | 6                 | 6        |
| Real estate   | —                  | —        | 521               | 42       |



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|  |          |        |          |        |
|--|----------|--------|----------|--------|
| Construction and land development  | —        | —      | —        | 51     |
| Total charge-offs  | —        | —      | 527      | 99     |
| Net recoveries (charge-offs)   | 1        | 3      | (509)    | 22     |
| Balance, end of period   | \$ 2,141 | \$ 729 | \$ 2,141 | \$ 729 |
| Covered allowance for loan losses as a percentage of gross covered loans |          |        | 1.12 %   | 0.25 % |

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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 non-covered and covered loan portfolios are presented in the tables below (dollars in thousands).

|   | September 30, 2017 |         |   | December 31, 2016 |         |   |
|---|--------------------|---------|---|-------------------|---------|---|
|   |                    | % of    |   |                   | % of    |   |
|   |                    | Gross   |   |                   | Gross   |   |
|   |                    | Non-    |   |                   | Non-    |   |
|   |                    | Covered |   |                   | Covered |   |
| Non-Covered Portfolio                                     | Reserve            | Loans   |   | Reserve           | Loans   |   |
| Commercial and industrial                                 | \$ 23,015          | 28.22   | % | \$ 21,369         | 29.03   | % |
| Real estate (including construction and land development) | 35,329             | 63.20   | % | 32,238            | 61.67   | % |
| Consumer  | 369                | 0.68    | % | 424               | 0.71    | % |
| Broker-dealer   | 66                 | 7.90    | % | 155               | 8.59    | % |
| Total   | \$ 58,779          | 100.00  | % | \$ 54,186         | 100.00  | % |

|   | September 30, 2017 |         |   | December 31, 2016 |         |   |
|---|--------------------|---------|---|-------------------|---------|---|
|   |                    | % of    |   |                   | % of    |   |
|   |                    | Gross   |   |                   | Gross   |   |
|   |                    | Covered |   |                   | Covered |   |
| Covered Portfolio   | Reserve            | loans   |   | Reserve           | Loans   |   |
| Commercial and industrial                                 | \$ 81              | 0.65    | % | \$ 35             | 1.05    | % |
| Real estate (including construction and land development) | 2,060              | 99.35   | % | 378               | 98.95   | % |
| Total   | \$ 2,141           | 100.00  | % | \$ 413            | 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 non-covered loan portfolio, we had eleven credit relationships totaling \$31.7 million of potential problem loans at September 30, 2017, compared with four credit relationships totaling \$3.8 million of non-covered potential problem loans at December 31, 2016. Within our covered loan portfolio, we had two credit relationships totaling \$0.4 million of potential problem loans at September 30, 2017, compared with one credit relationship totaling \$0.5 million of potential problem loans at December 31, 2016.



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## Non-Performing Assets

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

|   | September<br>30,<br>2017 |   | December<br>31,<br>2016 |   |
|---|--------------------------|---|-------------------------|---|
| Non-covered loans accounted for on a non-accrual basis:                     |                          |   |                         |   |
| Commercial and industrial   | \$ 21,434                |   | \$ 9,515                |   |
| Real estate   | 17,996                   |   | 13,932                  |   |
| Construction and land development   | 626                      |   | 755                     |   |
| Consumer  | 63                       |   | 244                     |   |
| Broker-dealer   | —                        |   | —                       |   |
|   | \$ 40,119                |   | \$ 24,446               |   |
| Non-covered non-performing loans as a percentage of total non-covered loans | 0.50                     | % | 0.32                    | % |
| Non-covered other real estate owned   | \$ 4,827                 |   | \$ 4,507                |   |
| Other repossessed assets  | \$ 437                   |   | \$ 1,117                |   |
| Non-covered non-performing assets   | \$ 45,383                |   | \$ 30,070               |   |
| Non-covered non-performing assets as a percentage of total assets           | 0.34                     | % | 0.24                    | % |
| Non-covered loans past due 90 days or more and still accruing               | \$ 45,134                |   | \$ 47,486               |   |
| Troubled debt restructurings included in accruing non-covered loans         | \$ 1,163                 |   | \$ 1,196                |   |

At September 30, 2017, total non-covered non-performing assets increased \$15.3 million to \$45.4 million, compared with \$30.1 million at December 31, 2016, primarily related to a single commercial and industrial loan secured by oil and gas. Non-covered non-performing loans totaled \$40.1 million at September 30, 2017 and \$24.4 million at December 31, 2016. At September 30, 2017, non-covered non-accrual loans included 24 commercial and industrial relationships with loans of \$21.4 million secured by accounts receivable, life insurance, oil and gas, livestock and equipment. Non-covered non-accrual loans at September 30, 2017 also included \$17.9 million characterized as real estate loans, including seven commercial real estate loan relationships of \$14.8 million and \$3.1 million in loans secured by residential real estate, \$1.6 million of which were classified as loans held for sale, as well as construction and land development loans of \$0.6 million. At December 31, 2016, non-covered non-accrual loans included 19 commercial and industrial relationships with loans of \$9.5 million secured by accounts receivable, life insurance, oil and gas, livestock, and equipment. Non-covered non-accrual loans at December 31, 2016 also included \$13.9 million characterized as real estate loans, including five commercial real estate loan relationships totaling \$11.0 million and \$2.9 million in loans secured by residential real estate, \$1.7 million of which were classified as loans held for sale, as well as construction and land development loans of \$0.8 million.

Non-covered OREO increased \$0.3 million to \$4.8 million at September 30, 2017, compared with \$4.5 million at December 31, 2016. Changes in non-covered OREO included the addition of six properties totaling \$2.2 million and the disposal of six properties of \$1.5 million. At September 30, 2017, non-covered OREO included commercial properties of \$4.0 million and other real estate properties of \$0.8 million, while at December 31, 2016, non-covered OREO included commercial properties of \$4.2 million and other real estate properties of \$0.3 million.

Non-covered non-PCI loans past due 90 days or more and still accruing were \$45.1 million and \$47.5 million at September 30, 2017 and December 31, 2016, respectively, substantially all of which were loans held for sale and guaranteed by U.S. Government agencies, including loans that are subject to repurchase, or have been repurchased, by PrimeLending.

At September 30, 2017, troubled debt restructurings (“TDRs”) on non-covered loans totaled \$7.5 million. These TDRs were comprised of \$1.2 million of non-covered loans that are considered to be performing and non-covered non-performing loans of \$6.3 million reported in non-accrual loans. At December 31, 2016, TDRs on non-covered loans

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totaled \$6.4 million, of which \$1.2 million related to non-covered loans that are considered to be performing and non-covered non-performing loans of \$5.2 million reported in non-accrual loans.

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

|   | September<br>30,<br>2017 |   | December<br>31,<br>2016 |   |
|---|--------------------------|---|-------------------------|---|
| Covered loans accounted for on a non-accrual basis:                 |                          |   |                         |   |
| Commercial and industrial   | \$ 44                    |   | \$ 52                   |   |
| Real estate   | 3,438                    |   | 3,765                   |   |
| Construction and land development                                   | 299                      |   | 19                      |   |
|   | \$ 3,781                 |   | \$ 3,836                |   |
| <br>  |                          |   |                         |   |
| Covered non-performing loans as a percentage of total covered loans | 1.99                     | % | 1.50                    | % |
| <br>  |                          |   |                         |   |
| Covered other real estate owned:                                    |                          |   |                         |   |
| Real estate - residential   | \$ 4,144                 |   | \$ 7,396                |   |
| Real estate - commercial  | 7,418                    |   | 9,558                   |   |
| Construction and land development - residential                     | 4,771                    |   | 7,926                   |   |
| Construction and land development - commercial                      | 24,010                   |   | 26,762                  |   |
|   | \$ 40,343                |   | \$ 51,642               |   |
| <br>  |                          |   |                         |   |
| Other repossessed assets  | \$ —                     |   | \$ —                    |   |
| <br>  |                          |   |                         |   |
| Covered non-performing assets                                       | \$ 44,124                |   | \$ 55,478               |   |
| <br>  |                          |   |                         |   |
| Covered non-performing assets as a percentage of total assets       | 0.33                     | % | 0.44                    | % |
| <br>  |                          |   |                         |   |
| Covered loans past due 90 days or more and still accruing           | \$ —                     |   | \$ 173                  |   |
| <br>  |                          |   |                         |   |
| Troubled debt restructurings included in accruing covered loans     | \$ 493                   |   | \$ 503                  |   |

At September 30, 2017, covered non-performing assets decreased by \$11.4 million to \$44.1 million, compared with \$55.5 million at December 31, 2016, due to decreases in covered non-accrual loans of \$0.1 million and covered other real estate owned of \$11.3 million. Covered non-performing loans totaled \$3.8 million at September 30, 2017 and \$3.8 million at December 31, 2016. At September 30, 2017, covered non-performing loans included 38 residential real estate loan relationships of \$3.4 million. At December 31, 2016, covered non-performing loans included one commercial and industrial relationship of \$0.1 million, three commercial real estate loan relationships of \$0.7 million and 31 residential real estate loan relationships of \$3.0 million.

OREO acquired in the FNB Transaction that is subject to the FDIC loss-share agreements is referred to as “covered OREO” and reported separately in our consolidated balance sheets. Covered OREO decreased \$11.3 million to \$40.3 million at September 30, 2017, compared with \$51.6 million at December 31, 2016. The decrease was primarily due to the disposal of 123 properties totaling \$14.9 million and fair value valuation decreases of \$2.5 million, partially offset by the addition of 46 properties totaling \$6.1 million.

There were no covered non-PCI loans past due 90 days or more and still accruing at September 30, 2017. At December 31, 2016, covered non-PCI loans past due 90 days or more and still accruing totaled \$0.2 million and included one residential real estate loan and one commercial and industrial loan.

At September 30, 2017, TDRs on covered loans totaled \$1.3 million, of which \$0.5 million relate to covered loans that are considered to be performing and covered non-performing loans of \$0.8 million included in non-accrual loans. At December 31, 2016, TDRs on covered loans totaled \$1.4 million, of which \$0.5 million related to covered loans that are considered to be performing and covered non-performing loans of \$0.9 million included in non-accrual loans.

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### Insurance Losses and Loss Adjustment Expenses

At September 30, 2017 and December 31, 2016, our gross reserve for unpaid losses and LAE was \$67.0 million and \$35.8 million, respectively, including estimated recoveries from reinsurance of \$35.3 million and \$9.4 million, respectively. This increase in the gross reserve for unpaid losses and LAE was primarily due to losses attributable to non-catastrophic weather-related events that occurred in 2017 and Hurricane Harvey. 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 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. Average deposits totaled \$7.4 billion during the nine months ended September 30, 2017, and were higher than the average deposits of \$7.0 billion during the nine months ended September 30, 2016 and \$7.1 billion during the year ended December 31, 2016. For the periods presented in the table below, the average rates paid associated with time deposits include the effects of amortization of the deposit premiums booked as a part of the Bank Transactions.

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

|  | Nine Months Ended September 30,<br>2017 |                      |   | Year Ended December 31,<br>2016 |                      |   |                    |                      |   |
|--|---|----------------------|---|---------------------------------|----------------------|---|--------------------|----------------------|---|
|  | Average<br>Balance                      | Average<br>Rate Paid |   | Average<br>Balance              | Average<br>Rate Paid |   | Average<br>Balance | Average<br>Rate Paid |   |
| Noninterest-bearing<br>demand deposits | \$ 2,266,361                            | 0.00                 | % | \$ 2,203,011                    | 0.00                 | % | \$ 2,241,561       | 0.00                 | % |
| Interest-bearing<br>demand deposits    | 3,629,012                               | 0.27                 | % | 3,139,554                       | 0.15                 | % | 3,185,006          | 0.14                 | % |
| Savings deposits                       | 239,817                                 | 0.10                 | % | 308,592                         | 0.16                 | % | 301,877            | 0.15                 | % |
| Time deposits                          | 1,275,344                               | 1.00                 | % | 1,371,190                       | 0.79                 | % | 1,337,491          | 0.81                 | % |
|  | \$ 7,410,534                            | 0.31                 | % | \$ 7,022,347                    | 0.23                 | % | \$ 7,065,935       | 0.22                 | % |

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## Borrowings

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

|                                | September 30, 2017 |                   |   | December 31, 2016 |                   |   |
|--------------------------------|--------------------|-------------------|---|-------------------|-------------------|---|
|                                | Balance            | Average Rate Paid |   | Balance           | Average Rate Paid |   |
| Short-term borrowings          | \$ 1,477,201       | 1.13              | % | \$ 1,417,289      | 0.65              | % |
| Notes payable                  | 300,196            | 3.62              | % | 317,912           | 3.89              | % |
| Junior subordinated debentures | 67,012             | 4.45              | % | 67,012            | 3.99              | % |
|                                | \$ 1,844,409       | 1.79              | % | \$ 1,802,213      | 1.57              | % |

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 \$59.9 million increase in short-term borrowings at September 30, 2017 compared with December 31, 2016 included an increase of \$425.0 million in short-term bank loans and securities sold under agreements to repurchase used by the Hilltop Broker-Dealers to finance their activities, partially offset by a decrease in borrowings of \$365.1 million in our banking segment primarily associated with the increased utilization of available internal funds. Notes payable at September 30, 2017 of \$300.2 million was comprised of \$148.4 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 \$98.1 million, insurance segment term notes of \$27.5 million, and mortgage origination segment borrowings of \$23.2 million. The decrease in notes payable at September 30, 2017 compared to December 31, 2016 included the payoff by NLC of its \$20.0 million insurance company note payable due March 2035. The average rate paid associated with notes payable includes the effect of amortization of the premiums on FHLB borrowings booked as a part of the SWS Merger.

## 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 preserve capital and have cash resources available to make acquisitions. At September 30, 2017, Hilltop had \$99.4 million in cash and cash equivalents, a decrease of \$4.5 million from \$103.9 million at December 31, 2016. This decrease in cash and cash equivalents was primarily due to the net effects of Hilltop’s receipt of \$75.7 million in dividends from its subsidiaries, partially offset by Hilltop’s payment of \$55.0 million related to the resolution of the SWS appraisal proceeding, \$27.4 million associated with our stock repurchase program, \$17.4 million in cash dividends declared, and other general corporate expenses. If necessary or appropriate, we may also finance acquisitions with the proceeds from equity or debt issuances. Subject to regulatory restrictions, Hilltop has received, and may also continue to receive, dividends from its subsidiaries. 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 October 26, 2017, our board of directors declared a quarterly cash dividend of \$0.06 per common share, payable on November 30, 2017 to all common stockholders of record as of the close of business on November 15, 2017.

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.

#### NLC Insurance Company Note Payable

On June 14, 2017, NLC paid off the \$20.0 million insurance company note payable due March 2035.

#### 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. 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

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redeemed plus accrued and unpaid interest to, but excluding, the redemption date. At September 30, 2017, \$150.0 million of our Senior Notes was outstanding. During the three months ended September 30, 2017, we accrued interest expense of \$1.9 million on the Senior Notes.

## Stock Repurchase Program

During January 2017, our board of directors reauthorized the stock repurchase program originally approved during the second quarter of 2016 through January 2018. Pursuant to the stock repurchase program, we are authorized to repurchase, in the aggregate, up to \$50.0 million of our outstanding common stock. Under the stock repurchase program authorized, we may repurchase shares in open-market purchases or through privately negotiated transactions as permitted under Rule 10b-18 promulgated under the Exchange Act. The extent to which the Company repurchases its 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 the pool of authorized but unissued shares of common stock. During the nine months ended September 30, 2017, the Company paid \$27.4 million to repurchase an aggregate of 1,057,656 shares of common stock at an average price of \$25.87 per share. The purchases were funded from available cash balances.

## Loss-Share Agreements

In connection with the FNB Transaction, the Bank entered into two loss-share agreements with the FDIC that collectively cover \$1.2 billion of loans and OREO acquired in the FNB Transaction, which we refer to as "covered assets". Pursuant to the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets: (i) 80% of net losses on the first \$240.4 million of net losses incurred; (ii) 0% of net losses in excess of \$240.4 million up to and including \$365.7 million of net losses incurred; and (iii) 80% of net losses in excess of \$365.7 million of net losses incurred. Net losses are defined as book value losses plus certain defined expenses incurred in the resolution of assets, less subsequent recoveries. Under the loss-share agreement for commercial assets, the amount of subsequent recoveries that are reimbursable to the FDIC for a particular asset is limited to book value losses and expenses actually billed plus any book value charge-offs incurred prior to the Bank Closing Date. There is no limit on the amount of subsequent recoveries reimbursable to the FDIC under the loss-share agreement for single family assets. The loss-share agreements for commercial and single family residential loans are in effect for 5 years and 10 years, respectively, from the Bank Closing Date and the loss recovery provisions to the FDIC are in effect for 8 years and 10 years, respectively, from the Bank Closing Date. As part of the loss-share agreements, the Bank is subject to annual FDIC compliance audits. In accordance with the loss-share agreements, the Bank may be required to make a "true-up" payment to the FDIC approximately ten years following the Bank Closing Date if our actual net realized losses over the life of the loss-share agreements are less than the FDIC's initial estimate of losses on covered assets. The "true-up" payment is calculated using a defined formula set forth in the P&A Agreement. While the ultimate amount of any "true-up" payment is unknown at this time and will vary based upon the amount of future losses or recoveries within our covered loan portfolio, the Bank has recorded a related "true-up" payment accrual of \$16.1 million at September 30, 2017 based on the current estimate of aggregate realized losses on covered assets over the life of the loss-share agreements.

## 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.

In order to avoid limitations on capital distributions, including dividend payments, stock repurchases and certain discretionary bonus payments to executive officers, Basel III also implemented a capital conservation buffer, which requires a banking organization to hold a buffer above its minimum risk-based capital requirements. This buffer helps to ensure that banking organizations conserve capital when it is most needed, allowing them to better weather periods of economic stress. The buffer is measured relative to risk-weighted assets. The phase-in of the capital conservation buffer requirements began on January 1, 2016 for Hilltop and PlainsCapital. Based on the actual ratios as noted above, Hilltop

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and PlainsCapital exceed each of the capital conservation buffer requirements in effect as of September 30, 2017, as well as the fully phased-in requirements through 2019.

In addition, under the final rules, 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 September 30, 2017, under guidance issued by the Board of Governors of the Federal Reserve System.

At September 30, 2017, Hilltop had a total capital to risk weighted assets ratio of 18.71%, Tier 1 capital to risk weighted assets ratio of 18.20%, common equity Tier 1 capital to risk weighted assets ratio of 17.66% and a Tier 1 capital to average assets, or leverage, ratio of 12.87%. 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 and on a fully phased-in basis as if such requirements were currently in effect.

At September 30, 2017, PlainsCapital had a total capital to risk weighted assets ratio of 15.23%, Tier 1 capital to risk weighted assets ratio of 14.44%, common equity Tier 1 capital to risk weighted assets ratio of 14.44% and a Tier 1 capital to average assets, or leverage, ratio of 12.18%. 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 and on a fully phased-in basis as if such requirements were currently in effect.

We discuss regulatory capital requirements in more detail in Note 15 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 2016 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.

We had deposits of \$7.7 billion at September 30, 2017, an increase of \$599.6 million from \$7.1 billion at December 31, 2016. 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 consistently evaluates its deposit products and pricing structures relative to the market to maintain competitiveness over time. At September 30, 2017, money market deposits, including brokered deposits, were \$2.3 billion; time deposits, including brokered deposits, were \$1.4 billion; and noninterest bearing demand deposits were \$2.3 billion. Money market deposits, including brokered deposits, increased by \$573.8 million from \$1.8 billion and time deposits, including brokered deposits, increased \$229.3 million from \$1.2 billion at December 31, 2016.

The Bank's 15 largest depositors, excluding Hilltop and Hilltop Securities, accounted for 8.29% of the Bank's total deposits, and the Bank's five largest depositors, excluding Hilltop and Hilltop Securities, accounted for 4.44% of the Bank's total deposits at September 30, 2017. The loss of one or more of our largest Bank customers, or a significant

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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.

### 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 September 30, 2017, Hilltop Securities had credit arrangements with five unaffiliated banks 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 September 30, 2017, Hilltop Securities had borrowed \$143.5 million under its credit arrangements and had no borrowings under its credit facility.

### Mortgage Origination Segment

PrimeLending funds the mortgage loans it originates through a warehouse line of credit maintained with the Bank. At September 30, 2017, PrimeLending had outstanding borrowings of \$1.8 billion against the warehouse line of credit. Effective April 1, 2017, this warehouse line of credit was increased to \$2.2 billion to address seasonal fluctuations in loan origination volumes. 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 JPMorgan Chase Bank, NA ("JPMorgan Chase") of up to \$1.0 million, of which no borrowings were outstanding at September 30, 2017.

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 September 30, 2017, these ABAs have combined available lines of credit totaling \$60.0 million, of which \$23.2 million was outstanding at September 30, 2017.

### 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 \$177.5 million, or 87.0%, equity investments of \$20.9 million and other investments of \$5.6 million comprised NLC's \$204.0 million in total cash and investments at September 30, 2017. 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 Wells Fargo Bank, N.A. 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.

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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.

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 \$2.0 billion at September 30, 2017 and outstanding financial and performance standby letters of credit of \$28.8 million at September 30, 2017.

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, FDIC Indemnification Asset, reserve for losses and LAE, goodwill and identifiable intangible assets, mortgage loan indemnification liability, mortgage servicing rights asset and acquisition accounting. Since December 31, 2016, 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 2016 Form 10-K.

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

Our assessment of market risk as of September 30, 2017 indicates there are no material changes in the quantitative and qualitative disclosures from those previously reported in our 2016 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.

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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.



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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).

|  | September 30, 2017 |                      |                     |                      |            | Total        |
|--|--------------------|----------------------|---------------------|----------------------|------------|--------------|
|  | 3 Months or Less   | > 3 Months to 1 Year | > 1 Year to 3 Years | > 3 Years to 5 Years | > 5 Years  |              |
| Interest sensitive assets:   |                    |                      |                     |                      |            |              |
| Loans  | \$ 4,638,153       | \$ 1,042,615         | \$ 1,395,330        | \$ 334,576           | \$ 220,417 | \$ 7,631,091 |
| Securities   | 128,473            | 151,482              | 242,277             | 93,480               | 388,600    | 1,004,312    |
| Federal funds sold and securities purchased under agreements to resell | 400                | —                    | —                   | —                    | —          | 400          |
| Other interest sensitive assets  | 149,802            | —                    | —                   | —                    | 29,136     | 178,938      |
| Total interest sensitive assets  | 4,916,828          | 1,194,097            | 1,637,607           | 428,056              | 638,153    | 8,814,741    |
| Interest sensitive liabilities:  |                    |                      |                     |                      |            |              |
| Interest bearing checking  | \$ 3,420,343       | \$ —                 | \$ —                | \$ —                 | \$ —       | \$ 3,420,343 |
| Savings  | 210,316            | —                    | —                   | —                    | —          | 210,316      |
| Time deposits  | 255,025            | 550,270              | 576,110             | 29,573               | 13,564     | 1,424,542    |
| Notes payable and other borrowings                                     | 886,765            | 63,181               | 5,040               | 1,302                | 6,299      | 962,587      |
| Total interest sensitive   | 4,772,449          | 613,451              | 581,150             | 30,875               | 19,863     | 6,017,788    |

## liabilities

Interest  
sensitivity  
gap

|            |            |              |            |            |              |
|------------|------------|--------------|------------|------------|--------------|
| \$ 144,379 | \$ 580,646 | \$ 1,056,457 | \$ 397,181 | \$ 618,290 | \$ 2,796,953 |
|------------|------------|--------------|------------|------------|--------------|

Cumulative  
interest  
sensitivity  
gap

|            |            |              |              |              |
|------------|------------|--------------|--------------|--------------|
| \$ 144,379 | \$ 725,025 | \$ 1,781,482 | \$ 2,178,663 | \$ 2,796,953 |
|------------|------------|--------------|--------------|--------------|

Percentage  
of  
cumulative  
gap to total  
interest  
sensitive  
assets

|      |   |      |   |       |   |       |   |       |   |
|------|---|------|---|-------|---|-------|---|-------|---|
| 1.64 | % | 8.23 | % | 20.21 | % | 24.72 | % | 31.73 | % |
|------|---|------|---|-------|---|-------|---|-------|---|

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 September 30, 2017 (dollars in thousands).

| Change in<br>Interest Rates<br>(basis points) | Changes in<br>Net Interest Income |         |   | Changes in<br>Economic Value of Equity |         |   |
|---|-----------------------------------|---------|---|--|---------|---|
|   | Amount                            | Percent | % | Amount                                 | Percent | % |
| +300  | \$ 56,592                         | 18.12   | % | \$ 236,763                             | 12.63   | % |
| +200  | \$ 36,454                         | 11.68   | % | \$ 162,769                             | 8.68    | % |
| +100  | \$ 4,996                          | 5.01    | % | \$ 77,898                              | 4.16    | % |
| -50   | \$ (1,914)                        | (0.61)  | % | \$ (118,044)                           | (6.30)  | % |

The projected changes in net interest income and economic value of equity to changes in interest rates at September 30, 2017 were in compliance with established internal policy guidelines. These projected changes are based on numerous assumptions of growth and changes in the mix of assets or liabilities.

The historically low level of interest rates, combined with the existence of rate floors that are in effect for a portion of the loan portfolio, are projected to cause yields on our earning assets to rise more slowly than increases in market interest rates. As a result, in a rising interest rate environment, our interest rate margins are projected to compress until the rise in market interest rates is sufficient to allow our loan portfolio to reprice above applicable rate floors.



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## Broker-Dealer Segment

Our broker-dealer segment is exposed to market risk primarily due to its role as a financial intermediary in customer transactions, which may include purchases and sales of securities, use of derivatives and securities lending activities, and in our trading activities, which are used to support sales, underwriting and other customer activities. We are subject to the risk of loss that may result from the potential change in value of a financial instrument as a result of fluctuations in interest rates, market prices, investor expectations and changes in credit ratings of the issuer.

Our broker-dealer segment is exposed to interest rate risk as a result of maintaining inventories of interest rate sensitive financial instruments and other interest earning assets including customer and correspondent margin loans and securities borrowing activities. Our exposure to interest rate risk is also from our funding sources including customer and correspondent cash balances, bank borrowings, repurchase agreements and securities lending activities. Interest rates on customer and correspondent balances and securities produce a positive spread with rates generally fluctuating in parallel.

With respect to securities held, our interest rate risk is managed by setting and monitoring limits on the size and duration of positions and on the length of time securities can be held. Much of the interest rates on customer and correspondent margin loans are indexed and can vary daily. Our funding sources are generally short term with interest rates that can vary daily.

The following table categorizes the broker-dealer segment's net trading securities which are subject to interest rate and market price risk (dollars in thousands):

|   | September 30, 2017 |                        |                          |            | Total      |
|---|--------------------|------------------------|--------------------------|------------|------------|
|   | 1 Year<br>or Less  | > 1 Year<br>to 5 Years | > 5 Years<br>to 10 Years | > 10 Years |            |
| Trading securities, at fair value                 |                    |                        |                          |            |            |
| Municipal obligations                             | \$ 388             | \$ 3,204               | \$ 11,898                | \$ 74,655  | \$ 90,145  |
| U.S. government and government agency obligations | 1,861              | (11,392)               | (30,092)                 | 398,477    | 358,854    |
| Corporate obligations                             | (6,068)            | (494)                  | (156)                    | 15,576     | 8,858      |
| Total debt securities                             | (3,819)            | (8,682)                | (18,350)                 | 488,708    | 457,857    |
| Corporate equity securities                       | 1                  | -                      | -                        | -          | 1          |
| Other   | 34,986             | -                      | -                        | -          | 34,986     |
|   | \$ 31,168          | \$ (8,682)             | \$ (18,350)              | \$ 488,708 | \$ 492,844 |
| Weighted average yield                            |                    |                        |                          |            |            |
| Municipal obligations                             | 1.32%              | 1.86%                  | 2.22%                    | 3.44%      | 3.22%      |

|   |       |       |       |       |       |
|---|-------|-------|-------|-------|-------|
| U.S. government and government agency obligations | 1.32% | 1.57% | 2.30% | 3.91% | 3.36% |
| Corporate obligations                             | 2.75% | 3.07% | 3.82% | 5.55% | 3.81% |

Derivatives are used to support certain customer programs and hedge our related exposure to interest rate risks.

Our broker-dealer segment is engaged in various brokerage and trading activities that expose us to credit risk arising from potential non-performance from counterparties, customers or issuers of securities. This risk is managed by setting and monitoring position limits for each counterparty, conducting periodic credit reviews of counterparties, reviewing concentrations of securities and conducting business through central clearing organizations.

Collateral underlying margin loans to customers and correspondents and with respect to securities lending activities is marked to market daily and additional collateral is required as necessary.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the supervision and participation of our Co-Principal Executive Officers and Principal Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report.

Based upon that evaluation, our Co-Principal Executive Officers and Principal Financial Officer concluded that, as of the end of such period, our disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and are effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to the Company’s management, including our Co-

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Principal Executive Officers and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

For a description of material pending legal proceedings, see the discussion set forth under the heading “Legal Matters” in Note 12 to our Consolidated Financial Statements, which is incorporated by reference herein.

Item 1A. Risk Factors.

There have been no material changes to the risk factors disclosed under “Item 1A. Risk Factors” of our 2016 Form 10-K. For additional information concerning our risk factors, please refer to “Item 1A. Risk Factors” of our 2016 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On July 14, 2017, we issued an aggregate of 4,446 shares of common stock under the Hilltop Holdings Inc. 2012 Equity Incentive Plan to certain non-employee directors as compensation for their service on our board of directors during the second quarter of 2017. The shares were issued pursuant to the exemption from registration under Section 4(a)(2) of the Securities Act.

The following table details our repurchases of shares of common stock during the three months ended September 30, 2017.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|--------|----------------------------------|------------------------------|--|--|
|        | —                                | \$ —                         | —  | \$ 33,990,469  |

|                                     |         |          |         |            |
|-------------------------------------|---------|----------|---------|------------|
| July 1 - July 31,<br>2017           |         |          |         |            |
| August 1 - August<br>31, 2017       | 452,225 | 25.14    | 452,225 | 22,610,603 |
| September 1 -<br>September 30, 2017 | —       | —        | —       | 22,610,603 |
| Total                               | 452,225 | \$ 25.14 | 452,225 |            |

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(1) On June 13, 2016, we announced a stock repurchase program which authorized us to repurchase, in the aggregate, up to \$50.0 million of our outstanding common stock. On January 26, 2017, we announced that our board of directors reauthorized this stock repurchase program through January 2018. As of September 30, 2017, we had repurchased an aggregate of \$27.4 million of our outstanding common stock under this stock repurchase program.

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Item 6. Exhibits.

| Exhibit<br>Number | Description of Exhibit   |
|-------------------|--|
| 2.1               | <u>Agreement and Plan of Merger by and among SWS Group, Inc., Hilltop Holdings Inc. and Peruna LLC, dated as of March 31, 2014 (filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on April 1, 2014 (File No. 001-31987) and incorporated herein by reference).</u>   |
| 2.2               | <u>Purchase and Assumption Agreement—Whole Bank, All Deposits, dated as of September 13, 2013, by and among the Federal Deposit Insurance Corporation, receiver of First National Bank, Edinburg, Texas, PlainsCapital Bank and the Federal Deposit Insurance Corporation (filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on September 19, 2013 (File No. 001-31987) and incorporated herein by reference).</u> |
| 31.1*             | <u>Certification of Co-Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.</u>  |
| 31.2*             | <u>Certification of Co-Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.</u>  |
| 31.3*             | <u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.</u>   |
| 32.1*             | <u>Certification of Co-Principal Executive Officers and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| 101.INS*          | XBRL Instance Document   |
| 101.SCH*          | XBRL Taxonomy Extension Schema   |
| 101.CAL*          | XBRL Taxonomy Extension Calculation Linkbase   |
| 101.DEF*          | XBRL Taxonomy Extension Definition Linkbase  |
| 101.LAB*          | XBRL Taxonomy Extension Label Linkbase   |
| 101.PRE*          | XBRL Taxonomy Extension Presentation Linkbase  |

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\*Filed herewith.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HILLTOP HOLDINGS INC.

Date: October 26, 2017 By: /s/ William B. Furr  
William B. Furr  
Chief Financial Officer

(Principal Financial Officer and duly authorized officer)