Hilltop Holdings Inc.
Form 10-Q
July 27, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

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

Commission File Number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

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

200 Crescent Court, Suite 1330

Dallas, TX	75201
(Address of principal executive offices)	(Zip Code)

(214) 855-2177

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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

The number of shares of the registrant's common stock outstanding at July 27, 2016 was 98,503,240.

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HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2016

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	June 30, 2016	December 31, 2015
Assets		
Cash and due from banks	$ 583,984	$ 652,036
Federal funds sold	29,677	17,409
Securities purchased under agreements to resell	149,474	105,660
Assets segregated for regulatory purposes	120,214	158,613
Securities:		
Trading, at fair value	305,418	214,146
Available for sale, at fair value (amortized cost of $504,672 and $670,003, respectively)	517,784	673,706
Held to maturity, at amortized cost (fair value of $359,921 and $331,468, respectively)	354,443	332,022
	1,177,645	1,219,874
Loans held for sale	1,550,475	1,533,678
Non-covered loans, net of unearned income	5,472,446	5,220,040
Allowance for non-covered loan losses	(51,013)	(45,415)
Non-covered loans, net	5,421,433	5,174,625
Covered loans, net of allowance of $1,455 and $1,532, respectively	322,073	378,762
Broker-dealer and clearing organization receivables	2,257,480	1,362,499
Premises and equipment, net	189,511	200,618
FDIC indemnification asset	74,460	91,648
Covered other real estate owned	67,634	99,090
Other assets	832,344	565,813
Goodwill	251,808	251,808
Other intangible assets, net	49,690	54,868
Total assets	$ 13,077,902	$ 11,867,001
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$ 2,280,108	$ 2,235,436
Interest-bearing	4,846,705	4,717,247
Total deposits	7,126,813	6,952,683

Broker-dealer and clearing organization payables	2,111,994	1,338,305
Short-term borrowings	1,012,862	947,373
Securities sold, not yet purchased, at fair value	178,235	130,044
Notes payable	319,636	238,716
Junior subordinated debentures	67,012	67,012
Other liabilities	464,904	454,743
Total liabilities	11,281,456	10,128,876
Commitments and contingencies (see Notes 12 and 13)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, $0.01 par value, 125,000,000 shares authorized; 98,498,077 and 98,896,184 shares issued and outstanding, respectively	985	989
Additional paid-in capital	1,568,053	1,577,270
Accumulated other comprehensive income	8,782	2,629
Retained earnings	214,116	155,475
Deferred compensation employee stock trust, net	938	1,034
Employee stock trust (17,376 and 22,196 shares, at cost, respectively)	(347)	(443)
Total Hilltop stockholders' equity	1,792,527	1,736,954
Noncontrolling interests	3,919	1,171
Total stockholders' equity	1,796,446	1,738,125
Total liabilities and stockholders' equity	$ 13,077,902	$ 11,867,001

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest income:				
Loans, including fees	$ 98,468	$ 96,967	$ 190,001	$ 184,355
Securities borrowed	6,326	9,675	13,915	19,693
Securities:				
Taxable	6,834	6,227	13,201	13,276
Tax-exempt	1,537	1,557	3,174	3,298
Other	1,037	1,236	2,065	2,709
Total interest income	114,202	115,662	222,356	223,331
Interest expense:				
Deposits	4,037	3,900	7,876	8,215
Securities loaned	4,916	6,889	10,903	14,395
Short-term borrowings	1,392	1,143	2,477	2,167
Notes payable	2,618	2,289	5,200	2,958
Junior subordinated debentures	655	595	1,300	1,180
Other	187	179	363	357
Total interest expense	13,805	14,995	28,119	29,272
Net interest income	100,397	100,667	194,237	194,059
Provision for loan losses	28,876	158	32,283	2,845
Net interest income after provision for loan losses	71,521	100,509	161,954	191,214
Noninterest income:				
Net realized gains (losses) on securities	(46)	—	—	4,403
Net gains from sale of loans and other mortgage production income	167,012	147,175	294,309	267,720
Mortgage loan origination fees	25,797	20,958	44,610	35,547
Net insurance premiums earned	38,721	40,318	78,454	79,885
Securities commissions and fees	40,444	41,213	78,763	84,131
Investment and securities advisory fees and commissions	29,354	29,665	53,173	54,587
Bargain purchase gain	—	—	—	81,289
Other	44,723	22,071	74,071	46,684
Total noninterest income	346,005	301,400	623,380	654,246
Noninterest expense:				

Employees' compensation and benefits	217,346	200,291	400,001	382,795
Loss and loss adjustment expenses	37,211	41,241	59,170	60,101
Policy acquisition and other underwriting expenses	11,316	11,740	22,568	23,414
Occupancy and equipment, net	26,937	30,842	54,728	60,027
Other	74,555	69,203	156,087	141,456
Total noninterest expense	367,365	353,317	692,554	667,793
Income before income taxes	50,161	48,592	92,780	177,667
Income tax expense	18,439	18,137	32,862	33,557
Net income	31,722	30,455	59,918	144,110
Less: Net income attributable to noncontrolling interest	648	405	1,277	758
Income attributable to Hilltop	31,074	30,050	58,641	143,352
Dividends on preferred stock	—	428	—	1,854
Income applicable to Hilltop common stockholders	$ 31,074	$ 29,622	$ 58,641	$ 141,498
Earnings per common share:				
Basic	$ 0.32	$ 0.30	$ 0.60	$ 1.41
Diluted	$ 0.32	$ 0.30	$ 0.60	$ 1.41
Weighted average share information:				
Basic	98,457	99,486	98,305	99,613
Diluted	98,586	100,410	98,619	100,507

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	$ 31,722	$ 30,455	$ 59,918	$ 144,110
Other comprehensive income:				
Net unrealized gains (losses) on securities available for sale, net of tax of $1,034, $(3,829), $3,424 and $625, respectively	1,874	(6,855)	6,153	1,058
Reclassification adjustment for gains (losses) included in net income, net of tax of $16 and $(1,589), respectively	30	—	—	(2,814)
Comprehensive income	33,626	23,600	66,071	142,354
Less: comprehensive income attributable to noncontrolling interest	648	405	1,277	758
Comprehensive income applicable to Hilltop	$ 32,978	$ 23,195	$ 64,794	$ 141,596

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS’ EQUITY

(in thousands)

(Unaudited)

ed Stock	Common Stock		Additional Paid-in	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Deferred Compensation Employee Stock Trust, Net	Employee Stock Trust		Total Hilltop Stockholders’
Amount	Shares	Amount	Capital				Shares	Amount	Equity
$ 114,068	90,182	$ 902	$ 1,390,788	$ 651	$ (45,957)	$ —	—	$ —	$ 1,460,452
—	—	—	—	—	143,352	—	—	—	143,352
—	—	—	—	(1,756)	—	—	—	—	(1,756)
—	10,113	101	199,932	—	—	—	—	—	200,033
—	—	—	4,293	—	—	—	—	—	4,293
—	6	—	113	—	—	—	—	—	113
—	(12)	—	(40)	—	—	—	—	—	(40)
—	—	—	—	—	(1,854)	—	—	—	(1,854)
(114,068)	—	—	—	—	—	—	—	—	(114,068)
—	(774)	(8)	(12,431)	—	(4,532)	—	—	—	(16,971)
—	—	—	—	—	—	1,182	30	(590)	592
—	—	—	—	—	—	—	—	—	—

$ —	99,515	$ 995	$ 1,582,655	$ (1,105)	$ 91,009	$ 1,182	30	$ (590)	$ 1,674,146
$ —	98,896	$ 989	$ 1,577,270	$ 2,629	$ 155,475	$ 1,034	22	$ (443)	$ 1,736,954
—	—	—	—	—	58,641	—	—	—	58,641
—	—	—	—	6,153	—	—	—	—	6,153
—	500	5	3,845	—	—	—	—	—	3,850
—	—	—	4,768	—	—	—	—	—	4,768
—	12	—	217	—	—	—	—	—	217
—	(94)	(1)	(1,779)	—	—	—	—	—	(1,780)
—	(816)	(8)	(16,268)	—	—	—	—	—	(16,276)
—	—	—	—	—	—	(96)	(5)	96	—
—	—	—	—	—	—	—	—	—	—
$ —	98,498	$ 985	$ 1,568,053	$ 8,782	$ 214,116	$ 938	17	$ (347)	$ 1,792,527

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended June 30, 2016	2015
Operating Activities		
Net income	$ 59,918	$ 144,110
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	32,283	2,845
Depreciation, amortization and accretion, net	(26,686)	(36,306)
Net realized gains on securities	—	(4,403)
Bargain purchase gain	—	(81,289)
Deferred income taxes	2,421	(3,327)
Other, net	7,663	(2,810)
Net change in securities purchased under agreements to resell	(43,814)	(34,412)
Net change in assets segregated for regulatory purposes	38,399	69,529
Net change in trading securities	(91,273)	66,356
Net change in broker-dealer and clearing organization receivables	(796,440)	(660,121)
Net change in FDIC Indemnification Asset	17,344	28,882
Net change in other assets	(90,113)	(67,594)
Net change in broker-dealer and clearing organization payables	676,621	672,259
Net change in other liabilities	2,538	(14,521)
Proceeds from sale of mortgage servicing rights asset	7,586	—
Net gains from sales of loans	(294,309)	(267,720)
Loans originated for sale	(7,487,620)	(6,858,751)
Proceeds from loans sold	7,610,371	6,993,935
Net cash used in operating activities	(375,111)	(53,338)
Investing Activities		
Proceeds from maturities and principal reductions of securities held to maturity	104,160	23,509
Proceeds from sales, maturities and principal reductions of securities available for sale	250,911	548,280
Purchases of securities held to maturity	(126,880)	(146,433)
Purchases of securities available for sale	(86,798)	(16,725)
Net change in loans	(281,489)	(24,674)
Purchases of premises and equipment and other assets	(19,097)	(14,394)
Proceeds from sales of premises and equipment and other real estate owned	51,192	70,767
Proceeds from redemption of bank owned life insurance	—	822
	6,342	(14,313)

Net cash received (paid) for Federal Home Loan Bank and Federal Reserve Bank stock		
Net cash from acquisition	—	41,097
Net cash provided by (used in) investing activities	(101,659)	467,936
Financing Activities		
Net change in deposits	271,198	(774,068)
Net change in short-term borrowings	65,489	173,089
Proceeds from notes payable	132,460	150,078
Payments on notes payable	(51,458)	(35,970)
Redemption of preferred stock	—	(114,068)
Proceeds from issuance of common stock	3,850	—
Payments to repurchase common stock	—	(16,971)
Dividends paid on preferred stock	—	(3,280)
Net cash distributed from (to) noncontrolling interest	1,471	(426)
Taxes paid on employee stock awards netting activity	(1,765)	(40)
Other, net	(259)	(160)
Net cash provided by (used in) financing activities	420,986	(621,816)
Net change in cash and cash equivalents	(55,784)	(207,218)
Cash and cash equivalents, beginning of period	669,445	813,075
Cash and cash equivalents, end of period	$ 613,661	$ 605,857
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	$ 28,206	$ 27,662
Cash paid for income taxes, net of refunds	$ 28,685	$ 95,708
Supplemental Schedule of Non-Cash Activities		
Conversion of loans to other real estate owned	$ 11,615	$ 37,241
Common stock issued in acquisition	$ —	$ 200,626
Additions to mortgage servicing rights	$ 9,893	$ 12,096

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 provides its products and services through three primary operating subsidiaries, PlainsCapital Corporation (“PlainsCapital”), Hilltop Securities Holdings LLC (“Securities Holdings”) and National Lloyds Corporation (“NLC”). PlainsCapital is a financial holding company, headquartered in Dallas, Texas, 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, headquartered in Dallas, Texas, 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, headquartered in Waco, Texas, that provides, through its subsidiaries, fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the southern United States.

On January 1, 2015, Hilltop completed its acquisition of SWS Group, Inc. (“SWS”) in a stock and cash transaction (the "SWS Merger"), whereby SWS’s broker-dealer subsidiaries, Southwest Securities, Inc. and SWS Financial Services, Inc., became subsidiaries of Securities Holdings, and SWS’s banking subsidiary, Southwest Securities, FSB (“SWS FSB”), was merged into the Bank. On October 5, 2015, Southwest Securities, Inc. and SWS Financial Services, Inc. were renamed “Hilltop Securities Inc.” (“Hilltop Securities”) and “Hilltop Securities Independent Network Inc.” (“HTS Independent Network”), respectively.

On October 22, 2015, the Financial Industry Regulatory Authority (“FINRA”) granted approval to combine First Southwest Company, LLC (“FSC”) and Hilltop Securities, subject to customary conditions. FSC, Hilltop Securities and

HTS Independent Network operated as separate broker-dealers, under coordinated leadership from the date of the SWS Merger until January 22, 2016, when FSC was merged into Hilltop Securities to form a combined firm operating under the "Hilltop Securities" name. We use the term "Hilltop Broker-Dealers" to refer to FSC, Hilltop Securities and HTS Independent Network prior to January 22, 2016 and Hilltop Securities and HTS Independent Network after such date.

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, 2015 ("2015 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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

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

Hilltop has a 100% membership interest in Securities Holdings, which operates through its wholly-owned subsidiaries, Hilltop Securities, HTS Independent Network and First Southwest Holdings, LLC ("First Southwest"). Hilltop Securities is a broker-dealer registered with 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 First Southwest, is a registered investment advisor under the Investment Advisors Act of 1940. As discussed above, prior to January 22, 2016, Securities Holdings' subsidiaries also included FSC, First Southwest's principal subsidiary and formerly a broker-dealer registered with the SEC and FINRA and a member of the NYSE.

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. Additionally, during the preparation of the condensed consolidated financial statements for the period ended September 30, 2015, the Company determined that its previously reported unaudited consolidated statements of cash flows contained in the previously filed Quarterly Reports on Form 10-Q filed with SEC on May 6, 2015 and July 29, 2015 contained a classification error related to how certain acquired balances related to its acquisition of SWS were reflected. Management has evaluated the quantitative and qualitative impact of the classification error to previously issued unaudited consolidated statements of cash flows and concluded that the previously issued condensed consolidated financial statements were not materially misstated. However, in order to correctly present the cash flow statements, management has elected to revise the unaudited consolidated statements of cash flows for the three months ended March 31, 2015 as disclosed in the Company’s Quarterly Report on Form 10-Q filed with the SEC on April 28, 2016 and for the six months ended June 30, 2015 included herein. The correction had no impact on the Company’s financial condition or results of operations for the periods presented.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following table summarizes the revisions made to the Company's unaudited consolidated statements of cash flows for the noted periods (in thousands).

	Six Months Ended June 30, 2015	
	As Originally Reported	As Revised
Operating Activities		
Net change in broker-dealer and clearing organization receivables	$ (929,477)	$ (660,121)
Net change in broker-dealer and clearing organization payables	1,021,493	672,259
Net cash used in operating activities	26,540	(53,338)
Investing Activities		
Net change in loans	244,681	(24,674)
Net cash provided by investing activities	737,291	467,936
Financing Activities		
Net change in deposits	(1,123,301)	(774,068)
Net cash used in financing activities	(971,049)	(621,816)
Net change in cash and cash equivalents	(207,218)	(207,218)

2. Acquisition

On January 1, 2015, Hilltop completed its acquisition of SWS in a stock and cash transaction, whereby each outstanding share of SWS common stock was converted into the right to receive 0.2496 shares of Hilltop common stock and $1.94 in cash, equating to $6.92 per share based on Hilltop's closing price on December 31, 2014 and resulting in an aggregate purchase price of $349.1 million, consisting of 10.1 million shares of common stock, $78.2 million in cash and $70.3 million associated with Hilltop's existing investment in SWS common stock. The operations of SWS are included in the Company's operating results beginning January 1, 2015. Such operating results include a bargain purchase gain of $81.3 million and are not necessarily indicative of future operating results. SWS's results of operations prior to the acquisition date are not included in the Company’s consolidated operating results.

The SWS Merger was accounted for using the acquisition method of accounting, and accordingly, purchased assets, including identifiable intangible assets, and assumed liabilities were recorded at their respective acquisition date fair values. The components of the consideration paid are shown in the following table (in thousands).

Fair value of consideration paid:	
Common stock issued	$ 200,626
Cash	78,217
Fair value of Hilltop’s existing investment in SWS	70,282
Total consideration paid	$ 349,125

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The resulting fair values of the identifiable assets acquired, and liabilities assumed, in the SWS Merger at January 1, 2015 are summarized in the following table (in thousands).

Cash and due from banks	$ 119,314
Federal funds sold and securities purchased under agreements to resell	44,741
Assets segregated for regulatory purposes	181,610
Securities	707,476
Non-covered loans, net	863,819
Broker-dealer and clearing organization receivables	1,221,793
Other assets	159,906
Total identifiable assets acquired	3,298,659
Deposits	(1,287,509)
Broker-dealer and clearing organization payables	(1,109,978)
Short-term borrowings	(164,240)
Securities sold, not yet purchased, at fair value	(140,409)
Notes payable	(76,643)
Other liabilities	(89,466)
Total liabilities assumed	(2,868,245)
Bargain purchase gain	(81,289)
	349,125
Less Hilltop existing investment in SWS	(70,282)
Net identifiable assets acquired	$ 278,843

The bargain purchase gain represents the excess of the estimated fair value of the underlying net tangible assets and intangible assets over the merger consideration. The SWS Merger was a tax-free reorganization under Section 368(a) of the Internal Revenue Code; therefore, no income taxes were recorded in connection with the bargain purchase gain. The Company used significant estimates and assumptions to value certain identifiable assets acquired and liabilities assumed. The bargain purchase gain was primarily driven by the Company’s ability to realize acquired deferred tax assets through its consolidated core earnings and the decline in the price of the Company’s common stock between the date the fixed conversion ratio was agreed upon and the closing date.

Included within the fair value of other assets in the table above are identifiable intangible assets recorded in connection with the SWS Merger. The allocation to intangible assets is as follows (dollars in thousands).

	Estimated Useful Life (Years)	Gross Intangible Assets
Customer relationships	14	$ 7,300
Core deposits	4	160
		$ 7,460

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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	Loans, excluding PCI Loans	PCI Loans	Total Loans
Commercial and industrial	$ 178,603	$ 9,850	$ 188,453
Real estate	324,477	62,218	386,695
Construction and land development	14,708	1,391	16,099
Consumer	3,216	—	3,216
Broker-dealer (1)	269,356	—	269,356
Total	$ 790,360	$ 73,459	$ 863,819

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

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

Contractually required principal and interest payments	$ 120,078
Nonaccretable difference	32,040
Cash flows expected to be collected	88,038
Accretable difference	14,579
Fair value of loans acquired with a deterioration of credit quality	$ 73,459

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

Contractually required principal and interest payments	$ 901,672
Contractual cash flows not expected to be collected	39,721
Fair value at acquisition	790,360

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.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

Fair Value Option

The Company has elected to measure substantially all of PrimeLending's mortgage loans held for sale and retained mortgage servicing rights ("MSR") asset at fair value, under the provisions of the Fair Value Option. The Company elected to apply the provisions of the Fair Value Option to these items so that it would have the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. At June 30, 2016 and December 31, 2015, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was $1.49 billion and $1.46 billion, respectively, and the unpaid principal balance of those loans was $1.43 billion and $1.41 billion, respectively. The interest component of fair value is reported as interest income on loans in the accompanying consolidated statements of operations.

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

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

June 30, 2016	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	$ 1,288	$ 304,129	$ 1	$ 305,418
Available for sale securities	18,863	498,921	—	517,784
Loans held for sale	—	1,446,155	45,645	1,491,800

Derivative assets	—	114,580	—	114,580
MSR asset	—	—	33,491	33,491
Securities sold, not yet purchased	90,758	87,477	—	178,235
Derivative liabilities	—	67,417	—	67,417

December 31, 2015	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	$ 21,807	$ 192,338	$ 1	$ 214,146
Available for sale securities	17,409	656,297	—	673,706
Loans held for sale	—	1,434,955	25,880	1,460,835
Derivative assets	—	35,676	—	35,676
MSR asset	—	—	52,285	52,285
Securities sold, not yet purchased	27,648	102,396	—	130,044
Derivative liabilities	—	5,426	—	5,426

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	Balance at Beginning of Period	Purchases/ Additions	Sales/ Reductions	Total Gains or Losses (Realized or Unrealized) Included in Net Income	Included in Other Comprehensive Income (Loss)	Balance at End of Period
Three months ended June 30, 2016						
Trading securities	$ 1	$ —	$ —	$ —	$ —	$ 1
Loans held for sale	40,545	19,803	(10,894)	(3,809)	—	45,645
MSR asset	39,863	8,254	(7,586)	(7,040)	—	33,491
Total	$ 80,409	$ 28,057	$ (18,480)	$ (10,849)	$ —	$ 79,137
Six months ended June 30, 2016						
Trading securities	$ 1	$ —	$ —	$ —	$ —	$ 1
Loans held for sale	25,880	43,039	(15,131)	(8,143)	—	45,645
MSR asset	52,285	9,893	(7,586)	(21,101)	—	33,491
Total	$ 78,166	$ 52,932	$ (22,717)	$ (29,244)	$ —	$ 79,137
Three months ended June 30, 2015						
Available for sale securities	$ 5,932	$ —	$ (3,397)	$ (2,519)	$ —	$ 16
Loans held for sale	19,495	17,473	(9,453)	(8,392)	—	19,123
MSR asset	31,648	9,406	—	3,931	—	44,985
Total	$ 57,075	$ 26,879	$ (12,850)	$ (6,980)	$ —	$ 64,124
Six months ended June 30, 2015						
Available for sale securities	$ —	$ 7,301	$ (3,397)	$ (3,888)	$ —	$ 16
Loans held for sale	9,017	28,609	(9,724)	(8,779)	—	19,123
MSR asset	36,155	12,096	—	(3,266)	—	44,985
Total	$ 45,172	$ 48,006	$ (13,121)	$ (15,933)	$ —	$ 64,124

All net realized and unrealized gains (losses) in the table above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at June 30, 2016.

For Level 3 financial instruments measured at fair value on a recurring basis at June 30, 2016, the significant unobservable inputs used in the fair value measurements were as follows.

Financial instrument	Valuation Technique	Unobservable Input	Range (Weighted-Average)
Trading securities	Discounted cash flow	Discount rate	8 - 17 % (10 %)
Loans held for sale	Discounted cash flow / Market comparable	Projected price	86 - 96 % (96 %)
MSR asset	Discounted cash flow	Constant prepayment rate	20.67 %
		Discount rate	10.85 %

Trading securities include corporate debt securities that are valued using a discounted cash flow model with observable market data; however, due to the distressed nature of these bonds, the Company has determined that these securities should be valued as a Level 3 financial instrument.

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, or unobservable, inputs. The fair value of such loans is generally based upon estimates of

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expected cash flows using unobservable inputs, including listing prices of comparable assets, uncorroborated expert opinions, and/or management's knowledge of underlying collateral.

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

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

The following tables present the changes in fair value of instruments that are reported at fair value under the Fair Value Option (in thousands).

	Three Months Ended June 30, 2016			Three Months Ended June 30, 2015		
	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value
Loans held for sale	$ 15,483	$ —	$ 15,483	$ (9,063)	$ —	$ (9,063)
MSR asset	(7,040)	—	(7,040)	3,931	—	3,931

	Six Months Ended June 30, 2016			Six Months Ended June 30, 2015		
	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value
Loans held for sale	$ 15,930	$ —	$ 15,930	$ (15,758)	$ —	$ (15,758)
MSR asset	(21,101)	—	(21,101)	(3,266)	—	(3,266)

The Company also determines the fair value of certain assets and liabilities on a non-recurring basis. In particular, the fair value of all of the assets acquired and liabilities assumed in the SWS Merger was determined at the acquisition date. 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. 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 PlainsCapital (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 SWS Merger, respectively (collectively, the “Bank Transactions”). Substantially all PCI loans acquired in the FNB Transaction are covered by FDIC loss-share agreements. The fair value of PCI loans was determined using Level 3 inputs, including estimates of expected cash flows that incorporated significant unobservable inputs regarding default rates, loss severity rates assuming default, prepayment speeds on acquired loans accounted for in pools (“Pooled Loans”), and estimated collateral values.

At June 30, 2016, estimates for these significant unobservable inputs were as follows.

	PCI Loans					
	PlainsCapital Merger		FNB Transaction		SWS Merger	
Weighted average default rate	60	%	54	%	51	%
Weighted average loss severity rate	53	%	33	%	30	%
Weighted average prepayment speed	0	%	7	%	0	%

At June 30, 2016, the resulting weighted average expected loss on PCI loans associated with the PlainsCapital Merger, FNB Transaction and SWS Merger was 32%, 18% and 15%, respectively.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

Other Real Estate Owned — The Company determines fair value primarily using independent appraisals of other real estate owned (“OREO”) properties. The resulting fair value measurements are classified as Level 2 or Level 3 inputs, depending upon the extent to which unobservable inputs determine the fair value measurement. The Company considers a number of factors in determining the extent to which specific fair value measurements utilize unobservable inputs, including, but not limited to, the inherent subjectivity in appraisals, the length of time elapsed since the receipt of independent market price or appraised value, and current market conditions. At June 30, 2016, the most significant unobservable input used in the determination of fair value of OREO was a discount to independent appraisals for estimated holding periods of OREO properties. Level 3 inputs were used to determine the initial fair value at acquisition of a large group of smaller balance properties that were acquired in the FNB Transaction. In the FNB Transaction, the Bank acquired OREO of $135.2 million, all of which is covered by FDIC loss-share agreements. At June 30, 2016 and December 31, 2015, the estimated fair value of covered OREO was $67.6 million and $99.1 million, respectively, and the underlying fair value measurements utilized Level 2 and Level 3 inputs. The fair value of non-covered OREO at June 30, 2016 and December 31, 2015 was $2.7 million and $0.4 million, respectively, and is included in other assets within the consolidated balance sheets. During the reported periods, all fair value measurements for non-covered OREO subsequent to initial recognition utilized Level 2 inputs.

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

June 30, 2016	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value	Total Gains (Losses) for the Three Months Ended June 30, 2016	2015	Total Gains (Losses) for the Six Months Ended June 30, 2016	2015
Non-covered impaired loans	$ —	$ —	$ 73,907	$ 73,907	$ 168	$ (578)	$ 135	$ (229)

Covered impaired loans	—	—	90,386	90,386	(242)	431	90	3,649
Non-covered other real estate owned	—	147	—	147	(12)	—	(12)	(28)
Covered other real estate owned	—	27,867	—	27,867	(1,967)	(3,108)	(11,732)	(4,058)

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. The methods for determining estimated fair value for financial assets and liabilities is described in detail in Note 3 to the consolidated financial statements included in the Company’s 2015 Form 10-K.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

		Estimated Fair Value			
June 30, 2016	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Financial assets:					
Cash and cash equivalents	$ 613,661	$ 613,661	$ —	$ —	$ 613,661
Securities purchased under agreements to resell	149,474	—	149,474	—	149,474
Assets segregated for regulatory purposes	120,214	120,214	—	—	120,214
Held to maturity securities	354,443	—	359,921	—	359,921
Loans held for sale	58,675	—	58,675	—	58,675
Non-covered loans, net	5,421,433	—	504,427	4,970,521	5,474,948
Covered loans, net	322,073	—	—	449,940	449,940
Broker-dealer and clearing organization receivables	2,257,480	—	2,257,480	—	2,257,480
FDIC indemnification asset	74,460	—	—	71,689	71,689
Other assets	59,971	—	54,372	5,599	59,971
Financial liabilities:					
Deposits	7,126,813	—	7,128,932	—	7,128,932
Broker-dealer and clearing organization payables	2,111,994	—	2,111,994	—	2,111,994
Short-term borrowings	1,012,862	—	1,012,862	—	1,012,862
Debt	386,648	—	380,325	—	380,325
Other liabilities	3,609	—	3,609	—	3,609

		Estimated Fair Value			
December 31, 2015	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total

Financial assets:					
Cash and cash equivalents	$ 669,445	$ 669,445	$ —	$ —	$ 669,445
Securities purchased under agreements to resell	105,660	—	105,660	—	105,660
Assets segregated for regulatory purposes	158,613	158,613	—	—	158,613
Held to maturity securities	332,022	—	331,468	—	331,468
Loans held for sale	72,843	—	72,843	—	72,843
Non-covered loans, net	5,174,625	—	602,968	4,600,406	5,203,374
Covered loans, net	378,762	—	—	527,201	527,201
Broker-dealer and clearing organization receivables	1,362,499	—	1,362,499	—	1,362,499
FDIC indemnification asset	91,648	—	—	91,648	91,648
Other assets	68,786	—	53,214	15,572	68,786
Financial liabilities:					
Deposits	6,952,683	—	6,955,919	—	6,955,919
Broker-dealer and clearing organization payables	1,338,305	—	1,338,305	—	1,338,305
Short-term borrowings	947,373	—	947,373	—	947,373
Debt	305,728	—	299,257	—	299,257
Other liabilities	3,699	—	3,699	—	3,699

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

4. Securities

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

	June 30, 2016	December 31, 2015
U.S. Treasury securities	$ —	$ 20,481
U.S. government agencies:		
Bonds	61,967	36,244
Residential mortgage-backed securities	4,897	12,505
Commercial mortgage-backed securities	17,141	19,280
Collateralized mortgage obligations	3,744	264
Corporate debt securities	57,805	34,735
States and political subdivisions	99,918	58,588
Unit investment trusts	52,778	18,400
Private-label securitized product	5,574	12,324
Other	1,594	1,325
Totals	$ 305,418	$ 214,146

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 obligation 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 $178.2 million and $130.0 million at June 30, 2016 and December 31, 2015, respectively.

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

	Available for Sale			
June 30, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 44,387	$ 572	$ —	$ 44,959
U.S. government agencies:				
Bonds	148,563	1,840	—	150,403
Residential mortgage-backed securities	29,809	1,121	—	30,930
Commercial mortgage-backed securities	9,007	419	(2)	9,424
Collateralized mortgage obligations	62,242	81	(608)	61,715
Corporate debt securities	86,260	5,980	—	92,240
States and political subdivisions	105,360	3,366	(2)	108,724
Commercial mortgage-backed securities	499	27	—	526
Equity securities	18,545	1,042	(724)	18,863
Totals	$ 504,672	$ 14,448	$ (1,336)	$ 517,784

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

	Available for Sale			
December 31, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 44,430	$ 206	$ (33)	$ 44,603
U.S. government agencies:				
Bonds	297,448	1,135	(1,947)	296,636
Residential mortgage-backed securities	34,864	1,008	(19)	35,853
Commercial mortgage-backed securities	9,174	35	(2)	9,207
Collateralized mortgage obligations	54,297	48	(1,644)	52,701
Corporate debt securities	94,877	3,399	(326)	97,950
States and political subdivisions	116,246	2,581	(102)	118,725
Commercial mortgage-backed securities	498	33	—	531
Equity securities	18,169	574	(1,243)	17,500
Totals	$ 670,003	$ 9,019	$ (5,316)	$ 673,706

	Held to Maturity			
June 30, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ —	$ —	$ —	$ —
U.S. government agencies:				
Bonds	34,311	108	(37)	34,382
Residential mortgage-backed securities	22,216	740	—	22,956
Commercial mortgage-backed securities	18,498	1,038	(10)	19,526
Collateralized mortgage obligations	251,777	3,194	—	254,971
States and political subdivisions	27,641	446	(1)	28,086
Totals	$ 354,443	$ 5,526	$ (48)	$ 359,921

	Held to Maturity			
December 31, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 25,146	$ —	$ (30)	$ 25,116
U.S. government agencies:				

Bonds	69,379	145	(372)	69,152
Residential mortgage-backed securities	23,735	311	—	24,046
Commercial mortgage-backed securities	18,658	27	(92)	18,593
Collateralized mortgage obligations	167,541	302	(970)	166,873
States and political subdivisions	27,563	168	(43)	27,688
Totals	$ 332,022	$ 953	$ (1,507)	$ 331,468

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	June 30, 2016			December 31, 2015		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Available for sale						
U.S. treasury securities:						
Unrealized loss for less than twelve months	—	$ —	$ —	8	$ 33,791	$ 33
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	8	33,791	33
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	—	—	—	7	148,327	896
Unrealized loss for twelve months or longer	—	—	—	3	44,321	1,051
	—	—	—	10	192,648	1,947
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	—	—	—	3	3,407	5
Unrealized loss for twelve months or longer	1	982	—	1	982	14
	1	982	—	4	4,389	19
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	—	—	—	1	1,611	2
Unrealized loss for twelve months or longer	1	1,598	2	—	—	—
	1	1,598	2	1	1,611	2
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	1	8,037	47	2	1,590	4

Unrealized loss for twelve months or longer	8	32,296	561	8	42,399	1,640
	9	40,333	608	10	43,989	1,644
Corporate debt securities:						
Unrealized loss for less than twelve months	—	—	—	16	16,635	277
Unrealized loss for twelve months or longer	—	—	—	1	1,949	49
	—	—	—	17	18,584	326
States and political subdivisions:						
Unrealized loss for less than twelve months	3	696	1	2	3,018	9
Unrealized loss for twelve months or longer	1	459	1	35	24,423	93
	4	1,155	2	37	27,441	102
Equity securities:						
Unrealized loss for less than twelve months	1	4,326	139	2	8,949	909
Unrealized loss for twelve months or longer	2	6,744	585	1	1,927	334
	3	11,070	724	3	10,876	1,243
Total available for sale:						
Unrealized loss for less than twelve months	5	13,059	187	41	217,328	2,135
Unrealized loss for twelve months or longer	13	42,079	1,149	49	116,001	3,181
	18	$ 55,138	$ 1,336	90	$ 333,329	$ 5,316

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

	June 30, 2016 Number of Securities	Fair Value	Unrealized Losses	December 31, 2015 Number of Securities	Fair Value	Unrealized Losses
Held to maturity						
U.S. treasury securities:						
Unrealized loss for less than twelve months	—	$ —	$ —	1	$ 25,115	$ 30
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	1	25,115	30
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	3	15,361	37	6	46,607	372
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	3	15,361	37	6	46,607	372
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	1	1,410	10	7	16,098	92
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	1	1,410	10	7	16,098	92
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	—	—	—	10	127,393	970
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	10	127,393	970
States and political subdivisions:						
Unrealized loss for less than twelve months	5	1,781	1	18	7,900	35
Unrealized loss for twelve months or longer	—	—	—	1	2,664	8
	5	1,781	1	19	10,564	43
Total held to maturity:						
	9	18,552	48	42	223,113	1,499

Unrealized loss for less than twelve months						
Unrealized loss for twelve months or longer	—	—	—	1	2,664	8
	9	$ 18,552	$ 48	43	$ 225,777	$ 1,507

During the three and six months ended June 30, 2016 and 2015, the Company did not record any other-than-temporary impairments ("OTTI"). Factors considered in the Company's analysis include the reasons for the unrealized loss position, the severity and duration of the unrealized loss position, credit worthiness, and forecasted performance of the investee. While some of the securities held in the investment portfolio have decreased in value since the date of acquisition, the severity of loss and the duration of the loss position are not believed to be significant enough to warrant recording any OTTI of the securities. The Company does not intend, nor does the Company believe that is it likely that the Company will be required, to sell these securities before the recovery of the cost basis.

Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The amortized cost and fair value of securities, excluding trading and available for sale equity securities, at June 30, 2016 are shown by contractual maturity below (in thousands).

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 119,102	$ 119,377	$ 1,279	$ 1,280
Due after one year through five years	83,931	87,611	9,521	9,664
Due after five years through ten years	61,188	66,469	18,577	18,584
Due after ten years	120,349	122,869	32,575	32,940
	384,570	396,326	61,952	62,468
Residential mortgage-backed securities	29,809	30,930	22,216	22,956
Collateralized mortgage obligations	62,242	61,715	251,777	254,971
Commercial mortgage-backed securities	9,506	9,950	18,498	19,526
	$ 486,127	$ 498,921	$ 354,443	$ 359,921

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

The Company realized net gains of $29.5 million and net losses of $0.6 million from its trading securities portfolio during the three months ended June 30, 2016 and 2015, respectively, and net gains from its trading securities portfolio of $40.8 million and $2.8 million during the six months ended June 30, 2016 and 2015, respectively, which are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of $681.1 million and $789.9 million (with a fair value of $692.3 million and $790.2 million, respectively) at June 30, 2016 and December 31, 2015, respectively, were pledged to secure public and trust deposits, federal funds purchased and securities sold under agreements to repurchase, and for other purposes as required or permitted by law. Substantially all of these pledged securities were included in our available for sale and held to maturity securities portfolios at June 30, 2016 and December 31, 2015.

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

At both June 30, 2016 and December 31, 2015, NLC had investments on deposit in custody for various state insurance departments with carrying values of $9.2 million.

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

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

	June 30,	December 31,

	2016	2015
Commercial and industrial	$ 1,638,119	$ 1,552,805
Real estate	2,594,835	2,313,239
Construction and land development	693,451	705,356
Consumer	41,614	45,672
Broker-dealer (1)	504,427	602,968
	5,472,446	5,220,040
Allowance for non-covered loan losses	(51,013)	(45,415)
Total non-covered loans, net of allowance	$ 5,421,433	$ 5,174,625

(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 the non-covered PCI loans (in thousands).

	June 30, 2016	December 31, 2015
Carrying amount	$ 61,400	$ 72,054
Outstanding balance	79,434	92,682

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	$ 16,168	$ 24,477	$ 17,744	$ 12,814
Additions	—	—	—	14,579
Reclassifications from (to) nonaccretable difference, net(1)	1,604	4,660	3,947	4,940
Disposals of loans	—	(2,329)	—	(2,778)
Accretion	(2,543)	(4,640)	(6,462)	(7,387)
Balance, end of period	$ 15,229	$ 22,168	$ 15,229	$ 22,168

(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 nonaccrual and expected cash flows are no longer predictable and the accretable yield is eliminated.

The remaining nonaccretable difference for non-covered PCI loans was $24.0 million and $28.5 million at June 30, 2016 and December 31, 2015, respectively.

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

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

June 30, 2016	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 27,426	$ 3,200	$ 9,254	$ 12,454	$ 1,053
Unsecured	2,500	—	—	—	—
Real estate:					
Secured by commercial properties	43,708	12,338	21,404	33,742	1,970
Secured by residential properties	14,252	5,101	5,886	10,987	176
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	6,552	3,202	639	3,841	114
Consumer	3,593	365	11	376	9
Broker-dealer	—	—	—	—	—
	98,031	24,206	37,194	61,400	3,322
Non-PCI					
Commercial and industrial:					
Secured	21,551	3,851	8,668	12,519	2,409
Unsecured	178	47	—	47	—
Real estate:					
Secured by commercial properties	2,312	2,100	—	2,100	—
Secured by residential properties	1,080	713	—	713	—
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	139	139	—	139	—
Consumer	62	61	—	61	—
Broker-dealer	—	—	—	—	—
	25,322	6,911	8,668	15,579	2,409
	$ 123,353	$ 31,117	$ 45,862	$ 76,979	$ 5,731

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December 31, 2015	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 32,597	$ 5,520	$ 7,830	$ 13,350	$ 1,341
Unsecured	2,572	—	—	—	—
Real estate:					
Secured by commercial properties	57,607	15,914	25,214	41,128	2,756
Secured by residential properties	15,278	8,957	2,690	11,647	175
Construction and land development:					
Residential construction loans	395	—	221	221	8
Commercial construction loans and land development	7,929	3,283	1,646	4,929	174
Consumer	4,162	734	45	779	32
Broker-dealer	—	—	—	—	—
	120,540	34,408	37,646	72,054	4,486
Non-PCI					
Commercial and industrial:					
Secured	21,222	6,736	6,017	12,753	1,380
Unsecured	224	47	—	47	—
Real estate:					
Secured by commercial properties	436	390	—	390	—
Secured by residential properties	1,229	918	—	918	—
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	131	114	—	114	—
Consumer	—	1	—	1	—
Broker-dealer	—	—	—	—	—
	23,242	8,206	6,017	14,223	1,380
	$ 143,782	$ 42,614	$ 43,663	$ 86,277	$ 5,866

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Commercial and industrial:				
Secured	$ 25,590	$ 36,525	$ 25,538	$ 29,721
Unsecured	41	35	47	115
Real estate:				
Secured by commercial properties	37,533	62,439	38,680	42,205
Secured by residential properties	12,092	18,553	12,133	9,321
Construction and land development:				
Residential construction loans	—	292	111	176
Commercial construction loans and land development	4,090	7,942	4,512	7,755
Consumer	483	1,357	609	1,652
Broker-dealer	—	—	—	—
	$ 79,829	$ 127,143	$ 81,630	$ 90,945

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(Unaudited)

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

	June 30, 2016	December 31, 2015
Commercial and industrial:		
Secured	$ 18,366	$ 17,717
Unsecured	46	47
Real estate:		
Secured by commercial properties	2,100	4,597
Secured by residential properties	796	999
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	139	114
Consumer	61	7
Broker-dealer	—	—
	$ 21,508	$ 23,481

At June 30, 2016 and December 31, 2015, non-covered non-accrual loans included non-covered PCI loans of $5.9 million and $9.3 million, respectively, for which discount accretion has been suspended because the extent and timing of cash flows from these non-covered PCI loans can no longer be reasonably estimated. In addition to the non-covered non-accrual loans in the table above, $1.9 million and $1.6 million of real estate loans secured by residential properties and classified as held for sale were in non-accrual status at June 30, 2016 and December 31, 2015, respectively.

Interest income, including recoveries and cash payments, recorded on non-covered impaired loans was $0.1 million and $1.8 million during the three months ended June 30, 2016 and 2015, respectively, and $0.2 million and $2.4 million during the six months ended June 30, 2016 and 2015, 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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The outstanding balance of TDRs granted during the six months ended June 30, 2016 is shown in the following table (in thousands). There were no TDRs granted during the three months ended June 30, 2016 and 2015. The TDR granted during the three months ended March 31, 2015 was paid off as of June 30, 2015. At June 30, 2016 and December 31, 2015, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

	Recorded Investment in Loans Modified by			
Six months ended June 30, 2016	A/B Note	Interest Rate Adjustment	Payment Term Extension	Total Modification
Commercial and industrial:				
Secured	$ —	$ —	$ 950	$ 950
Unsecured	—	—	—	—
Real estate:				
Secured by commercial properties	—	—	—	—
Secured by residential properties	—	—	—	—
Construction and land development:				
Residential construction loans	—	—	—	—
Commercial construction loans and land development	—	—	—	—
Consumer	—	—	—	—
Broker-dealer	—	—	—	—
	$ —	$ —	$ 950	$ 950

The following table presents information regarding TDRs granted during the twelve months preceding June 30, 2016 for which a payment was at least 30 days past due in the three and six months ended June 30, 2016, respectively (dollars in thousands). There were no TDRs granted during the twelve months preceding June 30, 2015 for which a payment was at least 30 days past due in the three and six months ended June 30, 2015.

	Number of Loans	Recorded Investment
Commercial and industrial:		
Secured	2	$ 1,022
Unsecured	—	—
Real estate:		

Secured by commercial properties	1	995
Secured by residential properties	—	—
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	—	—
Consumer	—	—
Broker-dealer	—	—
	3	$ 2,017

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

June 30, 2016	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non-PCI) Past Due 90 Days or More
Commercial and industrial:								
Secured	$ 5,727	$ 1,831	$ 6,427	$ 13,985	$ 1,513,375	$ 12,454	$ 1,539,814	$ 347
Unsecured	200	254	—	454	97,851	—	98,305	—
Real estate:								
Secured by commercial properties	1,882	268	1,867	4,017	1,759,228	33,742	1,796,987	—
Secured by residential properties	635	1	336	972	785,889	10,987	797,848	—
Construction and land development:								
Residential construction loans	—	—	—	—	96,755	—	96,755	—
Commercial construction loans and land development	21	188	—	209	592,646	3,841	596,696	—
Consumer	251	5	6	262	40,976	376	41,614	6
Broker-dealer	—	—	—	—	504,427	—	504,427	—
	$ 8,716	$ 2,547	$ 8,636	$ 19,899	$ 5,391,147	$ 61,400	$ 5,472,446	$ 353

	Loans Past Due	Loans Past Due	Loans Past Due	Total	Current	PCI	Total	Accruing Loans (Non-PCI) Past Due

December 31, 2015	30-59 Days	60-89 Days	90 Days or More	Past Due Loans	Loans	Loans	Loans	90 Days or Mo
Commercial and industrial:								
Secured	$ 14,869	$ 3,960	$ 8,414	$ 27,243	$ 1,406,537	$ 13,350	$ 1,447,130	$ 12
Unsecured	18	1	—	19	105,656	—	105,675	—
Real estate:								
Secured by commercial properties	1,008	964	293	2,265	1,528,084	41,128	1,571,477	—
Secured by residential properties	726	35	336	1,097	729,018	11,647	741,762	—
Construction and land development:								
Residential construction loans	343	—	—	343	103,819	221	104,383	—
Commercial construction loans and land development	733	1,845	114	2,692	593,352	4,929	600,973	—
Consumer	359	17	—	376	44,517	779	45,672	—
Broker-dealer	—	—	—	—	602,968	—	602,968	—
	$ 18,056	$ 6,822	$ 9,157	$ 34,035	$ 5,113,951	$ 72,054	$ 5,220,040	$ 12

In addition to the non-covered loans shown in the table above, $49.7 million and $50.8 million of loans included in loans held for sale (with an unpaid principal balance of $50.2 million and $51.1 million, respectively) were 90 days past due and accruing interest at June 30, 2016 and December 31, 2015, respectively. These loans are guaranteed by U.S. government agencies and include loans that are subject to repurchase, or have been repurchased, by PrimeLending.

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

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

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

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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).

June 30, 2016	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 1,448,023	$ 12,676	$ 66,661	$ 12,454	$ 1,539,814
Unsecured	98,138	—	167	—	98,305
Real estate:					
Secured by commercial properties	1,753,236	—	10,009	33,742	1,796,987
Secured by residential properties	782,779	—	4,082	10,987	797,848
Construction and land development:					
Residential construction loans	96,755	—	—	—	96,755
Commercial construction loans and land development	591,595	—	1,260	3,841	596,696
Consumer	41,163	—	75	376	41,614
Broker-dealer	504,427	—	—	—	504,427
	$ 5,316,116	$ 12,676	$ 82,254	$ 61,400	$ 5,472,446

December 31, 2015	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 1,372,671	$ —	$ 61,109	$ 13,350	$ 1,447,130
Unsecured	105,569	—	106	—	105,675
Real estate:					
Secured by commercial properties	1,517,049	1,536	11,764	41,128	1,571,477
Secured by residential properties	724,701	—	5,414	11,647	741,762
Construction and land development:					
Residential construction loans	104,162	—	—	221	104,383
Commercial construction loans and land development	594,614	—	1,430	4,929	600,973
Consumer	44,736	35	122	779	45,672
Broker-dealer	602,968	—	—	—	602,968
	$ 5,066,470	$ 1,571	$ 79,945	$ 72,054	$ 5,220,040

Allowance for Loan Losses

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

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Hilltop Holdings Inc. and Subsidiaries

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(Unaudited)

Allowance for Loan and Lease Losses and the Receivables and Contingencies Topics of the ASC is described in detail in Note 5 to the consolidated financial statements included in the Company's 2015 Form 10-K.

During the three months ended June 30, 2016, the Bank discovered irregularities in connection with a single 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, representing the entire outstanding principal balance of the loan. Changes in the allowance for non-covered loan losses, distributed by portfolio segment, are shown below (in thousands).

Three Months Ended June 30, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Balance, beginning of period	$ 20,169	$ 22,272	$ 5,561	$ 334	$ 114	$ 48,450
Provision charged to (recapture from) operations	25,503	2,216	727	(16)	263	28,693
Loans charged off	(25,433)	(1,298)	—	(37)	1	(26,767)
Recoveries on charged off loans	481	112	—	44	—	637
Balance, end of period	$ 20,720	$ 23,302	$ 6,288	$ 325	$ 378	$ 51,013

Six Months Ended June 30, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Balance, beginning of period	$ 19,845	$ 18,983	$ 6,064	$ 314	$ 209	$ 45,415
Provision charged to operations	26,520	5,448	224	16	170	32,378
Loans charged off	(26,783)	(1,298)	—	(89)	(1)	(28,171)
Recoveries on charged off loans	1,138	169	—	84	—	1,391
Balance, end of period	$ 20,720	$ 23,302	$ 6,288	$ 325	$ 378	$ 51,013

Three Months Ended June 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Balance, beginning of period	$ 20,234	$ 12,704	$ 5,842	$ 176	$ 409	$ 39,365
Provision charged to (recapture from) operations	(2,296)	1,863	1,003	163	(146)	587
Loans charged off	(678)	(92)	—	(146)	—	(916)
Recoveries on charged off loans	1,248	90	—	28	82	1,448
Balance, end of period	$ 18,508	$ 14,565	$ 6,845	$ 221	$ 345	$ 40,484

Six Months Ended June 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Balance, beginning of period	$ 18,833	$ 11,131	$ 6,450	$ 461	$ 166	$ 37,041
Provision charged to (recapture from) operations	(625)	3,669	395	(113)	55	3,381
Loans charged off	(1,620)	(369)	—	(180)	—	(2,169)
Recoveries on charged off loans	1,920	134	—	53	124	2,231
Balance, end of period	$ 18,508	$ 14,565	$ 6,845	$ 221	$ 345	$ 40,484

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

June 30, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	$ 11,287	$ 1,531	$ —	$ —	$ —	$ 12,818
Loans collectively evaluated for impairment	1,614,378	2,548,575	689,610	41,238	504,427	5,398,228
PCI Loans	12,454	44,729	3,841	376	—	61,400
	$ 1,638,119	$ 2,594,835	$ 693,451	$ 41,614	$ 504,427	$ 5,472,446

December 31, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	$ 11,354	$ 97	$ —	$ —	$ —	$ 11,451
Loans collectively evaluated for impairment	1,528,101	2,260,367	700,206	44,893	602,968	5,136,535
PCI Loans	13,350	52,775	5,150	779	—	72,054
	$ 1,552,805	$ 2,313,239	$ 705,356	$ 45,672	$ 602,968	$ 5,220,040

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

June 30, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	$ 2,409	$ —	$ —	$ —	$ —	$ 2,409
Loans collectively evaluated for impairment	17,258	21,156	6,174	316	378	45,282
PCI Loans	1,053	2,146	114	9	—	3,322
	$ 20,720	$ 23,302	$ 6,288	$ 325	$ 378	$ 51,013

December 31, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Broker-Dealer	Total
Loans individually evaluated for impairment	$ 1,380	$ —	$ —	$ —	$ —	$ 1,380
Loans collectively evaluated for impairment	17,124	16,052	5,882	282	209	39,549
PCI Loans	1,341	2,931	182	32	—	4,486
	$ 19,845	$ 18,983	$ 6,064	$ 314	$ 209	$ 45,415

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 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. The asset arising from the loss-share agreements, referred to as the “FDIC Indemnification Asset,” is measured separately from the covered loan portfolio because the agreements are not contractually embedded in the covered loans and are not transferable should the Bank choose to dispose of the covered loans.

In accordance with the loss-share agreements, the Bank may be required to make a “true-up” payment to the FDIC approximately ten years following the Bank Closing Date if its actual net realized losses over the life of the loss-share agreements are less than the FDIC’s initial estimate of losses on covered assets. The “true-up” payment is calculated using a defined formula set forth in the P&A Agreement. At June 30, 2016, the Bank recorded a related “true-up” payment accrual of $9.4 million based on the current estimate of aggregate realized losses on covered assets over the life of the loss-share agreements.

Covered Loans and Allowance for Covered Loan Losses

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

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(Unaudited)

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

In connection with the FNB Transaction, the Bank acquired loans both with and without evidence of credit quality deterioration since origination. The Company's accounting policies for acquired covered loans, including covered PCI loans, are consistent with the accounting policies for acquired non-covered loans, as described in Note 5 to the consolidated financial statements. The Company has established under its PCI accounting policy a framework to aggregate certain acquired covered loans into various loan pools based on a minimum of two layers of 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).

	June 30, 2016	December 31, 2015
Commercial and industrial	$ 6,739	$ 8,801
Real estate	300,632	341,048
Construction and land development	16,157	30,445
	323,528	380,294
Allowance for covered loans	(1,455)	(1,532)
Total covered loans, net of allowance	$ 322,073	$ 378,762

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

	June 30, 2016	December 31, 2015

Carrying amount	$ 184,564	$ 221,974
Outstanding balance	345,715	408,221

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	$ 169,133	$ 193,997	$ 176,719	$ 193,493
Reclassifications from (to) nonaccretable difference, net(1)	8,810	9,737	18,443	26,001
Transfer of loans to covered OREO(2)	(62)	327	(171)	1,499
Accretion	(20,277)	(18,080)	(37,387)	(35,012)
Balance, end of period	$ 157,604	$ 185,981	$ 157,604	$ 185,981

(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 nonaccrual and expected cash flows are no longer predictable and the accretable yield is eliminated.

(2) Transfer of loans to covered OREO is the difference between the value removed from the pool and the expected cash flows for the loan.

The remaining nonaccretable difference for covered PCI loans was $134.3 million and $172.2 million at June 30, 2016 and December 31, 2015, respectively. During the three and six months ended June 30, 2016 and 2015, a combination of factors affecting the inputs to the Bank’s quarterly recast process led to the reclassifications from nonaccretable difference to accretable yield. These transfers resulted from revised cash flows that reflect better-than-expected performance of the covered PCI loan portfolio as a result of the Bank’s strategic decision to dedicate resources to the liquidation of covered loans during the noted periods.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

June 30, 2016	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 11,652	$ 2,876	$ 762	$ 3,638	$ 39
Unsecured	8,171	1,404	17	1,421	1
Real estate:					
Secured by commercial properties	190,451	25,026	60,354	85,380	1,368
Secured by residential properties	164,659	82,609	20	82,629	2
Construction and land development:					
Residential construction loans	831	—	—	—	—
Commercial construction loans and land development	34,715	11,496	—	11,496	—
	410,479	123,411	61,153	184,564	1,410
Non-PCI					
Commercial and industrial:					
Secured	130	132	—	132	—
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	441	423	—	423	—
Secured by residential properties	2,643	2,430	—	2,430	—

Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	12	12	—	12	—
	3,226	2,997	—	2,997	—
	$ 413,705	$ 126,408	$ 61,153	$ 187,561	$ 1,410

December 31, 2015	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 15,454	$ 3,312	$ 2,415	$ 5,727	$ 495
Unsecured	9,377	618	1,162	1,780	246
Real estate:					
Secured by commercial properties	211,145	67,540	29,388	96,928	245
Secured by residential properties	182,698	93,438	3,180	96,618	514
Construction and land development:					
Residential construction loans	1,225	121	—	121	—
Commercial construction loans and land development	55,947	20,800	—	20,800	—
	475,846	185,829	36,145	221,974	1,500
Non-PCI					
Commercial and industrial:					
Secured	78	68	—	68	—
Unsecured	—	1	—	1	—
Real estate:					
Secured by commercial properties	512	443	—	443	—
Secured by residential properties	3,745	3,031	—	3,031	—
Construction and land development:					
Residential construction loans	799	540	—	540	—
Commercial construction loans and land development	123	110	—	110	—
	5,257	4,193	—	4,193	—
	$ 481,103	$ 190,022	$ 36,145	$ 226,167	$ 1,500

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Commercial and industrial:				
Secured	$ 4,497	$ 10,947	$ 4,783	$ 11,849
Unsecured	1,606	4,199	1,601	5,152
Real estate:				
Secured by commercial properties	87,157	165,012	91,587	189,759
Secured by residential properties	88,493	121,668	92,354	128,993
Construction and land development:				
Residential construction loans	343	1,107	331	1,143
Commercial construction loans and land development	12,664	36,972	16,209	40,254
	$ 194,760	$ 339,905	$ 206,865	$ 377,150

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

	June 30, 2016	December 31, 2015
Commercial and industrial:		
Secured	$ 132	$ 68
Unsecured	—	—
Real estate:		
Secured by commercial properties	423	442
Secured by residential properties	1,921	2,516
Construction and land development:		
Residential construction loans	—	541
Commercial construction loans and land development	12	5,411
	$ 2,488	$ 8,978

At June 30, 2016, there were no covered PCI loans included within non-accrual loans for which discount accretion has been suspended. At December 31, 2015, covered non-accrual loans included covered PCI loans of $5.3 million, for which discount accretion has been suspended because the extent and timing of cash flows from these covered PCI loans can no longer be reasonably estimated.

Interest income, including recoveries and cash payments, recorded on covered impaired loans during the three and six months ended June 30, 2016 and 2015 was nominal. Except as noted above, covered PCI loans are considered to be performing due to the application of the accretion method.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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. There were no TDRs granted during the three and six months ended June 30, 2016. The outstanding balance of TDRs granted during the three and six months ended June 30, 2015 is shown in the following tables (in thousands). Pooled Loans are not in the scope of the disclosure requirements for TDRs. At June 30, 2016 and December 31, 2015, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

	Recorded Investment in Loans Modified by			
Three Months Ended June 30, 2015	A/B Note	Interest Rate Adjustment	Payment Term Extension	Total Modification
Commercial and industrial:				
Secured	$ —	$ —	$ —	$ —
Unsecured	—	—	—	—
Real estate:				
Secured by commercial properties	—	—	—	—
Secured by residential properties	121	136	—	257
Construction and land development:				
Residential construction loans	—	—	—	—
Commercial construction loans and land development	—	—	—	—
	$ 121	$ 136	$ —	$ 257

	Recorded Investment in Loans Modified by			
Six Months Ended June 30, 2015	A/B Note	Interest Rate Adjustment	Payment Term Extension	Total Modification
Commercial and industrial:				
Secured	$ —	$ —	$ —	$ —
Unsecured	—	—	—	—
Real estate:				
Secured by commercial properties	—	—	566	566
Secured by residential properties	121	136	280	537
Construction and land development:				
Residential construction loans	—	—	—	—
	—	—	—	—

Commercial construction loans and land development	$ 121	$ 136	$ 846	$ 1,103

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

The following tables present information regarding TDRs granted during the twelve months preceding June 30, 2015 for which a payment was at least 30 days past due in the three and six months ended June 30, 2015, respectively (dollars in thousands). There were no TDRs granted during the twelve months preceding June 30, 2016 for which a payment was at least 30 days past due in the three and six months ended June 30, 2016.

	Number of Loans	Recorded Investment
Commercial and industrial:		
Secured	—	$ —
Unsecured	—	—
Real estate:		
Secured by commercial properties	1	566
Secured by residential properties	1	280
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	—	—
	2	$ 846

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

June 30, 2016	Loans Past Due 30 59 Days	Loans Past Due 60 89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non PCI) Past D 90 Days or More
Commercial and industrial:								
Secured	$ —	$ —	$ 98	$ 98	$ 1,582	$ 3,638	$ 5,318	$ 44
Unsecured	—	—	—	—	—	1,421	1,421	—
Real estate:								
Secured by commercial properties	—	122	96	218	24,816	85,380	110,414	—
Secured by residential properties	1,710	907	648	3,265	104,324	82,629	190,218	190

Construction and land development:								
Residential construction loans	—	—	—	—	—	—	—	—
Commercial construction loans and land development	—	—	—	—	4,661	11,496	16,157	—
	$ 1,710	$ 1,029	$ 842	$ 3,581	$ 135,383	$ 184,564	$ 323,528	$ 234

December 31, 2015	Loans Past Due 30 59 Days	Loans Past Due 60 89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non PCI) Past 90 Days or Mor
Commercial and industrial:								
Secured	$ 51	$ —	$ 68	$ 119	$ 1,175	$ 5,727	$ 7,021	$ —
Unsecured	—	—	—	—	—	1,780	1,780	—
Real estate:								
Secured by commercial properties	—	—	100	100	28,957	96,928	125,985	—
Secured by residential properties	3,399	418	1,104	4,921	113,524	96,618	215,063	—
Construction and land development:								
Residential construction loans	—	—	540	540	264	121	925	—
Commercial construction loans and land development	47	1	95	143	8,577	20,800	29,520	—
	$ 3,497	$ 419	$ 1,907	$ 5,823	$ 152,497	$ 221,974	$ 380,294	$ —

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(Unaudited)

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

June 30, 2016	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 939	$ —	$ 741	$ 3,638	$ 5,318
Unsecured	—	—	—	1,421	1,421
Real estate:					
Secured by commercial properties	20,590	—	4,444	85,380	110,414
Secured by residential properties	101,037	477	6,075	82,629	190,218
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	3,031	—	1,630	11,496	16,157
	$ 125,597	$ 477	$ 12,890	$ 184,564	$ 323,528

December 31, 2015	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 758	$ —	$ 536	$ 5,727	$ 7,021
Unsecured	—	—	—	1,780	1,780
Real estate:					
Secured by commercial properties	24,070	—	4,987	96,928	125,985
Secured by residential properties	111,128	491	6,826	96,618	215,063
Construction and land development:					
Residential construction loans	264	—	540	121	925
Commercial construction loans and land development	6,847	—	1,873	20,800	29,520
	$ 143,067	$ 491	$ 14,762	$ 221,974	$ 380,294

The Bank’s impairment methodology for the covered loans is consistent with that of non-covered loans, and is discussed in detail in Notes 5 and 6 to the consolidated financial statements included in the Company’s 2015 Form

10-K.

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

Three months ended June 30, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Balance, beginning of period	$ 438	$ 742	$ 37	$ 1,217
Provision charged to (recapture from) operations	(383)	674	(108)	183
Loans charged off	—	(26)	(30)	(56)
Recoveries on charged off loans	—	10	101	111
Balance, end of period	$ 55	$ 1,400	$ —	$ 1,455

Six months ended June 30, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Balance, beginning of period	$ 758	$ 774	$ —	$ 1,532
Provision charged to (recapture from) operations	(697)	651	(49)	(95)
Loans charged off	(6)	(42)	(52)	(100)
Recoveries on charged off loans	—	17	101	118
Balance, end of period	$ 55	$ 1,400	$ —	$ 1,455

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

Three months ended June 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Balance, beginning of period	$ 364	$ 927	$ 97	$ 1,388
Provision charged to (recapture from) operations	(202)	(474)	247	(429)
Loans charged off	(53)	(83)	(9)	(145)
Recoveries on charged off loans	21	99	—	120
Balance, end of period	$ 130	$ 469	$ 335	$ 934

Six months ended June 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Balance, beginning of period	$ 1,193	$ 3,334	$ 84	$ 4,611
Provision charged to (recapture from) operations	(131)	(665)	260	(536)
Loans charged off	(953)	(2,299)	(9)	(3,261)
Recoveries on charged off loans	21	99	—	120
Balance, end of period	$ 130	$ 469	$ 335	$ 934

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

June 30, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	1,680	132,623	4,661	138,964
PCI Loans	5,059	168,009	11,496	184,564
	$ 6,739	$ 300,632	$ 16,157	$ 323,528

December 31, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	$ —	$ —	$ 540	$ 540
Loans collectively evaluated for impairment	1,294	147,502	8,984	157,780
PCI Loans	7,507	193,546	20,921	221,974
	$ 8,801	$ 341,048	$ 30,445	$ 380,294

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

June 30, 2016	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	15	30	—	45
PCI Loans	40	1,370	—	1,410
	$ 55	$ 1,400	$ —	$ 1,455

December 31, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Total
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	17	15	—	32
PCI Loans	741	759	—	1,500
	$ 758	$ 774	$ —	$ 1,532

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Covered Other Real Estate Owned

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	$ 78,890	$ 137,703	$ 99,090	$ 136,945
Additions to covered OREO	4,739	12,021	9,281	36,063
Dispositions of covered OREO	(14,028)	(21,106)	(29,005)	(43,440)
Valuation adjustments in the period	(1,967)	(3,108)	(11,732)	(4,058)
Balance, end of period	$ 67,634	$ 125,510	$ 67,634	$ 125,510

During the three and six months ended June 30, 2016 and 2015, 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.

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. 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 fair value be recorded at the time such new information is received, while increases to fair value are recorded when the asset is subsequently sold.

FDIC Indemnification Asset

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	$ 80,522	$ 107,567	$ 91,648	$ 130,437
FDIC Indemnification Asset accretion (amortization)	69	320	156	826
Transfers to due from FDIC and other	(6,131)	(5,506)	(17,344)	(28,882)
Balance, end of period	$ 74,460	$ 102,381	$ 74,460	$ 102,381

As of June 30, 2016, the Bank had billed and collected $117.7 million from the FDIC, which represented reimbursable covered losses and expenses through March 31, 2016.

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(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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	$ 39,863	$ 31,648	$ 52,285	$ 36,155
Additions	8,254	9,406	9,893	12,096
Sales	(7,586)	—	(7,586)	—
Changes in fair value:				
Due to changes in model inputs or assumptions (1)	(5,494)	5,772	(18,336)	728
Due to customer payoffs	(1,546)	(1,841)	(2,765)	(3,994)
Balance, end of period	$ 33,491	$ 44,985	$ 33,491	$ 44,985

	June 30, 2016	December 31, 2015
Mortgage loans serviced for others	$ 4,845,114	$ 5,051,884
MSR asset as a percentage of serviced mortgage loans	0.69 %	1.03 %

(1) Primarily represents normal customer payments, changes in discount rates and prepayment speed assumptions, which are primarily affected by changes in interest rates and the refinement of other MSR model assumptions.

The key assumptions used in measuring the fair value of the Company's MSR asset were as follows.

	June 30, 2016	December 31, 2015
Weighted average constant prepayment rate	20.67 %	11.51 %
Weighted average discount rate	10.85 %	10.92 %
Weighted average life (in years)	4.0	6.5

A sensitivity analysis of the fair value of the Company's MSR asset to certain key assumptions is presented in the following table (in thousands).

	June 30, 2016	December 31, 2015
Constant prepayment rate:		
Impact of 10% adverse change	$ (2,190)	$ (2,177)
Impact of 20% adverse change	(4,161)	(4,195)
Discount rate:		
Impact of 10% adverse change	(1,007)	(2,073)
Impact of 20% adverse change	(1,953)	(3,989)

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 $5.7 million and $4.3 million during the three months ended June 30, 2016 and 2015, respectively, and $11.7 million and $8.5 million during the six months ended June 30, 2016 and 2015, respectively, were included in other noninterest income within the consolidated statements of operations.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

8. Deposits

Deposits are summarized as follows (in thousands).

	June 30, 2016	December 31, 2015
Noninterest-bearing demand	$ 2,280,108	$ 2,235,436
Interest-bearing:		
NOW accounts	1,151,922	1,077,576
Money market	1,501,950	1,500,780
Brokered - money market	77,711	133,380
Demand	356,066	380,214
Savings	342,763	273,390
Time	1,296,982	1,325,342
Brokered - time	119,311	26,565
	$ 7,126,813	$ 6,952,683

9. Short-term Borrowings

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

	June 30, 2016	December 31, 2015
Federal funds purchased	$ 99,600	$ 58,925
Securities sold under agreements to repurchase	285,262	217,748
Federal Home Loan Bank	375,000	600,000

Short-term bank loans	253,000	70,700
	$ 1,012,862	$ 947,373

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 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).

	Six Months Ended June 30,	
	2016	2015
Average balance during the period	$ 363,665	$ 347,698
Average interest rate during the period	0.53 %	0.27 %

	June 30, 2016	December 31, 2015
Average interest rate at end of period	0.39 %	0.26 %
Securities underlying the agreements at end of period:		
Carrying value	$ 313,938	$ 250,981
Estimated fair value	$ 315,197	$ 250,045

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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).

	Six Months Ended June 30,	
	2016	2015
Average balance during the period	$ 231,456	$ 284,448
Average interest rate during the period	0.46 %	0.22 %

	June 30, 2016	December 31, 2015
Average interest rate at end of period	0.43 %	0.35 %

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 June 30, 2016 and December 31, 2015 was 1.31% and 1.26%, respectively.

10. Notes Payable

Notes payable consisted of the following (in thousands).

	June 30, 2016	December 31, 2015

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 note payable due March 2035	20,000	20,000
Federal Home Loan Bank notes, maturities ranging from April 2017 to June 2030	106,475	36,042
Insurance company line of credit due December 31, 2016	2,500	7,000
Ventures line of credit due May 2017	14,919	—
Senior Notes due April 2025, net	148,242	148,174
	$ 319,636	$ 238,716

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 36.8% and 37.3% during the three months ended June 30, 2016 and 2015, respectively, and 35.4% and 18.9% during the six months ended June 30, 2016 and 2015, respectively. The effective tax rates during the three and six months ended June 30, 2016 were slightly lower than the statutory rate primarily due to recognition of excess tax benefits on share-based payment awards as a result of the Company's adoption of the provisions of Accounting Standards Update ("ASU") 2016-09 as of January 1, 2016 as discussed in Note 24 to the consolidated financial statements. The lower effective tax rate during the six months ended June 30, 2015 was primarily due to no income taxes being recorded during 2015 in connection with the bargain purchase gain of $81.3 million associated with the SWS Merger because the acquisition was a tax-free reorganization under Section 368(a) of the Internal Revenue Code. In addition, the Company recorded an income tax benefit during 2015 of $2.1 million as a result of the SWS Merger to reverse the deferred tax liability for the difference between book and tax basis on Hilltop's investment in SWS common stock.

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Notes to Consolidated Financial Statements (continued)

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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. When it is practicable, the Company estimates loss contingencies for possible litigation and claims, whether or not there is an accrued probable loss. When the Company is able to estimate such possible losses, and when it estimates that it is reasonably possible it could incur losses, in excess of amounts accrued, the Company is required to make a disclosure of the aggregate estimation. As available information changes, however, the matters for which the Company is able to estimate, as well as the estimates themselves will be adjusted, accordingly.

Assessments of litigation and claims exposures are difficult due to many factors that involve inherent unpredictability. Those factors include the following: the varying stages of the proceedings, particularly in the early stages; unspecified, unsupported, or uncertain damages; damages other than compensatory, such as punitive damages; a matter presenting meaningful legal uncertainties, including novel issues of law; multiple defendants and jurisdictions; whether discovery has begun or not or discovery is not complete; meaningful settlement discussions have not 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 filed petitions in the Court of Chancery of the State of Delaware 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. The consolidated matter represents a total of approximately 5.2 million shares of SWS common stock. The Company intends to vigorously defend this matter.

On or about November 2, 2012, FSC, along with thirteen other defendants, was named in a lawsuit pending in the state of Rhode Island Superior Court styled Rhode Island Economic Development Corporation v. Wells Fargo Securities, LLC, et al. FSC is included in connection with its role as financial advisor to the State of Rhode Island, specifically in connection with the Rhode Island Economic Development Corporation’s issuance of $75 million in bonds to finance a loan to 38 Studios, LLC. 38 Studios, LLC ultimately failed to repay the loan and the Rhode Island Economic Development Corporation is seeking recovery to repay the bonds it issued to make such loan. FSC intends to defend itself vigorously in this action.

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 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. No claims or demands have been asserted against PrimeLending. PrimeLending cannot predict the ultimate outcome of this investigation, and cannot make a reasonable estimate of potential liability, if any, at this time. PrimeLending continues to cooperate with the investigation.

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 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 of 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.

Other Contingencies

The mortgage origination segment may be responsible 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 the investor or reimburses the investor’s losses. The mortgage origination segment has established an indemnification liability reserve for such probable losses.

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

An additional reserve has been established for probable investor 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 investor requests, actual investor 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 investor 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 investor claims to date, and therefore, are not a primary factor considered in the calculation of this reserve.

At June 30, 2016 and December 31, 2015, the mortgage origination segment's indemnification liability reserve totaled $18.2 million and $16.6 million, respectively. The provision for indemnification losses was $1.2 million during each of the three months ended June 30, 2016 and 2015, and $2.1 million and $2.0 million during the six months ended June 30, 2016 and 2015, respectively.

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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 Activity - Origination Loan Balance			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	$ 54,202	$ 74,100	$ 57,298	$ 53,906
Claims made	5,006	14,658	9,554	51,981
Claims resolved with no payment	(4,502)	(10,451)	(10,617)	(22,138)
Repurchases	(714)	(3,075)	(1,871)	(8,314)
Indemnification payments	(116)	(2,668)	(488)	(2,871)
Balance, end of period	$ 53,876	$ 72,564	$ 53,876	$ 72,564

	Indemnification Liability Reserve Activity			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	$ 17,147	$ 17,342	$ 16,640	$ 17,619
Additions for new sales	1,245	1,150	2,123	1,994
Repurchases	(70)	(300)	(182)	(798)
Early payment defaults	(43)	(29)	(133)	(39)
Indemnification payments	(63)	(879)	(232)	(1,041)
Change in estimate	—	(5)	—	(456)
Balance, end of period	$ 18,216	$ 17,279	$ 18,216	$ 17,279

	June 30, 2016	December 31, 2015
Reserve for Indemnification Liability:		
Specific claims	$ 4,073	$ 5,210
Incurred but not reported claims	14,143	11,430
Total	$ 18,216	$ 16,640

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.

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 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 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

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using a defined formula set forth in the P&A Agreement. As of June 30, 2016, the Bank estimated that the sum of covered losses and reimbursable expenses subject to the loss-share agreements will exceed $240.4 million, but will not exceed $365.7 million. Unless actual plus projected covered losses and reimbursable expenses exceed $365.7 million, the Bank will not record additional amounts to the FDIC Indemnification Asset. As of June 30, 2016, the Bank had billed $147.1 million of covered net losses to the FDIC, of which 80%, or $117.7 million, were reimbursable under the loss-share agreements. As of June 30, 2016, the Bank had received aggregate reimbursements of $117.7 million from the FDIC, which represented reimbursable covered losses and expenses through March 31, 2016.

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 $1.8 billion at June 30, 2016 and outstanding financial and performance standby letters of credit of $47.0 million at June 30, 2016.

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.

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. Upon the approval by stockholders and effectiveness of the 2012 Plan in September 2012, no additional awards were permissible under the 2003 Equity Incentive Plan (the "2003 Plan"). In the aggregate, 4,000,000 shares of common stock may be delivered pursuant to awards granted under the 2012 Plan. At June 30, 2016, 2,018,495 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 and the 2003 Plan was $2.7 million and $2.5 million during the three months ended June 30, 2016 and 2015, respectively, and $5.0 million and $4.4 million during the six months ended June 30, 2016 and 2015, respectively.

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During the six months ended June 30, 2016 and 2015, Hilltop granted 11,343 and 5,707 shares of common stock, respectively, to certain non-employee members of the Company's Board of Directors for services rendered to the Company pursuant to the 2012 Plan.

Restricted Stock Awards and RSUs

The following table summarizes information about nonvested Restricted Stock Award and RSU activity for the six months ended June 30, 2016 (shares in thousands).

	Restricted Stock Awards		RSUs	
	Outstanding	Weighted Average Grant Date Fair Value	Outstanding	Weighted Average Grant Date Fair Value
Balance, December 31, 2015	453	$ 13.50	875	$ 21.22
Granted	-	$ -	545	$ 17.34
Vested/Released	(435)	$ 13.25	(5)	$ 22.24
Forfeited	(2)	$ 19.72	(2)	$ 21.41
Balance, June 30, 2016	16	$ 19.40	1,413	$ 19.75

Vested/Released Restricted Stock Awards and RSUs include an aggregate of 94,825 shares withheld to satisfy employee statutory tax obligations during the six months ended June 30, 2016. Pursuant to certain RSU award agreements, an aggregate of 8,247 vested RSUs at June 30, 2016 require deferral of the settlement in shares and statutory tax obligations to a future date.

At June 30, 2016, unrecognized compensation expense related to outstanding Restricted Stock Awards of $0.1 million is expected to be recognized over a weighted average period of 0.80 years.

During the six months ended June 30, 2016, the Compensation Committee of the Board of Directors of the Company awarded certain executives and key employees an aggregate of 545,457 RSUs pursuant to the 2012 Plan. These awards include 426,934 RSUs subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 118,523 RSUs that cliff vest based upon the achievement of certain performance goals over a three-year period. Total compensation expense related to these RSUs is expected to be $9.5 million, which will amortized through March 2019.

At June 30, 2016, 1,129,227 of the outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 284,398 outstanding RSUs cliff vest based upon the achievement of certain performance goals over a three-year period. At June 30, 2016, unrecognized compensation expense related to outstanding RSUs of $16.9 million is expected to be recognized over a weighted average period of 1.35 years.

Stock Options

Stock options granted on November 2, 2011 to two senior executives pursuant to the 2003 Plan to purchase an aggregate of 600,000 shares of the Company’s common stock (the “Stock Option Awards”) at an exercise price of $7.70 per share were fully vested and exercisable at November 2, 2015. As of June 30, 2016, an aggregate of 100,000 Stock Option Awards remain outstanding and will expire on November 2, 2016 if unexercised.

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15. Regulatory Matters

Banking and Hilltop

The Bank and Hilltop are subject to various regulatory capital requirements administered by the 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 the Bank 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 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).

The following table shows the Bank's and Hilltop's consolidated actual capital amounts and ratios compared to the regulatory minimum capital requirements and the Bank's regulatory minimum capital requirements needed to qualify as a "well-capitalized" institution in accordance with Basel III as measured at June 30, 2016 and December 31, 2015, respectively (dollars in thousands).

	Actual		Minimum Capital Requirements		To Be Well Capitalized Minimum Capital Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2016						
Tier 1 capital (to average assets):						
Bank	$ 1,070,348	12.72 %	$ 336,673	4.0 %	$ 420,842	5.0 %
Hilltop	1,568,045	13.18 %	475,967	4.0 %	N/A	N/A
Common equity Tier 1 capital (to risk-weighted assets):						
Bank	1,066,429	14.71 %	326,192	4.5 %	471,167	6.5 %
Hilltop	1,514,425	16.67 %	408,735	4.5 %	N/A	N/A

Tier 1 capital (to risk-weighted assets):												
Bank		1,070,348	14.77	%		434,923	6.0	%		579,897	8.0	%
Hilltop		1,568,045	17.26	%		544,980	6.0	%		N/A	N/A	
Total capital (to risk-weighted assets):												
Bank		1,124,283	15.51	%		579,897	8.0	%		724,872	10.0	%
Hilltop		1,607,059	17.69	%		726,640	8.0	%		N/A	N/A	
December 31, 2015												
Tier 1 capital (to average assets):												
Bank	$	1,064,212	13.22	%	$	322,104	4.0	%	$	402,630	5.0	%
Hilltop		1,520,514	12.65	%		480,928	4.0	%		N/A	N/A	
Common equity Tier 1 capital (to risk-weighted assets):												
Bank		1,063,041	16.23	%		294,716	4.5	%		425,701	6.5	%
Hilltop		1,469,642	17.87	%		370,156	4.5	%		N/A	N/A	
Tier 1 capital (to risk-weighted assets):												
Bank		1,064,212	16.25	%		392,954	6.0	%		523,939	8.0	%
Hilltop		1,520,514	18.48	%		493,541	6.0	%		N/A	N/A	
Total capital (to risk-weighted assets):												
Bank		1,112,654	16.99	%		523,939	8.0	%		654,924	10.0	%
Hilltop		1,553,867	18.89	%		658,055	8.0	%		N/A	N/A	

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To be considered "adequately capitalized" (as defined) under regulatory requirements, the Bank must maintain minimum Tier 1 capital to total average assets of 4%, common equity Tier 1 capital to risk-weighted assets of 4.5%, Tier 1 capital to risk-weighted assets ratios of 6%, and a total capital to risk-weighted assets ratio of 8%. Based on the actual capital amounts and ratios shown in the previous table, the Bank's ratios place it in the "well capitalized" (as defined) capital category under regulatory requirements.

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 above, Hilltop and the Bank exceed each of the capital conservation buffer requirements in effect as of June 30, 2016, as well as the fully phased-in requirements through 2019.

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 June 30, 2016, the net capital position of each of the Hilltop Broker-Dealers was as follows (in thousands).

		HTS

	Hilltop Securities	Independent Network
Net capital	$ 118,183	$ 1,275
Less required net capital	10,928	250
Excess net capital	$ 107,255	$ 1,025
Net capital as a percentage of aggregate debit items	21.6 %	
Net capital in excess of 5% aggregate debit items	$ 90,863	

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 June 30, 2016, Hilltop Securities held cash of $120.2 million 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 June 30, 2016. The fair values of any segregated assets included in special reserve accounts were determined using Level 1 inputs.

Mortgage Origination

As a mortgage originator, PrimeLending is subject to minimum net worth requirements established by the U.S. Department of Housing and Urban Development ("HUD") and the GNMA. On an annual basis, PrimeLending submits audited financial statements to HUD and GNMA documenting PrimeLending's compliance with its minimum net worth

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requirements. In addition, PrimeLending monitors compliance on an ongoing basis and, as of June 30, 2016, PrimeLending's net worth exceeded the amounts required by both HUD and GNMA.

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).

	June 30, 2016	December 31, 2015
Capital and surplus:		
National Lloyds Insurance Company	$ 113,772	$ 121,750
American Summit Insurance Company	29,408	30,592

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Statutory net income (loss):				
National Lloyds Insurance Company	$ (7,196)	$ (8,853)	$ (3,639)	$ (4,076)
American Summit Insurance Company	234	(342)	1,086	567

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 June 30, 2016, 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 June 30, 2016, the Company's insurance subsidiaries' RBC ratio exceeded the level at which regulatory action would be required.

16. Stockholders’ Equity

Stock Repurchase Program

During the second quarter of 2016, the Company’s Board of Directors approved a stock repurchase program under which it authorized the Company to repurchase, in the aggregate, up to $50.0 million of its outstanding common stock. Under the stock repurchase program authorized, 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. As of June 30, 2016, the Company had not repurchased any shares of its outstanding common stock under this stock repurchase program. 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. The purchases will be funded from available cash balances. The Company’s accounting treatment and policy regarding stock repurchases is discussed in detail in Note 22 to the consolidated financial statements included in the Company’s 2015 Form 10-K.

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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 and swaptions, 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, and interest rate swaps and swaptions 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 $0.7 million during the three months ended June 30, 2016, compared with an increase of $14.5 million during the same period in 2015, and increased $11.8 million during the six months ended June 30, 2016, compared with an increase of $33.3 million during the same period in 2015. 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' derivative instruments are recorded in other assets or other liabilities, as appropriate, and the fair values of the Hilltop Broker-Dealers' derivatives increased $2.6 million and $9.2 million during the three months ended June 30, 2016 and 2015, respectively, and increased $9.5 million and $17.8 million during the six months ended June 30, 2016 and 2015, respectively. The changes in fair value were recorded as a component of other noninterest income.

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

	June 30, 2016		December 31, 2015	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Derivative instruments:				
IRLCs	$ 1,665,883	$ 52,318	$ 944,942	$ 23,762
Commitments to purchase MBSs	4,474,657	35,912	3,151,862	8,350
Commitments to sell MBSs	6,974,812	(42,239)	5,038,565	(2,352)
Interest rate swaps and swaptions	409,195	1,172	409,982	490

PrimeLending had cash collateral advances totaling $21.1 million and $0.8 million to offset net liability derivative positions on its commitments to sell MBSs at June 30, 2016 and December 31, 2015, respectively. In addition, PrimeLending advanced cash collateral totaling $10.5 million and $6.4 million in initial margin on its interest rate swaps and swaptions at June 30, 2016 and December 31, 2015, respectively. These amounts are included in other assets within the consolidated balance sheets.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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).

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet: Financial Instruments	Cash Collateral Pledged	Net Amount
June 30, 2016						
Securities borrowed:						
Institutional counterparties	$ 2,105,818	$ —	$ 2,105,818	$ (2,105,818)	$ —	$ —
Interest rate swaps and swaptions:						
Institutional counterparties	3,397	(984)	2,413	—	—	2,413
Reverse repurchase agreements:						
Institutional counterparties	149,474	—	149,474	(149,318)	—	156
Forward MBS derivatives:						
Institutional counterparties	37,190	—	37,190	(35,978)	—	1,212
	$ 2,295,879	$ (984)	$ 2,294,895	$ (2,291,114)	$ —	$ 3,781
December 31, 2015						
Securities borrowed:						
Institutional counterparties	$ 1,307,741	$ —	$ 1,307,741	$ (1,307,741)	$ —	$ —

Interest rate swaps and swaptions:						
Institutional counterparties	1,526	(393)	1,133	—	—	1,133
Reverse repurchase agreements:						
Institutional counterparties	105,660	—	105,660	(105,412)	—	248
Forward MBS derivatives:						
Institutional counterparties	1,377	—	1,377	(1,377)	—	—
	$ 1,416,304	$ (393)	$ 1,415,911	$ (1,414,530)	$ —	$ 1,381

	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet Financial Instruments	Cash Collateral Pledged	Net Amount
June 30, 2016						
Securities loaned:						
Institutional counterparties	$ 2,009,065	$ —	$ 2,009,065	$ (2,009,065)	$ —	$ —
Interest rate swaps and swaptions:						
Institutional counterparties	1,241	—	1,241	(3,000)	—	(1,759)
Repurchase agreements:						
Institutional counterparties	143,253	—	143,253	(143,253)	—	—
Customer counterparties	142,009	—	142,009	(142,009)	—	—
Forward MBS derivatives:						
Institutional counterparties	43,517	—	43,517	(23,064)	—	20,453
	$ 2,339,085	$ —	$ 2,339,085	$ (2,320,391)	$ —	$ 18,694
December 31, 2015						
Securities loaned:						
Institutional counterparties	$ 1,235,466	—	1,235,466	(1,235,466)	—	—

Interest rate swaps and swaptions:						
Institutional counterparties	643	—	643	(2,519)	—	(1,876)
Repurchase agreements:						
Institutional counterparties	69,748	—	69,748	(69,748)	—	—
Customer counterparties	148,000	—	148,000	(148,000)	—	—
Forward MBS derivatives:						
Institutional counterparties	4,385	(1,769)	2,616	(1,420)	—	1,196
	$ 1,458,242	$ (1,769)	$ 1,456,473	$ (1,457,153)	$ —	$ (680)

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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 within one to thirty days from the transaction 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 includes 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.

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 June 30, 2016 and December 31, 2015.

	Remaining Contractual Maturities				
June 30, 2016	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
Repurchase agreement transactions:					
U.S. Treasury and agency securities	$ 211,537	$ 73,725	$ —	$ —	$ 285,262
Securities lending transactions:					
Corporate securities	10,519	—	—	—	10,519
Equity securities	1,998,546	—	—	—	1,998,546
Total	$ 2,220,602	$ 73,725	$ —	$ —	$ 2,294,327
Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above					$ 2,294,327
Amount related to agreements not included in offsetting disclosure above					$ —

	Remaining Contractual Maturities				
December 31, 2015	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
Repurchase agreement transactions:					
U.S. Treasury and agency securities	$ 201,090	$ 16,658	$ —	$ —	$ 217,748
Securities lending transactions:					
U.S. Treasury and agency securities	12,646	—	—	—	12,646
Corporate securities	5,993	—	—	—	5,993
Equity securities	1,216,827	—	—	—	1,216,827
Total	$ 1,436,556	$ 16,658	$ —	$ —	$ 1,453,214
Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above					$ 1,453,214
Amount related to agreements not included in offsetting disclosure above					$ —

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

19. Broker-Dealer and Clearing Organization Receivables and Payables

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

	June 30, 2016	December 31, 2015
Receivables:		
Securities borrowed	$ 2,105,818	$ 1,307,741
Securities failed to deliver	61,763	25,087
Clearing organizations	—	16,701
Trades in process of settlement, net	83,420	5,707
Other	6,479	7,263
	$ 2,257,480	$ 1,362,499
Payables:		
Securities loaned	$ 2,009,065	$ 1,235,466
Correspondents	32,687	69,046
Securities failed to receive	68,062	28,352
Clearing organizations and other	2,180	5,441
	$ 2,111,994	$ 1,338,305

20. Reserve for Losses and Loss Adjustment Expenses

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

Six Months Ended June 30,

	2016	2015
Balance, beginning of period	$ 44,357	$ 29,716
Less reinsurance recoverables	(13,502)	(4,315)
Net balance, beginning of period	30,855	25,401
Incurred related to:		
Current year	58,760	53,368
Prior years	410	6,733
Total incurred	59,170	60,101
Payments related to:		
Current year	(41,659)	(34,696)
Prior years	(12,216)	(11,544)
Total payments	(53,875)	(46,240)
Net balance, end of period	36,150	39,262
Plus reinsurance recoverables	19,959	19,458
Balance, end of period	$ 56,109	$ 58,720

The prior period adverse development of $6.7 million during the six months ended June 30, 2015 was primarily related to litigation emerging from a series of hail storms within the 2012 through 2014 accident years.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 June 30, 2016, reinsurance receivables had a carrying value of $25.1 million, which is included in other assets within the consolidated balance sheet. There was no allowance for uncollectible accounts at June 30, 2016, based on NLC’s quality requirements.

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
	Written	Earned	Written	Earned	Written	Earned	Written	Earned
Premiums from direct business	$ 42,675	$ 40,177	$ 46,564	$ 42,520	$ 81,754	$ 81,063	$ 89,313	$ 84,610
Reinsurance assumed	3,146	2,714	2,942	2,547	5,825	5,382	5,458	4,990
Reinsurance ceded	(4,246)	(4,170)	(4,737)	(4,749)	(7,745)	(7,991)	(9,442)	(9,715)
Net premiums	$ 41,575	$ 38,721	$ 44,769	$ 40,318	$ 79,834	$ 78,454	$ 85,329	$ 79,885

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Loss and LAE incurred	$ 55,461	$ 54,266	$ 78,950	$ 77,597
Reinsurance recoverables	(18,250)	(13,025)	(19,780)	(17,496)
Net loss and LAE incurred	$ 37,211	$ 41,241	$ 59,170	$ 60,101

Catastrophic coverage

At June 30, 2016, 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 four layers of protection: $17 million in excess of $8 million retention and/or loss; $25 million in excess of $25 million loss; $25 million in excess of $50 million loss and $50 million in excess of $75 million loss. NLIC and ASIC retain no participation in any of the layers, beyond the first $8 million and $1.5 million, respectively. At June 30, 2016, total retention for any one catastrophe that affects both NLIC and ASIC was limited to $8 million in the aggregate.

Effective January 1, 2016, NLC did not renew its multi-line excess of loss coverage that previously limited each risk with respect to property and liability. 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, down from 9% participation in this coverage during 2015.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 President and Chief Executive Officer of the Company and the Chief Executive Officer of PlainsCapital. For the third quarter of 2015, the Company began presenting the bargain purchase gain associated with the SWS Merger, previously allocated to the banking and broker-dealer reportable business segments, within corporate to reflect the Company's internal evaluation of segment performance. This change is reflected in the segment operating results within noninterest income for the three and six months ended June 30, 2015. This change had no impact on the Company's consolidated results of operations.

The banking segment includes the operations of the Bank. The broker-dealer segment includes the operations of the Hilltop Broker-Dealers, while 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.

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

Three Months Ended June 30, 2016	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated

Net interest income (expense)	$ 92,029	$ 7,440	$ (2,299)	$ 758	$ (1,846)	$ 4,315	$ 100,397
Provision for loan losses	28,613	263	—	—	—	—	28,876
Noninterest income	13,346	102,900	192,881	41,392	1	(4,515)	346,005
Noninterest expense	55,132	91,780	162,488	51,717	6,483	(235)	367,365
Income (loss) before income taxes	$ 21,630	$ 18,297	$ 28,094	$ (9,567)	$ (8,328)	$ 35	$ 50,161

			Mortgage			All Other and	Hilltop
Six Months Ended June 30, 2016	Banking	Broker-Dealer	Origination	Insurance	Corporate	Eliminations	Consolidated
Net interest income (expense)	$ 178,133	$ 14,491	$ (4,865)	$ 1,497	$ (3,559)	$ 8,540	$ 194,237
Provision for loan losses	32,113	170	—	—	—	—	32,283
Noninterest income	26,301	183,782	339,219	83,196	2	(9,120)	623,380
Noninterest expense	119,480	176,041	297,160	88,091	12,332	(550)	692,554
Income (loss) before income taxes	$ 52,841	$ 22,062	$ 37,194	$ (3,398)	$ (15,889)	$ (30)	$ 92,780

			Mortgage			All Other and	Hilltop
Three Months Ended June 30, 2015	Banking	Broker-Dealer	Origination	Insurance	Corporate	Eliminations	Consolidated
Net interest income (expense)	$ 90,881	$ 8,023	$ (2,277)	$ 699	$ (1,599)	$ 4,940	$ 100,667
Provision for loan losses	304	(146)	—	—	—	—	158
Noninterest income	15,049	80,248	168,228	42,837	—	(4,962)	301,400
Noninterest expense	60,328	90,348	144,819	56,061	1,892	(131)	353,317
	$ 45,298	$ (1,931)	$ 21,132	$ (12,525)	$ (3,491)	$ 109	$ 48,592

Income (loss) before income taxes

Six Months Ended June 30, 2015	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 174,323	$ 16,019	$ (5,291)	$ 1,456	$ (1,490)	$ 9,042	$ 194,059
Provision for loan losses	2,790	55	—	—	—	—	2,845
Noninterest income	34,358	159,776	303,520	84,682	81,289	(9,379)	654,246
Noninterest expense	118,860	181,143	267,121	89,527	11,518	(376)	667,793
Income (loss) before income taxes	$ 87,031	$ (5,403)	$ 31,108	$ (3,389)	$ 68,281	$ 39	$ 177,667
June 30, 2016							
Goodwill	$ 207,741	$ 7,008	$ 13,071	$ 23,988	$ —	$ —	$ 251,808
Total assets	$ 8,926,275	$ 3,668,414	$ 1,798,012	$ 361,183	$ 1,946,943	$ (3,622,925)	$ 13,077,902
December 31, 2015							
Goodwill	$ 207,741	$ 7,008	$ 13,071	$ 23,988	$ —	$ —	$ 251,808
Total assets	$ 8,707,433	$ 2,673,455	$ 1,737,843	$ 349,259	$ 1,905,547	$ (3,506,536)	$ 11,867,001

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 are the only instruments issued by Hilltop which qualify 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 six months ended June 30, 2016 and 2015, stock options and RSUs are the only potentially dilutive non-participating instruments issued by Hilltop. Next, the Company determines and includes in the diluted earnings per common share calculation the more dilutive effect of the participating securities using the treasury stock method or the two-class method. Undistributed losses are not allocated to the nonvested share-based payment awards (the participating securities) under the two-class method as the holders are not contractually obligated to share in the losses of the Company.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015

Basic earnings per share:				
Income applicable to Hilltop common stockholders	$ 31,074	$ 29,622	$ 58,641	$ 141,498
Less: income applicable to participating shares	(5)	(139)	(9)	(663)
Net earnings available to Hilltop common stockholders	$ 31,069	$ 29,483	$ 58,632	$ 140,835
Weighted average shares outstanding - basic	98,457	99,486	98,305	99,613
Basic earnings per common share	$ 0.32	$ 0.30	$ 0.60	$ 1.41
Diluted earnings per share:				
Income applicable to Hilltop common stockholders	$ 31,074	$ 29,622	$ 58,641	$ 141,498
Weighted average shares outstanding - basic	98,457	99,486	98,305	99,613
Effect of potentially dilutive securities	129	924	314	894
Weighted average shares outstanding - diluted	98,586	100,410	98,619	100,507
Diluted earnings per common share	$ 0.32	$ 0.30	$ 0.60	$ 1.41

24. Recently Issued Accounting Standards

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 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

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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. Early adoption is permitted no earlier than the first quarter of 2019. The Company is currently evaluating the provisions of the amendment and the impact on its future consolidated financial statements.

In March 2016, FASB issued ASU 2016-09 as part of its simplification initiative and affects all entities that issue share-based payment awards to their employees. The amendments in this update cover such areas as the recognition of excess tax benefits and deficiencies, the classification of those excess tax benefits on the statement of cash flows, an accounting policy election for forfeitures, the amount an employer can withhold to cover income taxes and still qualify for equity classification and the classification of those taxes paid on the statement of cash flows. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2016 using either prospective, retrospective or modified retrospective transition method, depending on the area covered in this update. As permitted within the amendment, the Company elected to early adopt and prospectively apply the provisions of this amendment as of January 1, 2016.

In February 2016, FASB issued ASU 2016-02 related to leases. The new standard is intended to increase transparency and comparability among organizations and require lessees to record a right-to-use asset and liability representing the obligation to make lease payments for long-term leases. Accounting by lessors will remain largely unchanged. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted. Adoption will require a modified retrospective transition where the lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented. The Company is currently evaluating the provisions of the amendment and the impact on its future consolidated financial statements.

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 pronouncement also impacts financial liabilities under the Fair Value Option and the presentation and disclosure requirements for financial instruments. The amendment is effective for annual periods, and interim periods within those fiscal periods, beginning after December 15, 2017. Adoption of the amendment is not expected to have a significant effect on the Company's consolidated financial statements.

In July 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 by one year, to clarify the principles for recognizing revenue from contracts with customers. The amendment outlines 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 amendment also requires 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 amendment is 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 retrospective transition method. The Company is currently evaluating the provisions of the amendment, including subsequently issued amendments that clarify the principles outlined in the original amendment, and the impact on its future consolidated financial statements.

In May 2015, the FASB issued ASU 2015-09 requiring enhanced disclosures for insurers relating to short-duration insurance contract claims and the unpaid claims liability rollforward for long and short-duration contracts. The amendment is effective for annual periods beginning after December 15, 2015 and interim reporting periods thereafter. The Company adopted the amendment as of January 1, 2016 and will include the enhanced disclosures beginning with its Annual Report on Form 10-K for the year ended December 31, 2016.

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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 "PlainsCapital" 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 PlainsCapital), references to "FNB" refer to First National Bank, references to "SWS" refer to the former SWS Group, Inc., references to "First Southwest" refer to First Southwest Holdings, LLC (a wholly owned subsidiary of Securities Holdings) and its subsidiaries as a whole, references to "FSC" refer to First Southwest Company, LLC (a former wholly owned subsidiary of First Southwest), references to "PrimeLending" refer to PrimeLending, a PlainsCapital Company (a wholly owned subsidiary of the Bank) and its subsidiaries as a whole, references to "NLC" refer to National Lloyds Corporation (a wholly owned subsidiary of Hilltop) and its subsidiaries as a whole, references to "NLIC" refer to National Lloyds Insurance Company (a wholly owned subsidiary of NLC) and references to "ASIC" refer to American Summit Insurance Company (a wholly owned subsidiary of NLC).

FORWARD-LOOKING STATEMENTS

This Quarterly Report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included in this Quarterly Report that address results or developments that we expect or anticipate will or may occur in the future, and statements that are preceded by, followed by or include, words such as "anticipates," "believes," "could," "estimates," "expects," "forecasts," "goal," "intends," "may," "might," "plan," "probable," "projects," "seeks," "shoul "would" or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our financial condition, our efforts to make strategic acquisitions, the 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, expectations concerning mortgage loan origination volume, expected losses on covered loans and related reimbursements from the Federal Deposit Insurance Corporation ("FDIC"), expected levels of refinancing as a percentage of total loan origination volume, projected losses on mortgage loans originated, anticipated changes in our revenues or earnings, the effects of government regulation applicable to our operations, the appropriateness of our allowance for loan losses and provision for loan losses, 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:

- risks associated with merger and acquisition integration, including our ability to promptly and effectively integrate our businesses with those acquired in the SWS Merger and achieve the anticipated synergies and cost savings in connection therewith, as well as the diversion of management time on acquisition- and integration-related issues;
- our ability to estimate loan losses;
- changes in the default rate of our loans;

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

risks associated with concentration in real estate related loans;

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

changes in the interest rate environment;

· cost and availability of capital;
effectiveness of our data security controls in the face of cyber attacks;

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;

approval of new, or changes in, accounting policies and practices;

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;

our ability to obtain reimbursements for losses on acquired loans under loss-share agreements with the FDIC to the extent the FDIC determines that we did not adequately manage the covered loan portfolio;

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

· our ability to use excess cash in an effective manner, including the execution of successful acquisitions.

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, 2015 (“2015 Form 10-K”), which was filed with the Securities and Exchange Commission (the “SEC”) on February 24, 2016, 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 operating business units.

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

Securities Holdings. Securities Holdings is a holding company headquartered in Dallas, Texas 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 headquartered in Waco, Texas 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 six months ended June 30, 2016, our net income to common stockholders was $31.1 million, or $0.32 per diluted share, and $58.6 million, or $0.60 per diluted share, respectively.

We reported $50.2 million and $92.8 million of consolidated income before income taxes during the three and six months ended June 30, 2016, respectively, including the following contributions from our four reportable operating segments.

- The banking segment contributed $21.6 million and $52.8 million of income before income taxes during the three and six months ended June 30, 2016, respectively;
- The broker-dealer segment contributed $18.3 million and $22.1 million of income before income taxes during the three and six months ended June 30, 2016, respectively;
- The mortgage origination segment contributed $28.1 million and $37.2 million of income before income taxes during the three and six months ended June 30, 2016, respectively; and
- The insurance segment incurred losses before income taxes of $9.6 million and $3.4 million during the three and six months ended June 30, 2016, respectively.

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 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 three and six months ended June 30, 2016 reflect this charge-off. The Bank is actively investigating the loan relationship and is pursuing legal remedies to recover losses arising from this isolated incident, including litigation against the borrower and guarantors. Given the preliminary nature of the investigation and related proceedings, the Bank cannot currently estimate the amount of any future recoveries or additional expenses related to this charged-off loan.

At June 30, 2016, on a consolidated basis, we had total assets of $13.1 billion, total deposits of $7.1 billion, total loans, including loans held for sale, of $7.3 billion and stockholders' equity of $1.8 billion.

On January 1, 2015, we completed our acquisition of SWS in a stock and cash transaction (the "SWS Merger"), whereby SWS's broker-dealer subsidiaries, Southwest Securities, Inc. and SWS Financial Services, Inc., became subsidiaries of Securities Holdings, and SWS's banking subsidiary, Southwest Securities, FSB ("SWS FSB"), was merged into the Bank, an indirect wholly owned subsidiary of Hilltop. On October 5, 2015, Southwest Securities, Inc. and SWS Financial Services, Inc. were renamed "Hilltop Securities Inc." and "Hilltop Securities Independent Network

Inc.", respectively. The operations acquired in the SWS Merger were included in our operating results beginning January 1, 2015 and such operations included a bargain purchase gain of $81.3 million.

On October 22, 2015, the Financial Industry Regulatory Authority ("FINRA") granted approval to combine FSC and Hilltop Securities, subject to customary conditions. Following this approval, we integrated the back-office systems of FSC and Hilltop Securities and, on January 22, 2016, merged FSC and Hilltop Securities into a combined firm operating under the "Hilltop Securities" name. We use the term "Hilltop Broker-Dealers" to refer to FSC, Hilltop Securities and HTS Independent Network prior to such date and Hilltop Securities and HTS Independent Network after such date.

Segment Information

We have three primary operating business units, PlainsCapital (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. For the third quarter of 2015, we began presenting the bargain purchase gain associated with the SWS Merger, previously allocated to the banking and broker-dealer reportable business segments, within corporate to better reflect segment performance. This

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change is reflected in the segment operating results within noninterest income, and MD&A, for the three and six months ended June 30, 2015. This change had no impact on our consolidated results of operations. 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 Hilltop Securities and HTS Independent Network. From the date of the SWS Merger until January 22, 2016, when we merged FSC into Hilltop Securities to form a combined firm operating under the "Hilltop Securities" name, our broker-dealer segment was operated through FSC, Hilltop Securities and HTS Independent Network as separate broker-dealers under coordinated leadership. The broker-dealer segment generates a majority of its revenues from fees and commissions earned from investment advisory and securities brokerage services. Hilltop Securities is a broker-dealer registered with the SEC and 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 advisor under the Investment Advisors 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. 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 in Texas and other areas of the southern United States.

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).

Three Months Ended June 30, 2016	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 92,029	$ 7,440	$ (2,299)	$ 758	$ (1,846)	$ 4,315	$ 100,397
Provision for loan losses	28,613	263	—	—	—	—	28,876
Noninterest income	13,346	102,900	192,881	41,392	1	(4,515)	346,005
Noninterest expense	55,132	91,780	162,488	51,717	6,483	(235)	367,365
Income (loss) before income taxes	$ 21,630	$ 18,297	$ 28,094	$ (9,567)	$ (8,328)	$ 35	$ 50,161

Six Months Ended June 30, 2016	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 178,133	$ 14,491	$ (4,865)	$ 1,497	$ (3,559)	$ 8,540	$ 194,237
Provision for loan losses	32,113	170	—	—	—	—	32,283
Noninterest income	26,301	183,782	339,219	83,196	2	(9,120)	623,380
Noninterest expense	119,480	176,041	297,160	88,091	12,332	(550)	692,554
Income (loss) before income taxes	$ 52,841	$ 22,062	$ 37,194	$ (3,398)	$ (15,889)	$ (30)	$ 92,780

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Three Months Ended June 30, 2015	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 90,881	$ 8,023	$ (2,277)	$ 699	$ (1,599)	$ 4,940	$ 100,667
Provision for loan losses	304	(146)	—	—	—	—	158
Noninterest income	15,049	80,248	168,228	42,837	—	(4,962)	301,400
Noninterest expense	60,328	90,348	144,819	56,061	1,892	(131)	353,317
Income (loss) before income taxes	$ 45,298	$ (1,931)	$ 21,132	$ (12,525)	$ (3,491)	$ 109	$ 48,592

Six Months Ended June 30, 2015	Banking	Broker-Dealer	Mortgage Origination	Insurance	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	$ 174,323	$ 16,019	$ (5,291)	$ 1,456	$ (1,490)	$ 9,042	$ 194,059
Provision for loan losses	2,790	55	—	—	—	—	2,845
Noninterest income	34,358	159,776	303,520	84,682	81,289	(9,379)	654,246
Noninterest expense	118,860	181,143	267,121	89,527	11,518	(376)	667,793
Income (loss) before income taxes	$ 87,031	$ (5,403)	$ 31,108	$ (3,389)	$ 68,281	$ 39	$ 177,667

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 $194.2 million in net interest income during the six months ended June 30, 2016, compared with net interest income of $194.1 million during the same period in 2015. While net interest income was consistent between these noted periods, changes in net interest income included an increase within our banking segment, offset by interest expense incurred on our $150.0 million aggregate principle amount of 5% senior notes due 2025 ("Senior Notes") that were not issued until the second quarter of 2015 and a decrease in net interest income within our broker-dealer segment.

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

(i) Income from broker-dealer operations. Through the Hilltop Broker-Dealers, we provide investment banking and other related financial services. We generated $131.9 million and $138.7 million in securities brokerage commissions and fees and investment advisory fees and commissions, and $49.7 million and $20.4 million in gains from derivative and trading portfolio activities (included within other noninterest income) during the six months ended June 30, 2016 and 2015, respectively.

(ii) Income from mortgage operations. Through PrimeLending, we generate noninterest income by originating and selling mortgage loans. During the six months ended June 30, 2016 and 2015, we generated $338.9 million and $303.3 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 $78.5 million and $79.9 million in net insurance premiums earned during the six months ended June 30, 2016 and 2015, respectively.

In the aggregate, we generated $623.4 million and $654.2 million in noninterest income during the six months ended June 30, 2016 and 2015, respectively. Excluding the bargain purchase gain of $81.3 million related to the SWS Merger, our noninterest income during the six months ended June 30, 2015 was $573.0 million. We are presenting this financial measure because certain investors may use it to evaluate our business and financial results. This year-over-year increase in noninterest income, other than bargain purchase gain, is predominantly attributable to increases in noninterest income in our mortgage origination and broker-dealer segments.

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.

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Consolidated Operating Results

Net income applicable to common stockholders during the three months ended June 30, 2016 was $31.1 million, or $0.32 per diluted share, compared with net income applicable to common stockholders of $29.6 million, or $0.30 per diluted share, during the three months ended June 30, 2015. Net income applicable to common stockholders during the six months ended June 30, 2016 was $58.6 million, or $0.60 per diluted share, compared with net income applicable to common stockholders of $141.5 million, or $1.41 per diluted share, during the six months ended June 30, 2015. The consolidated operating results during the three and six months ended June 30, 2016 included the previously mentioned $24.5 million charge-off of a single large loan by the Bank. The consolidated operating results during the six months ended June 30, 2015 included the recognition of a bargain purchase gain related to the SWS Merger of $81.3 million, or $0.81 per diluted share. Included in the bargain purchase gain is a reversal of a $33.4 million valuation allowance against SWS deferred tax assets. This amount is based on our expected ability to realize these acquired deferred tax assets through our consolidated core earnings, the implementation of certain tax planning strategies and reversal of timing differences. SWS's net operating loss carryforwards are subject to an annual limitation on their usage because of the ownership change effected in connection with the SWS Merger. In addition, the bargain purchase gain reflects our acquisition date fair value allocation to identifiable intangible assets of $7.5 million.

Our consolidated operating results during the six months ended June 30, 2016 also include transaction costs related to the SWS Merger, 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 six months ended June 30, 2016, we incurred $2.3 million in pre-tax transaction costs related to the SWS Merger, while pre-tax integration-related costs associated with employee, professional fee and contractual expenses during this same period were $2.1 million, $2.6 million, and $0.1 million, respectively. During the six months ended June 30, 2015, we incurred $3.6 million in pre-tax transaction costs related to the SWS Merger, while pre-tax integration-related costs associated with employee, professional fee and contractual expenses during this same period were $6.9 million, $1.6 million and $2.3 million, respectively. On October 22, 2015, FINRA granted approval to combine FSC and Hilltop Securities, subject to customary conditions. Since this approval, we have integrated the back-office systems of FSC and Hilltop Securities and, 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. As a result, we began realizing cost savings in 2016, although these cost savings have been partially offset by additional integration costs that we incurred during the first six months of 2016.

Certain items included in net income for 2016 and 2015 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 June 30, 2016 included net accretion of $2.7 million, $12.6 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 $0.3 million, respectively. During the three months ended June 30, 2015, income before taxes included net accretion of $6.0 million, $11.8 million and $5.0 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of $2.3 million, $0.2

million and $0.1 million, respectively. Income before taxes during the six months ended June 30, 2016 included net accretion of $6.0 million, $24.0 million and $2.3 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of $4.0 million, $0.4 million and $0.5 million, respectively. During the six months ended June 30, 2015, income before taxes included net accretion of $10.0 million, $21.6 million and $7.4 million on earning assets and liabilities acquired in the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, offset by amortization of identifiable intangibles of $4.3 million, $0.5 million and $0.5 million, respectively.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Performance Ratios:				
Return on average stockholder's equity	7.07 %	7.12 %	6.72 %	16.99 %
Return on average assets	1.05 %	0.97 %	1.01 %	2.32 %
Net interest margin (1) (3)	3.77 %	3.72 %	3.74 %	3.63 %
Net interest margin (taxable equivalent) (2) (3)	3.80 %	3.75 %	3.76 %	3.66 %

(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 65 basis points and 84 basis points during the three months ended June 30, 2016 and 2015, respectively, and 62 basis points and 77 basis points during the six months ended June 30, 2016 and 2015, respectively.

We present net interest margin in the previous table, and net interest margin and net interest income in the following discussion and tables, 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 June 30, 2016, the consolidated taxable equivalent net interest margin of 3.80% was 72 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of $3.7 million, $12.6 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 $0.9 million. The consolidated taxable equivalent net interest margin during the three months ended June 30, 2015 of 3.75% was 96 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of $7.1 million, $11.8 million and $4.7 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $1.0 million.

During the six months ended June 30, 2016, the consolidated taxable equivalent net interest margin of 3.76% was 73 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of $7.8 million, $24.0 million and $2.2 million million associated with the PlainsCapital Merger, FNB Transaction and

SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $1.7 million. The consolidated taxable equivalent net interest margin during the six months ended June 30, 2015 of 3.66% was 85 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of $12.1 million, $21.6 million and $6.9 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $1.9 million.

The FNB Transaction-related accretion of discount on loans of $24.0 million and $21.6 million during the six months ended June 30, 2016 and 2015, respectively, each included accretion of approximately $6 million due to better-than-expected resolution of covered purchased credit impaired ("PCI") loans during the respective periods. The better-than-expected performance of the covered PCI loan portfolio since 2014 has led to higher yields calculated as a result of the Bank's quarterly cash flow recast process. The recast process performed during the six months ended June 30, 2016 and 2015 resulted in the reclassification of $18.4 million and $26.0 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 June 30,					
	2016			2015		
	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)	$ 7,038,518	$ 98,468	5.56 %	$ 6,563,094	$ 96,967	5.88 %
Investment securities - taxable	1,080,097	6,813	2.53 %	1,087,238	6,210	2.29 %
Investment securities - non-taxable (2)	291,288	2,166	2.98 %	235,229	2,296	3.91 %
Federal funds sold and securities purchased under agreements to resell	144,820	36	0.10 %	93,871	15	0.06 %
Interest-bearing deposits in other financial institutions	388,520	484	0.50 %	580,610	327	0.23 %
Other	1,760,367	6,864	1.54 %	2,293,444	10,586	1.83 %
Interest-earning assets, gross	10,703,610	114,831	4.27 %	10,853,486	116,401	4.27 %
Allowance for loan losses	(51,247)			(41,789)		
Interest-earning assets, net	10,652,363			10,811,697		
Noninterest-earning assets	1,523,095			1,748,109		
Total assets	$ 12,175,458			$ 12,559,806		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities						
Interest-bearing deposits	$ 4,821,695	$ 4,037	0.34 %	$ 4,749,690	$ 3,900	0.33 %
Notes payable and other borrowings	2,722,028	9,768	1.44 %	3,345,511	11,095	1.32 %
Total interest-bearing	7,543,723	13,805	0.73 %	8,095,201	14,995	0.74 %

liabilities								
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,203,065				2,168,728			
Other liabilities	657,435				601,480			
Total liabilities	10,404,223				10,865,409			
Stockholders’ equity	1,768,717				1,693,785			
Noncontrolling interest	2,518				612			
Total liabilities and stockholders' equity	$ 12,175,458				$ 12,559,806			
Net interest income (2)		$ 101,026				$ 101,406		
Net interest spread (2)			3.53	%			3.53	%
Net interest margin (2)			3.80	%			3.75	%

	Six Months Ended June 30, 2016				2015			
	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)	$ 6,886,108	$ 190,001	5.49	%	$ 6,460,000	$ 184,355	5.69	%
Investment securities - taxable	1,062,401	13,161	2.48	%	1,124,453	13,241	2.36	%
Investment securities - non-taxable (2)	276,472	4,490	3.25	%	249,596	4,819	3.87	%
Federal funds sold and securities purchased under agreements to resell	135,064	63	0.09	%	81,696	32	0.08	%
Interest-bearing deposits in other financial institutions	408,301	958	0.47	%	725,516	901	0.25	%
Other	1,685,425	15,001	1.76	%	2,138,308	21,504	2.00	%
Interest-earning assets, gross	10,453,771	223,674	4.25	%	10,779,569	224,852	4.16	%
Allowance for loan losses	(50,049)				(41,607)			

Interest-earning assets, net	10,403,722				10,737,962			
Noninterest-earning assets	1,559,888				1,770,586			
Total assets	$ 11,963,610				$ 12,508,548			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities								
Interest-bearing deposits	$ 4,802,849	$ 7,876	0.33	%	$ 4,926,974	$ 8,215	0.34	%
Notes payable and other borrowings	2,583,418	20,243	1.57	%	3,062,589	21,057	1.38	%
Total interest-bearing liabilities	7,386,267	28,119	0.76	%	7,989,563	29,272	0.74	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,178,378				2,161,493			
Other liabilities	641,335				656,268			
Total liabilities	10,205,980				10,807,324			
Stockholders’ equity	1,755,963				1,700,666			
Noncontrolling interest	1,667				558			
Total liabilities and stockholders' equity	$ 11,963,610				$ 12,508,548			
Net interest income (2)		$ 195,555				$ 195,580		
Net interest spread (2)			3.49	%			3.42	%
Net interest margin (2)			3.76	%			3.66	%

(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 $0.7 million for the three months ended June 30, 2016 and 2015, respectively, and $1.3 million and $1.5 million for the six months ended June 30, 2016 and 2015, respectively.

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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 decreased $0.3 million during the three months ended June 30, 2016 and increased $0.2 million during the six months ended June 30, 2016, compared with the same periods in 2015. While net interest income was relatively consistent between these noted periods, changes in net interest income included reductions in interest earned on securities lending activities in our broker-dealer segment, increases in interest expense at corporate on our outstanding Senior Notes, the offering of which was completed during the second quarter of 2015, and the net effect of increases in the volume of the loan portfolio, partially offset by lower yields on the loan portfolio within our banking segment.

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 $28.9 million and $0.2 million during the three months ended June 30, 2016 and 2015, respectively. During the three months ended June 30, 2016, the provision for loan losses was comprised of charges relating to newly originated loans and acquired loans without credit impairment at acquisition of $30.7 million, partially offset by the recapture of charges on PCI loans of $2.0 million, compared to charges relating to newly originated loans and acquired loans without credit impairment at acquisition of $0.7 million, significantly offset by the recapture of charges on PCI loans of $0.5 million during the three months ended June 30, 2015. During the six months ended June 30, 2016 and 2015, the consolidated provision for loan losses, substantially all of which related to the banking segment, was $32.3 million and $2.8 million, respectively. The provision for loan losses during the six months ended June 30, 2016 was comprised of charges relating to newly originated loans and acquired loans without credit impairment at acquisition of $33.2 million, partially offset by the recapture of charges on PCI loans of $0.8 million, compared to charges relating to newly originated loans and acquired loans without credit impairment at acquisition of $4.1 million, partially offset by the recapture of charges on PCI loans of $1.3 million during the six months ended June 30, 2015. In addition, as previously mentioned, the consolidated provision for loan losses during the three and six months ended June 30, 2016 included a $24.5 million charge-off of a single large loan by the Bank.

Consolidated noninterest income increased $44.6 million during the three months ended June 30, 2016 and decreased $30.9 million during the six months ended June 30, 2016, compared with the same periods in 2015. Consolidated noninterest income during the six months ended June 30, 2015 included the recognition of a bargain purchase gain related to the SWS Merger of $81.3 million. The year-over-year increases in noninterest income, other than bargain purchase gain, during the three and six months ended June 30, 2016, compared with the same periods in 2015, of $44.6 million and $50.4 million, respectively, were primarily driven by increases in noninterest income within our mortgage origination segment of $24.7 million and $35.7 million, respectively, and increases in income earned on derivative and trading portfolio activities within our broker-dealer segment of $23.1 million and $29.3 million, respectively.

Consolidated noninterest expense during the three and six months ended June 30, 2016 increased $14.0 million and $24.8 million, respectively, compared with the same periods in 2015. The year-over-year increase noninterest expense during the three months ended June 30, 2016, compared with the same period in 2015, primarily included an increase in noninterest expense within our mortgage origination segment, partially offset by decreases within our banking and insurance segments. The year-over-year increase in noninterest expense during the six months ended June 30, 2016, compared with the same period in 2015, primarily included an increase in noninterest expense within our mortgage origination segment, partially offset by a decrease in our broker-dealer segment. During the six months ended June 30, 2016, we incurred pre-tax transaction and integration costs related to the SWS Merger of $7.1 million, compared with $14.4 million during the same period in 2015. Changes between the three and six months ended June 30, 2016 and the comparable periods in 2015 within the major components of noninterest expense included increases of $17.1 million and $17.2 million, respectively, in employees' compensation and benefits, and $5.4 million and $14.6 million, respectively, in other expenses primarily attributable to increases in our broker-dealer and mortgage origination segments, partially

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offset by decreases of $3.9 million and $5.3 million, respectively, in occupancy and equipment, net, primarily related to our broker-dealer and banking segments.

Consolidated income tax expense during the three months ended June 30, 2016 and 2015 was $18.4 million and $18.1 million, respectively, reflecting effective tax rates of 36.8% and 37.3%, respectively. During the six months ended June 30, 2016 and 2015, consolidated income tax expense was $32.9 million and $33.6 million, respectively, reflecting effective tax rates of 35.4% and 18.9%, respectively. The effective tax rates during the three and six months ended June 30, 2016 were slightly lower than the statutory rate primarily due to recognition of excess tax benefits on share-based payment awards as a result of our adoption of the provisions of Accounting Standards Update 2016-09 as of January 1, 2016. The lower effective tax rate during the six months ended June 30, 2015 was primarily due to no income taxes being recorded during 2015 in connection with the bargain purchase gain of $81.3 million associated with the SWS Merger because the acquisition was a tax-free reorganization under Section 368(a) of the Internal Revenue Code. In addition, during the quarter ended March 31, 2015, we recorded an income tax benefit of $2.1 million as a result of the SWS Merger to reverse the deferred tax liability for the difference between book and tax basis on Hilltop’s investment in SWS common stock. Therefore, the effective income tax rate during the six months ended June 30, 2016 is not necessarily indicative of anticipated future effective tax rates.

Segment Results

Banking Segment

Income before income taxes in our banking segment during the three months ended June 30, 2016 and 2015 was $21.6 million and $45.3 million, respectively, while income before income taxes in our banking segment during the six months ended June 30, 2016 and 2015 was $52.8 million and $87.0 million, respectively. The decrease in income before income taxes during the three months ended June 30, 2016, compared with the same period in 2015, was primarily due to an increase in the provision for loan losses associated with the previously mentioned $24.5 million charge-off of a single large loan by the Bank, partially offset by an increase in net interest income and a decline in noninterest expense. The decrease in income before income taxes during the six months ended June 30, 2016, compared with the same period in 2015, was primarily due to the previously mentioned increase in the provision for loan losses, as well as the decrease in noninterest income associated with the prior year recognition of gains on securities acquired in the SWS Merger and subsequently sold, partially offset by an increase in net interest income.

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

	Three Months Ended June 30,	Six Months Ended June 30,

	2016	2015	2016	2015
Performance Ratios:				
Efficiency ratio (1)	52.32 %	56.95 %	58.44 %	56.96 %
Return on average assets	0.66 %	1.41 %	0.82 %	1.31 %
Net interest margin (2)	4.85 %	5.00 %	4.78 %	4.78 %
Net interest margin (taxable equivalent) (3)	4.87 %	5.02 %	4.81 %	4.80 %

(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.

The banking segment presents net interest margin in the previous table, and net interest margin and net interest income in the following discussion and tables, 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 June 30, 2016, the banking segment’s taxable equivalent net interest margin of 4.87% was 104 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of $3.7 million, $12.6 million and $1.1 million associated with the PlainsCapital Merger, FNB Transaction and

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SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $0.9 million. The banking segment's taxable equivalent net interest margin during the three months ended June 30, 2015 of 5.02% was 145 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of $7.1 million, $11.8 million and $4.7 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $1.0 million.

During the six months ended June 30, 2016, the banking segment's taxable equivalent net interest margin of 4.81% was 104 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of $7.8 million, $24.0 million and $2.2 million million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $1.7 million. The banking segment's taxable equivalent net interest margin during the six months ended June 30, 2015 of 4.80% was 127 basis points greater due to the impact of purchase accounting and primarily related to accretion of discount on loans of $12.1 million, $21.6 million and $6.9 million associated with the PlainsCapital Merger, FNB Transaction and SWS Merger, respectively, and PlainsCapital Merger-related amortization of premium on acquired securities of $1.9 million.

The FNB Transaction-related accretion of discount on loans of $24.0 million and $21.6 million during the six months ended June 30, 2016 and 2015, respectively, each included accretion of approximately $6 million due to better-than-expected resolution of covered PCI loans during the respective periods. The better-than-expected performance of the covered PCI loan portfolio since 2014 has led to higher yields calculated as a result of the Bank's quarterly cash flow recast process. The recast process performed during the six months ended June 30, 2016 and 2015 resulted in the reclassification of $18.4 million and $26.0 million, respectively, from nonaccretable difference to accretable yield.

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

	Three Months Ended June 30,							
	2016				2015			
	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)	$ 5,264,002	$ 81,306	6.13	%	$ 4,756,730	$ 80,687	6.74	%
Subsidiary warehouse lines of credit	1,150,015	11,282	3.88	%	1,112,636	9,888	3.52	%
Investment securities - taxable	733,539	3,735	2.04	%	763,905	3,998	2.09	%
Investment securities - non-taxable (2)	135,749	1,267	3.73	%	138,267	1,318	3.81	%
	27,114	36	0.54	%	20,801	15	0.29	%

Federal funds sold and securities purchased under agreements to resell								
Interest-bearing deposits in other financial institutions	302,485	426	0.57	%	479,752	302	0.25	%
Other	49,455	487	3.94	%	48,554	429	3.53	%
Interest-earning assets, gross	7,662,359	98,539	5.11	%	7,320,645	96,637	5.25	%
Allowance for loan losses	(51,004)				(41,466)			
Interest-earning assets, net	7,611,355				7,279,179			
Noninterest-earning assets	1,040,375				1,126,700			
Total assets	$ 8,651,730				$ 8,405,879			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities								
Interest-bearing deposits	$ 4,558,852	$ 4,982	0.44	%	$ 4,363,195	$ 4,556	0.42	%
Notes payable and other borrowings	515,004	727	0.56	%	651,281	379	0.23	%
Total interest-bearing liabilities (3)	5,073,856	5,709	0.44	%	5,014,476	4,935	0.39	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	2,225,626				2,140,807			
Other liabilities	59,844				48,358			
Total liabilities	7,359,326				7,203,641			
Stockholders' equity	1,292,404				1,202,238			
Total liabilities and stockholders' equity	$ 8,651,730				$ 8,405,879			
Net interest income (2)		$ 92,830				$ 91,702		
Net interest spread (2)			4.66	%			4.85	%
Net interest margin (2)			4.87	%			5.02	%

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	Six Months Ended June 30, 2016				2015			
	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)	$ 5,180,571	$ 157,687	6.04	%	$ 4,742,687	$ 154,628	6.50	%
Subsidiary warehouse lines of credit	1,071,328	20,991	3.88	%	1,010,350	17,951	3.53	%
Investment securities - taxable	735,553	7,667	2.08	%	802,914	8,781	2.19	%
Investment securities - non-taxable (2)	139,068	2,568	3.69	%	142,141	2,704	3.80	%
Federal funds sold and securities purchased under agreements to resell	23,221	63	0.54	%	23,069	32	0.28	%
Interest-bearing deposits in other financial institutions	316,936	855	0.54	%	617,865	844	0.28	%
Other	51,504	998	3.87	%	46,647	850	3.64	%
Interest-earning assets, gross	7,518,181	190,829	5.04	%	7,385,673	185,790	5.01	%
Allowance for loan losses	(49,821)				(41,282)			
Interest-earning assets, net	7,468,360				7,344,391			
Noninterest-earning assets	1,053,622				1,155,379			
Total assets	$ 8,521,982				$ 8,499,770			
Liabilities and Stockholders’ Equity								
Interest-bearing liabilities								
Interest-bearing deposits	$ 4,494,259	$ 9,689	0.43	%	$ 4,520,424	$ 8,879	0.40	%
Notes payable and other borrowings	512,534	1,400	0.54	%	620,499	935	0.30	%
Total interest-bearing liabilities (3)	5,006,793	11,089	0.44	%	5,140,923	9,814	0.38	%
Noninterest-bearing liabilities	2,190,428				2,112,617			

Noninterest-bearing deposits								
Other liabilities	47,401				62,009			
Total liabilities	7,244,622				7,315,549			
Stockholders' equity	1,277,360				1,184,221			
Total liabilities and stockholders' equity	$ 8,521,982				$ 8,499,770			
Net interest income (2)		$ 179,740				$ 175,976		
Net interest spread (2)			4.59	%			4.63	%
Net interest margin (2)			4.81	%			4.80	%

(1) Average balance includes non-accrual loans.
(2) Presented on a taxable basis with annualized taxable equivalent adjustments based on a 35% federal income tax rate. The adjustment to interest income was $0.5 million and $0.5 million for the three months ended June 30, 2016 and 2015, respectively, and $0.9 million and $1.0 million for the six months ended June 30, 2016 and 2015, respectively.
(3) Excludes the allocation of interest expense on PlainsCapital debt of $0.3 million and $0.4 million for the three months ended June 30, 2016 and 2015, respectively, and $0.7 million and $0.7 million for the six months ended June 30, 2016 and 2015, respectively.

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.

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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).