

Hilltop Holdings Inc.  
Form 10-Q  
May 05, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2014**

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

**Commission File Number: 1-31987**

**Hilltop Holdings Inc.**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of incorporation or organization)

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

**200 Crescent Court, Suite 1330**

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**Dallas, TX**  
(Address of principal executive offices)

**75201**  
(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 May 2, 2014 was 90,180,699.

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**HILLTOP HOLDINGS INC.**

**FORM 10-Q**

**FOR THE QUARTER ENDED MARCH 31, 2014**

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(in thousands, except share and per share data)

	March 31, 2014 (Unaudited)	December 31, 2013
<b>Assets</b>		
Cash and due from banks	\$ 889,950	\$ 713,099
Federal funds sold and securities purchased under agreements to resell	27,460	32,924
Securities:		
Trading, at fair value	53,350	58,846
Available for sale, at fair value (amortized cost of \$1,270,685 and \$1,256,862, respectively)	1,245,359	1,203,143
Held to maturity, at amortized cost (fair value of \$30,902)	30,981	
	1,329,690	1,261,989
Loans held for sale	887,200	1,089,039
Non-covered loans, net of unearned income	3,646,946	3,514,646
Allowance for non-covered loan losses	(34,645)	(33,241)
Non-covered loans, net	3,612,301	3,481,405
Covered loans, net of allowance of \$2,665 and \$1,061, respectively	909,783	1,005,308
Broker-dealer and clearing organization receivables	174,442	119,317
Insurance premiums receivable	26,234	25,597
Deferred policy acquisition costs	21,096	20,991
Premises and equipment, net	202,155	200,706
FDIC indemnification asset	188,736	188,291
Covered other real estate owned	152,310	142,833
Mortgage servicing rights	29,939	20,149
Other assets	262,220	279,745
Goodwill	251,808	251,808
Other intangible assets, net	68,108	70,921
Total assets	\$ 9,033,432	\$ 8,904,122
<b>Liabilities and Stockholders' Equity</b>		
Deposits:		
Noninterest-bearing	\$ 1,748,391	\$ 1,773,749
Interest-bearing	4,914,785	4,949,169
Total deposits	6,663,176	6,722,918
Broker-dealer and clearing organization payables	161,888	129,678
Reserve for losses and loss adjustment expenses	28,258	27,468
Unearned insurance premiums	89,646	88,422
Short-term borrowings	491,406	342,087
Notes payable	55,465	56,327
Junior subordinated debentures	67,012	67,012
Other liabilities	121,368	158,288
Total liabilities	7,678,219	7,592,200
Commitments and contingencies (see Notes 11 and 12)		
Stockholders' equity:		
Hilltop stockholders' equity:		
	114,068	114,068

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Preferred stock, \$0.01 par value, 10,000,000 shares authorized; Series B, liquidation value per share of \$1,000; 114,068 shares issued and outstanding			
Common stock, \$0.01 par value, 100,000,000 shares authorized; 90,177,991 and 90,175,688 shares issued and outstanding, respectively		902	902
Additional paid-in capital		1,388,002	1,388,641
Accumulated other comprehensive loss		(16,054)	(34,863)
Accumulated deficit		(132,421)	(157,607)
Total Hilltop stockholders' equity		1,354,497	1,311,141
Noncontrolling interest		716	781
Total stockholders' equity		1,355,213	1,311,922
Total liabilities and stockholders' equity	\$	9,033,432	\$ 8,904,122

*See accompanying notes.*

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**HILLTOP HOLDINGS INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Interest income:		
Loans, including fees	\$ 79,744	\$ 64,886
Securities:		
Taxable	7,588	5,912
Tax-exempt	1,242	1,347
Federal funds sold and securities purchased under agreements to resell	19	21
Interest-bearing deposits with banks	595	333
Other	2,640	2,105
Total interest income	91,828	74,604
Interest expense:		
Deposits	3,759	3,450
Short-term borrowings	395	513
Notes payable	648	2,322
Junior subordinated debentures	584	608
Other	1,021	450
Total interest expense	6,407	7,343
Net interest income	85,421	67,261
Provision for loan losses	3,242	13,005
Net interest income after provision for loan losses	82,179	54,256
Noninterest income:		
Net gains from sale of loans and other mortgage production income	79,111	127,596
Mortgage loan origination fees	12,344	18,893
Net insurance premiums earned	40,319	37,473
Investment and securities advisory fees and commissions	21,335	22,009
Other	16,991	7,307
Total noninterest income	170,100	213,278
Noninterest expense:		
Employees' compensation and benefits	106,429	116,190
Loss and loss adjustment expenses	18,337	21,185
Policy acquisition and other underwriting expenses	11,687	10,803
Occupancy and equipment, net	26,338	19,412
Other	49,838	47,401
Total noninterest expense	212,629	214,991
Income before income taxes	39,650	52,543
Income tax expense	14,354	19,170
Net income	25,296	33,373
Less: Net income attributable to noncontrolling interest	110	300

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Income attributable to Hilltop		25,186		33,073
Dividends on preferred stock		1,426		703
Income applicable to Hilltop common stockholders	\$	23,760	\$	32,370
Earnings per common share:				
Basic	\$	0.26	\$	0.39
Diluted	\$	0.26	\$	0.39
Weighted average share information:				
Basic		89,707		83,487
Diluted		90,585		83,743

*See accompanying notes.*

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**HILLTOP HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Net income	\$ 25,296	\$ 33,373
Other comprehensive income:		
Unrealized gains on securities available for sale, net of tax of \$9,583 and \$473	18,809	879
Comprehensive income	44,105	34,252
Less: comprehensive income attributable to noncontrolling interest	110	300
Comprehensive income applicable to Hilltop	\$ 43,995	\$ 33,952

*See accompanying notes.*



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**HILLTOP HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(in thousands)

(Unaudited)

	Preferred Stock		Common Stock		Additional	Accumulated	Accumulated	Total	Noncontrolling	Total
	Shares	Amount	Shares	Amount	Paid-in	Other	Deficit	Hilltop	Interest	Stockholders'
					Capital	Income (Loss)		Equity		Equity
Balance, December 31, 2012	114	\$ 114,068	83,487	\$ 835	\$ 1,304,448	\$ 8,094	\$ (282,949)	\$ 1,144,496	\$ 2,054	\$ 1,146,550
Net income							33,073	33,073	300	33,373
Other comprehensive income						879		879		879
Stock-based compensation expense					64			64		64
Dividends on preferred stock					(703)			(703)		(703)
Cash distributions to noncontrolling interest									(1,578)	(1,578)
Balance, March 31, 2013	114	\$ 114,068	83,487	\$ 835	\$ 1,303,809	\$ 8,973	\$ (249,876)	\$ 1,177,809	\$ 776	\$ 1,178,585
Balance, December 31, 2013	114	\$ 114,068	90,176	\$ 902	\$ 1,388,641	\$ (34,863)	\$ (157,607)	\$ 1,311,141	\$ 781	\$ 1,311,922
Net income							25,186	25,186	110	25,296
Other comprehensive income						18,809		18,809		18,809
Stock-based compensation expense					735			735		735
Common stock issued to board members			2		52			52		52
Dividends on preferred stock					(1,426)			(1,426)		(1,426)
Cash distributions to noncontrolling interest									(175)	(175)
Balance, March 31, 2014	114	\$ 114,068	90,178	\$ 902	\$ 1,388,002	\$ (16,054)	\$ (132,421)	\$ 1,354,497	\$ 716	\$ 1,355,213

See accompanying notes.

Table of Contents**HILLTOP HOLDINGS INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Operating Activities</b>		
Net income	\$ 25,296	\$ 33,373
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	3,242	13,005
Depreciation, amortization and accretion, net	(20,615)	(9,548)
Deferred income taxes	4,878	(7,067)
Other, net	1,435	85
Net change in securities purchased under resale agreements		(3,254)
Net change in trading securities	5,496	29,344
Net change in broker-dealer and clearing organization receivables	(88,613)	(77,077)
Net change in other assets	454	47,641
Net change in broker-dealer and clearing organization payables	62,842	34,075
Net change in loss and loss adjustment expense reserve	790	(1,942)
Net change in unearned insurance premiums	1,224	1,434
Net change in other liabilities	(36,773)	(56,899)
Net gains from sale of loans	(79,111)	(127,596)
Loans originated for sale	(1,954,133)	(3,025,709)
Proceeds from loans sold	2,227,917	3,310,115
Net cash provided by operating activities	154,329	159,980
<b>Investing Activities</b>		
Proceeds from maturities and principal reductions of securities held to maturity	351	
Proceeds from sales, maturities and principal reductions of securities available for sale	31,845	53,759
Purchases of securities held to maturity	(31,334)	
Purchases of securities available for sale	(46,024)	(209,507)
Net change in loans	(256)	(41,872)
Purchases of premises and equipment and other assets	(8,710)	(5,041)
Proceeds from sales of premises and equipment and other real estate owned	14,713	3,880
Net cash received for Federal Home Loan Bank and Federal Reserve Bank stock		6,702
Net cash used in investing activities	(39,415)	(192,079)
<b>Financing Activities</b>		
Net change in deposits	(90,374)	68,869
Net change in short-term borrowings	149,319	(151,520)
Payments on notes payable	(862)	(792)
Dividends paid on preferred stock	(1,342)	
Net cash distributed to noncontrolling interest	(175)	(1,578)
Other, net	(93)	(65)
Net cash provided by (used in) financing activities	56,473	(85,086)
Net change in cash and cash equivalents	171,387	(117,185)
Cash and cash equivalents, beginning of period	746,023	726,460
Cash and cash equivalents, end of period	\$ 917,410	\$ 609,275

**Supplemental Disclosures of Cash Flow Information**

Cash paid for interest	\$	6,934	\$	8,313
Cash paid for income taxes, net of refunds	\$	(1,845)	\$	2,205
<b>Supplemental Schedule of Non-Cash Activities</b>				
Conversion of loans to other real estate owned	\$	25,588	\$	284

*See accompanying notes.*

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(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, as amended by the Gramm-Leach-Bliley Act of 1999. On November 30, 2012, Hilltop acquired PlainsCapital Corporation pursuant to a plan of merger whereby PlainsCapital Corporation merged with and into a wholly owned subsidiary of Hilltop (the PlainsCapital Merger ), which continued as the surviving entity under the name PlainsCapital Corporation ( PlainsCapital ).

The Company has two primary operating business units, PlainsCapital and National Lloyds Corporation ( NLC ). PlainsCapital is a financial holding company, headquartered in Dallas, Texas, that provides, through its subsidiaries, an array of financial products and services. In addition to traditional banking services, PlainsCapital provides residential mortgage lending, investment banking, public finance advisory, wealth and investment management, treasury management, capital equipment leasing, fixed income sales, asset management, and correspondent clearing services. NLC is a property and casualty insurance holding company that provides, through its subsidiaries, fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the southern United States.

On September 13, 2013 (the Bank Closing Date ), PlainsCapital Bank (the Bank ) assumed substantially all of the liabilities, including all of the deposits, and acquired substantially all of the assets of Edinburg, Texas-based First National Bank ( FNB ) from the Federal Deposit Insurance Corporation (the FDIC ), as receiver, and reopened former FNB branches acquired from the FDIC under the PlainsCapital Bank name (the FNB Transaction ). Pursuant to the Purchase and Assumption Agreement (the P&A Agreement ), the Bank and the FDIC entered into loss-share agreements whereby the FDIC agreed to share in the losses of certain covered loans and covered other real estate owned ( OREO ) that the Bank acquired, as further described in Note 2 to the consolidated financial statements. The fair value of the assets acquired was \$2.2 billion, including \$1.1 billion in covered loans, \$286.2 million in securities, \$135.2 million in covered OREO and \$42.9 million in non-covered loans. The Bank also assumed \$2.2 billion in liabilities, consisting primarily of deposits. The acquisition of FNB s expansive branch network allowed the Bank to increase its presence in Texas to include the Rio Grande Valley, Houston, Corpus Christi, Laredo and El Paso markets, among others.

On March 31, 2014, the Company entered into a definitive merger agreement with SWS Group, Inc. ( SWS ) providing for the merger of SWS with and into a wholly owned subsidiary of Hilltop formed for the purpose of facilitating this transaction. SWS stockholders will receive per share consideration of 0.2496 shares of Hilltop common stock and \$1.94 of cash, equating to \$7.88 per share based on Hilltop s closing price on March 31, 2014. The Company intends to fund the cash portion of the consideration through available cash. The merger is subject to customary closing conditions, including regulatory approvals and approval of the stockholders of SWS, and is expected to be completed prior to the end of 2014.

**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, 2013. 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 accounting principles generally accepted in the United States ( 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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 under the loss-share agreements with the FDIC ( FDIC Indemnification Asset ), reserves for losses and loss adjustment expenses, the mortgage loan indemnification liability, and the potential impairment of assets are particularly subject to change. The Company has applied its critical accounting policies and estimation methods consistently in all periods presented in these consolidated financial statements.

Certain reclassifications have been made to the prior period consolidated financial statements to conform with the current period presentation. In addition, the Company revised its historical consolidated balance sheets to correct the classification of certain noninterest-bearing deposits. The correction resulted in an increase in noninterest-bearing deposits and a decrease in interest-bearing deposits of \$1.3 billion and \$1.0 billion at December 31, 2013 and 2012, respectively, and the correction of the deposits note to the consolidated financial statements. Management has evaluated the impact of the correction as immaterial to previously issued financial statements; however, has elected to revise such amounts in the accompanying consolidated financial statements. The Company will similarly revise the consolidated balance sheets and deposits note to the quarterly and annual consolidated financial statements in its future filings.

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 ) and PCB-ARC, Inc. The Bank has a 100% membership interest in First Southwest Holdings, LLC ( First Southwest ) and PlainsCapital Securities, LLC, as well as a 51% voting interest in PlainsCapital Insurance Services, LLC.

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

PrimeLending owns a 100% membership interest in PrimeLending Ventures Management, LLC, the controlling and sole managing member of PrimeLending Ventures, LLC ( Ventures ).

The principal subsidiaries of First Southwest are First Southwest Company ( FSC ), a broker-dealer registered with the SEC and the Financial Industry Regulatory Authority, and First Southwest Asset Management, Inc., a registered investment advisor under the Investment Advisors Act of 1940.

The consolidated financial statements include the accounts of the above-named entities. All significant 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 Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ).

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 ASC, because the primary beneficiaries of the Trusts are not within the consolidated group.

## 2. Acquisitions

### *FNB Transaction*

On the Bank Closing Date, the Bank assumed substantially all of the liabilities, including all of the deposits, and acquired substantially all of the assets of FNB from the FDIC in an FDIC-assisted transaction. As part of 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 sheet. Collectively, covered loans and covered OREO are referred to as covered assets.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 the FDIC's initial estimate of losses on covered assets is greater than the actual realized losses. The true-up payment is calculated using a defined formula set forth in the P&A Agreement.

The FNB Transaction was accounted for using the purchase method of accounting and, accordingly, purchased assets, including identifiable intangible assets and assumed liabilities, were recorded at their respective fair values as of the Bank Closing Date using significant estimates and assumptions to value certain identifiable assets acquired and liabilities assumed. The amounts are subject to adjustments based upon final settlement with the FDIC. The terms of the P&A Agreement provide for the FDIC to indemnify the Bank against claims with respect to liabilities and assets of FNB or any of its affiliates not assumed or otherwise purchased by the Bank and with respect to certain other claims by third parties.

*Pro Forma Results of Operations*

The operations acquired in the FNB Transaction are included in the Company's operating results beginning September 14, 2013. The purchase of assets and assumption of certain liabilities of FNB from the FDIC, as receiver, was sufficiently significant to require disclosure of historical financial statements and related pro forma financial disclosure. Due to the nature and magnitude of the FNB Transaction, coupled with the federal assistance and protection resulting from the FDIC loss-share agreements, historical financial information of FNB is not relevant to future operations. The Company has omitted certain historical financial information and the related pro forma financial information of FNB pursuant to the guidance provided in Staff Accounting Bulletin Topic 1.K, Financial Statements of Acquired Troubled Financial Institutions (SAB 1:K), and a request for relief granted by the SEC. SAB 1:K provides relief from the requirements of Rule 3-05 of Regulation S-X in certain instances, such as the FNB Transaction, where a registrant engages in an acquisition of a significant amount of assets of a troubled financial institution for which audited financial statements are not reasonably available and in which federal assistance is so persuasive as to substantially reduce the relevance of such information to an assessment of future operations.

**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 (e.g., interest rates, yield curves, prepayment speeds, default rates, credit risks, loss severities, etc.), 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) at fair value, and certain time deposits at the Bank 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. The Company determines the fair value of the financial instruments accounted for under the provisions of the Fair Value Option in compliance with the provisions of the Fair Value Topic of the ASC discussed above.

At March 31, 2014, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was \$886.6 million, and the unpaid principal balance of those loans was \$860.5 million. At December 31, 2013, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was \$1.09 billion, and the unpaid principal balance of those loans was \$1.07 billion. 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, data from independent pricing services and rates paid in the brokered certificate of deposit market.

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

March 31, 2014	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	\$ 33	\$ 53,317	\$	\$ 53,350
Available for sale securities	24,663	1,156,598	64,098	1,245,359
Loans held for sale		860,374	26,826	887,200
Derivative assets		23,365		23,365
Mortgage servicing rights asset			29,939	29,939
Trading liabilities			48	48

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Derivative liabilities		5,950	5,950
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December 31, 2013	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	33	58,813	\$	58,846
Available for sale securities	22,079	1,121,011	60,053	1,203,143
Loans held for sale		1,061,310	27,729	1,089,039
Derivative assets		23,564		23,564
Mortgage servicing rights asset			20,149	20,149
Trading liabilities		46		46
Derivative liabilities		139	5,600	5,739

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### Hilltop Holdings Inc. and Subsidiaries

#### Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	Balance at Beginning of Period	Purchases/ Additions	Sales/ Reductions	Included in Net Income	Total Gains or Losses (Realized or Unrealized) Included in Other Comprehensive Income (Loss)	Balance at End of Period
<b><u>Three months ended March 31, 2014</u></b>						
Available for sale securities	\$ 60,053	\$	\$	\$ 593	\$ 3,452	\$ 64,098
Loans held for sale	27,729	4,900	(5,594)	(209)		26,826
Mortgage servicing rights asset	20,149	7,432		2,358		29,939
Derivative liabilities	(5,600)			(350)		(5,950)
<b>Total</b>	<b>\$ 102,331</b>	<b>\$ 12,332</b>	<b>\$ (5,594)</b>	<b>\$ 2,392</b>	<b>\$ 3,452</b>	<b>\$ 114,913</b>
<b><u>Three months ended March 31, 2013</u></b>						
Available for sale securities	\$ 56,277	\$	\$	\$ 512	\$ 2,012	\$ 58,801
Mortgage servicing rights asset	2,080	2,125		225		4,430
Derivative liabilities	(4,490)			(224)		(4,714)
<b>Total</b>	<b>\$ 53,867</b>	<b>\$ 2,125</b>	<b>\$</b>	<b>\$ 513</b>	<b>\$ 2,012</b>	<b>\$ 58,517</b>

All net unrealized gains (losses) in the tables above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at March 31, 2014. The available for sale securities noted in the table above reflect Hilltop's note receivable and warrant to purchase common stock of SWS as discussed in Note 4 to the consolidated financial statements.

Hilltop's note receivable is valued using a cash flow model that estimates yield based on comparable securities in the market. The interest rate used to discount cash flows is the most significant unobservable input. An increase or decrease in the discount rate would result in a corresponding decrease or increase, respectively, in the fair value measurement of the note receivable.

The warrant is valued utilizing a binomial model. The underlying SWS common stock price and its related volatility, an unobservable input, are the most significant inputs into the model, and, therefore, decreases or increases to the SWS common stock price would result in a significant change in the fair value measurement of the warrant.

Loans held for sale, including monitored mortgage loans, are valued using commitments on hand from investors or prevailing market prices.

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The MSR asset is valued by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair value of the MSR asset is impacted by a variety of factors, including prepayment assumptions, discount rates, delinquency rates, contractually specified servicing fees, servicing costs and underlying portfolio characteristics.

Derivative liabilities in the tables above include a derivative option agreement ( Fee Award Option ) entered into by First Southwest and valued using discounted cash flows and probability of exercise.

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

The following table presents the changes in fair value for instruments that are reported at fair value under the Fair Value Option (in thousands).

	Changes in Fair Value for Assets and Liabilities Reported at Fair Value under Fair Value Option Three Months Ended March 31, 2014			Three Months Ended March 31, 2013		
	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	\$ 4,518	\$	\$ 4,518	\$ (5,438)	\$	\$ (5,438)
Mortgage servicing rights asset	2,358		2,358	225		225
Time deposits					8	8

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### Hilltop Holdings Inc. and Subsidiaries

#### Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

**Impaired Loans** The Company reports impaired loans based on the underlying fair value of the collateral through specific allowances within the allowance for loan losses. Purchased credit impaired ( PCI ) loans with a fair value of \$172.9 million and \$822.8 million were acquired by the Company upon completion of the PlainsCapital Merger and the FNB Transaction, respectively. 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 assumptions regarding default rates, loss severity rates assuming default, prepayment speeds and estimated collateral values.

**Other Real Estate Owned** The Company reports OREO at fair value less estimated cost to sell. Any excess of recorded investment over fair value, less cost to sell, is charged against the allowance for loan losses when property is initially transferred to OREO. Subsequent to the initial transfer to OREO, downward valuation adjustments are charged against earnings. The Company determines fair value primarily using independent appraisals of 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. In the FNB Transaction, the Bank acquired OREO of \$135.2 million, all of which is covered by FDIC loss-share agreements. At March 31, 2014 and December 31, 2013, the estimated fair value of covered OREO was \$152.3 million and \$142.8 million, respectively, and the underlying fair value measurements utilize Level 3 inputs. The fair value of non-covered OREO at March 31, 2014 and December 31, 2013 was \$5.8 million and \$4.8 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 utilized Level 2 inputs.

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

March 31, 2014	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value	Total Gains (Losses) for the Three Months Ended March 31, 2014	Total Gains (Losses) for the Three Months Ended March 31, 2013
Non-covered impaired loans	\$	\$	\$ 29,043	\$ 29,043	\$ (215)	\$ (431)
Covered impaired loans			35,519	35,519	(1,691)	
Non-covered other real estate owned		18		18	(102)	(160)
Covered other real estate owned			34,167	34,167	(431)	

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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 our Annual Report on Form 10-K for the year ended December 31, 2013.

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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).

March 31, 2014	Carrying Amount	Level 1 Inputs	Estimated Fair Value		Total
			Level 2 Inputs	Level 3 Inputs	
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 917,410	\$ 917,410	\$	\$	\$ 917,410
Held to maturity securities	30,981		30,902		30,902
Non-covered loans, net	3,612,301		315,199	3,313,626	3,628,825
Covered loans, net	909,783			1,060,417	1,060,417
Broker-dealer and clearing organization receivables	174,442		174,442		174,442
FDIC indemnification asset	188,736			188,736	188,736
Other assets	64,178		42,233	21,945	64,178
<b>Financial liabilities:</b>					
Deposits	6,663,176		6,667,621		6,667,621
Broker-dealer and clearing organization payables	161,888		161,888		161,888
Short-term borrowings	491,406		491,406		491,406
Debt	122,477		115,777		115,777
Other liabilities	2,834		2,834		2,834

December 31, 2013	Carrying Amount	Level 1 Inputs	Estimated Fair Value		Total
			Level 2 Inputs	Level 3 Inputs	
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 746,023	\$ 746,023	\$	\$	\$ 746,023
Non-covered loans, net	3,481,405		281,712	3,119,319	3,401,031
Covered loans, net	1,005,308			997,371	997,371
Broker-dealer and clearing organization receivables	119,317		119,317		119,317
FDIC indemnification asset	188,291			188,291	188,291
Other assets	66,055		43,946	22,109	66,055
<b>Financial liabilities:</b>					
Deposits	6,722,019		6,722,909		6,722,909
Broker-dealer and clearing organization payables	129,678		129,678		129,678
Short-term borrowings	342,087		342,087		342,087
Debt	123,339		114,671		114,671
Other liabilities	3,362		3,362		3,362





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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

**4. Securities**

The amortized cost and fair value of securities, excluding trading securities, are summarized as follows (in thousands).

March 31, 2014	Amortized Cost	Available for Sale		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Treasury securities	\$ 63,684	\$ 80	\$ (94)	\$ 63,670
U.S. government agencies:				
Bonds	704,980	1,051	(38,903)	667,128
Residential mortgage-backed securities	57,781	1,269	(505)	58,545
Collateralized mortgage obligations	117,336	296	(3,800)	113,832
Corporate debt securities	95,422	4,955	(226)	100,151
States and political subdivisions	155,292	843	(3,550)	152,585
Commercial mortgage-backed securities	618	69		687
Equity securities	20,237	4,426		24,663
Note receivable	43,267	5,315		48,582
Warrant	12,068	3,448		15,516
Totals	\$ 1,270,685	\$ 21,752	\$ (47,078)	\$ 1,245,359

December 31, 2013	Amortized Cost	Available for Sale		Fair Value
		Unrealized Gains	Unrealized Losses	
U.S. Treasury securities	\$ 43,684	\$ 82	\$ (238)	\$ 43,528
U.S. government agencies:				
Bonds	717,909	550	(55,727)	662,732
Residential mortgage-backed securities	59,936	735	(584)	60,087
Collateralized mortgage obligations	124,502	349	(4,390)	120,461
Corporate debt securities	72,376	4,610	(378)	76,608
States and political subdivisions	162,955	388	(6,508)	156,835
Commercial mortgage-backed securities	691	69		760
Equity securities	20,067	2,012		22,079
Note receivable	42,674	5,235		47,909
Warrant	12,068	76		12,144
Totals	\$ 1,256,862	\$ 14,106	\$ (67,825)	\$ 1,203,143

March 31, 2014	Amortized Cost	Held to Maturity		Fair Value
		Unrealized Gains	Unrealized Losses	
U.S. government agencies:				

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Residential mortgage-backed securities	\$	29,582	\$	\$	(70)	\$	29,512
States and political subdivisions		1,399		1	(10)		1,390
Totals	\$	30,981	\$	1	\$	(80)	\$ 30,902

Available for sale securities includes 1,475,387 shares of SWS common stock, a \$50.0 million aggregate principal amount note issued by SWS and a warrant to purchase 8,695,652 shares of SWS common stock. SWS issued the note in July 2011 under a credit agreement pursuant to a senior unsecured loan from Hilltop. The note bears interest at a rate of 8.0% per annum, is prepayable by SWS subject to certain conditions after three years, and has a maturity of five years. The warrant provides for the purchase of 8,695,652 shares of SWS common stock at an exercise price of \$5.75 per share, subject to anti-dilution adjustments. If the warrant was fully exercised, Hilltop would beneficially own 24.4% of SWS.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Information regarding securities that were in an unrealized loss position is shown in the following tables (dollars in thousands).

<b>Available for Sale</b>							
U.S. treasury securities:							
Unrealized loss for less than twelve months	6	\$ 13,289	\$ 94	6	\$ 12,748	\$ 238	
Unrealized loss for twelve months or longer							
	6	13,289	94	6	12,748	238	
U.S. government agencies:							
Bonds:							
Unrealized loss for less than twelve months	31	399,291	24,490	35	526,817	45,274	
Unrealized loss for twelve months or longer	7	160,352	14,413	5	90,931	10,453	
	38	559,643	38,903	40	617,748	55,727	
Residential mortgage-backed securities:							
Unrealized loss for less than twelve months	1	1,595	62	2	2,194	54	
Unrealized loss for twelve months or longer	3	9,325	443	3	9,309	530	
	4	10,920	505	5	11,503	584	
Collateralized mortgage obligations:							
Unrealized loss for less than twelve months	6	68,200	3,740	7	84,054	4,320	
Unrealized loss for twelve months or longer	2	4,095	60	2	4,995	70	
	8	72,295	3,800	9	89,049	4,390	
Corporate debt securities:							
Unrealized loss for less than twelve months	7	10,732	226	7	10,754	378	
Unrealized loss for twelve months or longer							
	7	10,732	226	7	10,754	378	
States and political subdivisions:							
Unrealized loss for less than twelve months	29	21,753	257	46	30,245	669	
Unrealized loss for twelve months or longer	140	92,954	3,293	150	96,882	5,839	
	169	114,707	3,550	196	127,127	6,508	
Total available for sale:							
Unrealized loss for less than twelve months	80	514,860	28,869	103	666,812	50,933	
Unrealized loss for twelve months or longer	152	266,726	18,209	160	202,117	16,892	
	232	\$ 781,586	\$ 47,078	263	\$ 868,929	\$ 67,825	

		<b>March 31, 2014</b>			<b>December 31, 2013</b>	
	<b>Number of</b>		<b>Unrealized</b>	<b>Number of</b>		<b>Unrealized</b>

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	Securities	Fair Value	Losses	Securities	Fair Value	Losses
<b>Held to Maturity</b>						
U.S. government agencies:						
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	3	\$ 29,512	\$ 70	\$	\$	\$
Unrealized loss for twelve months or longer	3	29,512	70			
States and political subdivisions:						
Unrealized loss for less than twelve months	2	1,112	10			
Unrealized loss for twelve months or longer	2	1,112	10			
Total held to maturity:						
Unrealized loss for less than twelve months	5	30,624	80			
Unrealized loss for twelve months or longer	5	\$ 30,624	\$ 80	\$	\$	\$

During the three months ended March 31, 2014 and 2013, the Company did not record any other-than-temporary impairments. While all of the investments are monitored for potential other-than-temporary impairment, the Company's analysis and experience indicate that these available for sale investments generally do not present a great risk of other-than-temporary-impairment, as fair value should recover over time. 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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

significant enough to warrant other-than-temporary impairment of the securities. The Company does not intend, nor is it likely that the Company will be required, to sell these securities before the recovery of the cost basis. Therefore, management does not believe any other-than-temporary impairments exist at March 31, 2014.

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 and the available for sale warrant, at March 31, 2014 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	\$ 135,582	\$ 135,741	\$	\$
Due after one year through five years	117,222	126,696		
Due after five years through ten years	85,407	86,616		
Due after ten years	724,434	683,063	1,399	1,390
	1,062,645	1,032,116	1,399	1,390
Residential mortgage-backed securities	57,781	58,545	29,582	29,512
Collateralized mortgage obligations	117,336	113,832		
Commercial mortgage-backed securities	618	687		
	\$ 1,238,380	\$ 1,205,180	\$ 30,981	\$ 30,902

The Company realized a net gain from its trading securities portfolio of \$0.6 million during the three months ended March 31, 2014 and a net loss of \$1.2 million during the three months ended March 31, 2013, which are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of \$1.1 billion and \$1.0 billion (with a fair value of \$1.0 billion and \$938.1 million) at March 31, 2014 and December 31, 2013, 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.

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.

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At March 31, 2014 and December 31, 2013, NLC had investments on deposit in custody for various state insurance departments with carrying values of \$8.6 million and \$9.4 million, respectively.

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

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

	March 31, 2014	December 31, 2013
Commercial and industrial	\$ 1,670,087	\$ 1,637,266
Real estate	1,535,361	1,457,253
Construction and land development	387,382	364,551
Consumer	54,116	55,576
	3,646,946	3,514,646
Allowance for non-covered loan losses	(34,645)	(33,241)
Total non-covered loans, net of allowance	\$ 3,612,301	\$ 3,481,405

The Bank has lending policies in place with the goal of establishing an asset portfolio that will provide a return on stockholders' equity sufficient to maintain capital to assets ratios that meet or exceed established regulations. Loans are underwritten with careful consideration of the borrower's financial condition, the specific purpose of the loan, the primary sources of repayment and any collateral pledged to secure the loan.

Underwriting procedures address financial components based on the size or complexity of the credit. The financial components include, but are not limited to, current and projected cash flows, shock analysis and/or stress testing, and trends in appropriate balance sheet and statement of operations ratios. Collateral analysis includes a complete description of the collateral, as well as determining values, monitoring requirements, loan to value ratios, concentration risk, appraisal requirements and other information relevant to the collateral being pledged. Guarantor analysis includes liquidity and cash flow analysis based on the significance the guarantors are expected to serve as secondary repayment sources. The Bank's underwriting standards are governed by adherence to its loan policy. The loan policy provides for specific guidelines by portfolio segment, including commercial and industrial, real estate, construction and land development, and consumer loans. Within each individual portfolio segment, permissible and impermissible loan types are explicitly outlined. Within the loan types, minimum requirements for the underwriting factors listed above are provided.

The Bank maintains a loan review department that reviews credit risk in response to both external and internal factors that potentially impact the performance of either individual loans or the overall loan portfolio. The loan review process reviews the creditworthiness of borrowers and determines compliance with the loan policy. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel. Results of these reviews are presented to management and the Bank's board of directors.



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In connection with the PlainsCapital Merger and the FNB Transaction, 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).

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Carrying amount	\$ 85,396	\$ 100,392
Outstanding balance	122,881	141,983

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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).

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Balance, beginning of period	\$ 17,601	\$ 17,553
Additions		
Increases in expected cash flows	3,475	11,996
Disposals of loans	(603)	(26)
Accretion	(2,760)	(3,277)
Balance, end of period	\$ 17,713	\$ 26,246

Impaired loans exhibit a clear indication that the borrower's cash flow may not be sufficient to meet principal and interest payments, which is generally 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.

Non-covered PCI loans are summarized by class in the following tables (in thousands). In addition to the non-covered PCI loans, there were \$5.3 million and \$4.1 million of additional non-covered impaired loans at March 31, 2014 and December 31, 2013, respectively.

<b>March 31, 2014</b>	<b>Unpaid Contractual Principal Balance</b>	<b>Recorded Investment with No Allowance</b>	<b>Recorded Investment with Allowance</b>	<b>Total Recorded Investment</b>	<b>Related Allowance</b>
Commercial and industrial:					
Secured	\$ 57,302	\$ 19,727	\$ 12,894	\$ 32,621	\$ 2,716
Unsecured	11,421	1,225		1,225	
Real estate:					
Secured by commercial properties	41,051	12,053	17,439	29,492	450
Secured by residential properties	4,589	1,353	1,356	2,709	79
Construction and land development:					
Residential construction loans	33				
Commercial construction loans and land development	25,535	14,912	706	15,618	107
Consumer	7,516	3,731		3,731	
	\$ 147,447	\$ 53,001	\$ 32,395	\$ 85,396	\$ 3,352

<b>December 31, 2013</b>	<b>Unpaid Contractual Principal Balance</b>	<b>Recorded Investment with No Allowance</b>	<b>Recorded Investment with Allowance</b>	<b>Total Recorded Investment</b>	<b>Related Allowance</b>
Commercial and industrial:					

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Secured	\$	60,309	\$	19,280	\$	16,092	\$	35,372	\$	2,705
Unsecured		11,772		240		1,204		1,444		15
Real estate:										
Secured by commercial properties		49,306		20,185		16,070		36,255		339
Secured by residential properties		5,013		1,347		1,648		2,995		39
Construction and land development:										
Residential construction loans		33								
Commercial construction loans and land development		48,515		15,225		4,592		19,817		39
Consumer		7,946		4,509				4,509		
	\$	182,894	\$	60,786	\$	39,606	\$	100,392	\$	3,137

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Commercial and industrial:</b>		
Secured	\$ 33,997	\$ 68,316
Unsecured	1,335	3,107
<b>Real estate:</b>		
Secured by commercial properties	32,874	53,371
Secured by residential properties	2,852	7,413
<b>Construction and land development:</b>		
Residential construction loans		354
Commercial construction loans and land development	17,718	29,266
Consumer	4,120	75
	\$ 92,896	\$ 161,902

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

	<b>March 31,</b>	<b>December 31,</b>
	<b>2014</b>	<b>2013</b>
<b>Commercial and industrial:</b>		
Secured	\$ 14,551	\$ 15,430
Unsecured	1,024	1,300
<b>Real estate:</b>		
Secured by commercial properties	1,094	2,638
Secured by residential properties	2,371	398
<b>Construction and land development:</b>		
Residential construction loans		
Commercial construction loans and land development	142	112
Consumer		
	\$ 19,182	\$ 19,878

At March 31, 2014 and December 31, 2013, non-covered non-accrual loans included non-covered PCI loans of \$13.9 million and \$15.8 million, respectively, for which discount accretion has been suspended because the extent and timing of cash flows from these non-covered PCI loans can no longer be reasonably estimated. In addition to the non-covered non-accrual loans in the table above, \$3.7 million and \$3.5 million of real estate loans secured by residential properties and classified as held for sale were in non-accrual status at March 31, 2014 and December 31, 2013, respectively.

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Interest income recorded on accruing impaired loans and on non-accrual loans was \$1.4 million for the three months ended March 31, 2014. Interest income recorded on accruing impaired loans and on non-accrual loans for the three months ended March 31, 2013 was nominal.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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 also reconfigures 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.

Information regarding TDRs granted is shown in the following tables (in thousands). At March 31, 2014, the Bank had no unadvanced commitments to borrowers whose loans have been restructured in TDRs. At December 31, 2013, the Bank had \$0.5 million in such unadvanced commitments.

Three months ended March 31, 2014	A/B Note	Recorded Investment in Loans Modified by		Total Modification
		Interest Rate Adjustment	Payment Term Extension	
Commercial and industrial:				
Secured	\$	\$	\$	\$
Unsecured				
Real estate:				
Secured by commercial properties			345	345
Secured by residential properties			258	258
Construction and land development:				
Residential construction loans				
Commercial construction loans and land development			142	142
Consumer				
	\$	\$	\$ 745	\$ 745

Three months ended March 31, 2013	A/B Note	Recorded Investment in Loans Modified by		Total Modification
		Interest Rate Adjustment	Payment Term Extension	
Commercial and industrial:				
Secured	\$	\$	\$ 28	\$ 28
Unsecured				
Real estate:				
Secured by commercial properties			1,236	1,236
Secured by residential properties			262	262
Construction and land development:				
Residential construction loans				
Commercial construction loans and land development			570	570
Consumer				
	\$	\$	\$ 2,096	\$ 2,096



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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

March 31, 2014	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 Past Due 90 Days or More
Commercial and industrial:								
Secured	\$ 4,492	\$ 4,914	\$ 379	\$ 9,785	\$ 1,528,769	\$ 32,621	\$ 1,571,175	\$ 1
Unsecured	88	1		89	97,598	1,225	98,912	
Real estate:								
Secured by commercial properties	205			205	1,083,444	29,492	1,113,141	
Secured by residential properties	1,976	49	70	2,095	417,416	2,709	422,220	
Construction and land development:								
Residential construction loans	381			381	67,540		67,921	
Commercial construction loans and land development		3,121		3,121	300,722	15,618	319,461	
Consumer	240	10	1	251	50,134	3,731	54,116	1
	\$ 7,382	\$ 8,095	\$ 450	\$ 15,927	\$ 3,545,623	\$ 85,396	\$ 3,646,946	\$ 2

December 31, 2013	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 Past Due 90 Days or More
Commercial and industrial:								
Secured	\$ 2,171	\$ 277	\$ 1,354	\$ 3,802	\$ 1,492,793	\$ 35,372	\$ 1,531,967	\$ 272
Unsecured	333	9	60	402	103,453	1,444	105,299	59
Real estate:								
Secured by commercial properties	192		132	324	1,044,437	36,255	1,081,016	
Secured by residential properties	1,045	36	203	1,284	371,958	2,995	376,237	203
Construction and land development:								
Residential construction loans	415			415	64,664		65,079	
Commercial construction loans and land development	41	881	112	1,034	278,621	19,817	299,472	
Consumer	201	60		261	50,806	4,509	55,576	
	\$ 4,398	\$ 1,263	\$ 1,861	\$ 7,522	\$ 3,406,732	\$ 100,392	\$ 3,514,646	\$ 534



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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.

**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.

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### Hilltop Holdings Inc. and Subsidiaries

#### Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

<b>March 31, 2014</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>PCI</b>	<b>Total</b>
<b>Commercial and industrial:</b>					
Secured	\$ 1,474,358	\$ 29,114	\$ 35,082	\$ 32,621	\$ 1,571,175
Unsecured	97,512	8	167	1,225	98,912
<b>Real estate:</b>					
Secured by commercial properties	1,076,039	5,835	1,775	29,492	1,113,141
Secured by residential properties	413,626		5,885	2,709	422,220
<b>Construction and land development:</b>					
Residential construction loans	67,921				67,921
Commercial construction loans and land development	299,760	280	3,803	15,618	319,461
Consumer	50,348		37	3,731	54,116
	\$ 3,479,564	\$ 35,237	\$ 46,749	\$ 85,396	\$ 3,646,946

<b>December 31, 2013</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>PCI</b>	<b>Total</b>
<b>Commercial and industrial:</b>					
Secured	\$ 1,450,734	\$ 16,840	\$ 29,021	\$ 35,372	\$ 1,531,967
Unsecured	103,674	12	169	1,444	105,299
<b>Real estate:</b>					
Secured by commercial properties	1,038,930	4,436	1,395	36,255	1,081,016
Secured by residential properties	367,758		5,484	2,995	376,237
<b>Construction and land development:</b>					
Residential construction loans	65,079				65,079
Commercial construction loans and land development	275,808	3,384	463	19,817	299,472
Consumer	51,052	1	14	4,509	55,576
	\$ 3,353,035	\$ 24,673	\$ 36,546	\$ 100,392	\$ 3,514,646

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

It is management's responsibility at the end of each quarter, or more frequently as deemed necessary, to analyze the level of the allowance for loan losses to ensure that it is appropriate for the estimated credit losses in the portfolio consistent with the Interagency Policy Statement on the Allowance for Loan and Lease Losses and the Receivables and Contingencies Topics of the ASC. Estimated credit losses are the probable current amount of loans that the Company will be unable to collect given facts and circumstances as of the evaluation date. When management determines that a loan or portion thereof is uncollectible, the loan, or portion thereof, is charged off against the allowance for loan losses. Any

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subsequent recovery of charged-off loans is added back to the allowance for loan losses. The Bank's loan portfolio is designated into two populations: acquired loans and originated loans. The allowance for loan losses is calculated separately for acquired and originated loans.

### *Originated Loans*

The Company has developed a methodology that seeks to determine an allowance within the scope of the Receivables and Contingencies Topics of the ASC. Each of the loans that has been determined to be impaired is within the scope of the Receivables Topic. Impaired loans that are equal to or greater than \$0.5 million are individually evaluated for impairment using one of three impairment measurement methods as of the evaluation date: (1) the present value of expected future discounted cash flows on the loan, (2) the loan's observable market price, or (3) the fair value of the collateral if the loan is collateral dependent. Specific reserves are provided in the estimate of the allowance based on the measurement of impairment under these three methods, except for collateral dependent loans, which require the fair value method. All non-impaired loans are within the scope of the Contingencies Topic. Estimates of loss for the Contingencies Topic are calculated based on historical loss experience by loan portfolio segment adjusted for changes in trends, conditions, and other relevant factors that affect repayment of loans as of the evaluation date. While historical loss experience provides a

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

reasonable starting point for the analysis, historical losses, or recent trends in losses, are not the sole basis upon which to determine the appropriate level for the allowance for loan losses. Management considers recent qualitative or environmental factors that are likely to cause estimated credit losses associated with the existing portfolio to differ from historical loss experience, including but not limited to: changes in lending policies and procedures; changes in underwriting standards; changes in economic and business conditions and developments that affect the collectability of the portfolio; the condition of various market segments; changes in the nature and volume of the portfolio and in the terms of loans; changes in lending management and staff; changes in the volume and severity of past due loans, the volume of non-accrual loans, and the volume and severity of adversely classified or graded loans; changes in the loan review system; changes in the value of underlying collateral for collateral-dependent loans; and any concentrations of credit and changes in the level of such concentrations.

The loan review program is designed to identify and monitor problem loans by maintaining a credit grading process, requiring that timely and appropriate changes be made to reviewed loans and coordinating the delivery of the information necessary to assess the appropriateness of the allowance for loan losses. Loans are evaluated for impaired status when: (i) payments on the loan are delayed, typically by 90 days or more (unless the loan is both well secured and in the process of collection), (ii) the loan becomes classified, (iii) the loan is being reviewed in the normal course of the loan review scope, or (iv) the loan is identified by the servicing officer as a problem.

Homogeneous loans, such as consumer installment loans, residential mortgage loans and home equity loans, are not individually reviewed and are generally risk graded at the same levels. The risk grade and reserves are established for each homogeneous pool of loans based on the expected net charge-offs from current trends in delinquencies, losses or historical experience and general economic conditions. At March 31, 2014 and December 31, 2013, there were no material delinquencies in these types of loans.

*Acquired Loans*

Loans acquired in a business combination are recorded at their estimated fair value on their purchase date and with no carryover of the related allowance for loan losses. Loans without evidence of credit impairment at acquisition are subsequently evaluated for any required allowance at each reporting date. An allowance for loan losses is calculated using a methodology similar to that described above for originated loans. The allowance as determined for each loan collateral type is compared to the remaining fair value discount for that loan collateral type. If greater, the excess is recognized as an addition to the allowance through a provision for loan losses. If less than the discount, no additional allowance is recorded. Charge-offs and losses first reduce any remaining fair value discount for the loan and once the discount is depleted, losses are applied against the allowance established for that loan.

PCI loans acquired in the PlainsCapital Merger are accounted for on an individual loan basis, while PCI loans acquired in the FNB Transaction are accounted for both in pools and at the individual loan level. Cash flows expected to be collected are recast quarterly for each loan or pool. These evaluations require the continued use and updating of key assumptions and estimates such as default rates, loss severity given default and prepayment speed assumptions, similar to those used for the initial fair value estimate. Management judgment must be applied in developing these assumptions. If expected cash flows for a loan or pool decreases, an increase in the allowance for loan losses is made through a charge to

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the provision for loan losses. If expected cash flows for a loan or pool increase, any previously established allowance for loan losses is reversed and any remaining difference increases the accretable yield which will be taken into income over the remaining life of the loan.

The allowance 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.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

<b>Three months ended March 31, 2014</b>	<b>Commercial and Industrial</b>	<b>Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Total</b>
Balance, beginning of period	\$ 16,865	\$ 8,331	\$ 7,957	\$ 88	\$ 33,241
Provision charged to operations	(57)	1,319	17	109	1,388
Loans charged off	(807)			(74)	(881)
Recoveries on charged off loans	725	32	122	18	897
Balance, end of period	\$ 16,726	\$ 9,682	\$ 8,096	\$ 141	\$ 34,645

<b>Three months ended March 31, 2013</b>	<b>Commercial and Industrial</b>	<b>Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Total</b>
Balance, beginning of period	\$ 1,845	\$ 977	\$ 582	\$ 5	\$ 3,409
Provision charged to operations	6,911	2,437	3,597	60	13,005
Loans charged off	(438)	(31)		(56)	(525)
Recoveries on charged off loans	494	139	107	8	748
Balance, end of period	\$ 8,812	\$ 3,522	\$ 4,286	\$ 17	\$ 16,637

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

<b>March 31, 2014</b>	<b>Commercial and Industrial</b>	<b>Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Total</b>
Loans individually evaluated for impairment	\$ 1,930	\$ 2,399	\$ 142	\$	\$ 4,471
Loans collectively evaluated for impairment	1,634,311	1,500,761	371,622	50,385	3,557,079
PCI Loans	33,846	32,201	15,618	3,731	85,396
	\$ 1,670,087	\$ 1,535,361	\$ 387,382	\$ 54,116	\$ 3,646,946

<b>December 31, 2013</b>	<b>Commercial and Industrial</b>	<b>Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Total</b>
Loans individually evaluated for impairment	\$ 2,273	\$ 373	\$ 112	\$	\$ 2,758
Loans collectively evaluated for impairment	1,598,177	1,417,630	344,622	51,067	3,411,496
PCI Loans	36,816	39,250	19,817	4,509	100,392
	\$ 1,637,266	\$ 1,457,253	\$ 364,551	\$ 55,576	\$ 3,514,646

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

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<b>March 31, 2014</b>	<b>Commercial and Industrial</b>	<b>Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Total</b>
Loans individually evaluated for impairment	\$ 421	\$	\$	\$	\$ 421
Loans collectively evaluated for impairment	13,589	9,153	7,989	141	30,872
PCI Loans	2,716	529	107		3,352
	\$ 16,726	\$ 9,682	\$ 8,096	\$ 141	\$ 34,645

<b>December 31, 2013</b>	<b>Commercial and Industrial</b>	<b>Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Total</b>
Loans individually evaluated for impairment	\$ 421	\$	\$	\$	\$ 421
Loans collectively evaluated for impairment	13,724	7,953	7,918	88	29,683
PCI Loans	2,720	378	39		3,137
	\$ 16,865	\$ 8,331	\$ 7,957	\$ 88	\$ 33,241

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

**6. Covered Assets and Indemnification Asset**

As discussed in Note 2 to the consolidated financial statements, the Bank assumed substantially all of the liabilities, including all of the deposits, and acquired substantially all of the assets of FNB in an FDIC-assisted transaction on September 13, 2013. 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 losses on the first \$240.4 million of losses incurred; (ii) 0% of losses in excess of \$240.4 million up to and including \$365.7 million of losses incurred; and (iii) 80% of losses in excess of \$365.7 million of losses incurred. The Bank has also agreed to reimburse the FDIC for any subsequent recoveries. The loss-share agreements for commercial and single family residential loans are in effect for 5 years and 10 years, respectively, from the Bank Closing Date, and the loss recovery provisions to the FDIC are in effect for 8 years and 10 years, respectively, from the Bank Closing Date. The asset arising from the loss-share agreements, which we refer 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 the FDIC's initial estimate of losses on covered assets is greater than the actual realized losses. The true-up payment is calculated using a defined formula set forth in the P&A Agreement.

*Covered Loans and Allowance for Covered Loan Losses*

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

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

In connection with the FNB Transaction, the Bank acquired loans both with and without evidence of credit quality deterioration since origination. The Company's accounting policies for acquired covered loans, including covered PCI loans, are consistent with that of 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.



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

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Commercial and industrial	\$ 52,363	\$ 66,943
Real estate	746,454	787,982
Construction and land development	113,631	151,444
Consumer		
Total covered loans	912,448	1,006,369
Allowance for covered loans	(2,665)	(1,061)
Total covered loans, net of allowance	\$ 909,783	\$ 1,005,308

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Carrying amount	\$ 651,927	\$ 729,156
Outstanding balance	940,972	1,022,514

Changes in the accretable yield for the covered PCI loans for the three months ended March 31, 2014 were as follows (in thousands).

Balance, beginning of period	\$ 156,548
Additions	
Increases in expected cash flows	30,710
Transfer of loans to covered OREO	5,261
Accretion	(16,050)
Balance, end of period	\$ 176,469

Covered PCI loans are summarized by class in the following tables (in thousands). In addition to the covered PCI loans, there were \$2.7 million and \$0.9 million of additional covered impaired loans at March 31, 2014 and December 31, 2013, respectively.

<b>March 31, 2014</b>	<b>Unpaid Contractual Principal Balance</b>	<b>Recorded Investment with No Allowance</b>	<b>Recorded Investment with Allowance</b>	<b>Total Recorded Investment</b>	<b>Related Allowance</b>
<b>Commercial and industrial:</b>					
Secured	\$ 36,395	\$ 22,110	\$ 132	\$ 22,242	\$
Unsecured	16,577	8,065	903	8,968	883
<b>Real estate:</b>					
<b>Secured by commercial properties</b>					
	505,438	312,576	26,786	339,362	142
<b>Secured by residential properties</b>					
	280,825	177,719	10,271	187,990	1,548
<b>Construction and land development:</b>					
<b>Residential construction loans</b>					
	5,029	2,363		2,363	
<b>Commercial construction loans and land development</b>					
	151,091	91,002		91,002	
<b>Consumer</b>					
	\$ 995,355	\$ 613,835	\$ 38,092	\$ 651,927	\$ 2,573

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December 31, 2013	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
<b>Commercial and industrial:</b>					
Secured	\$ 43,867	\$ 28,520	\$	\$ 28,520	\$
Unsecured	16,280	9,008	882	9,890	882
<b>Real estate:</b>					
<b>Secured by commercial properties</b>					
	528,785	365,306		365,306	
<b>Secured by residential properties</b>					
	288,859	199,372		199,372	
<b>Construction and land development:</b>					
<b>Residential construction loans</b>					
	8,341	4,705		4,705	
<b>Commercial construction loans and land development</b>					
	183,117	121,363		121,363	
<b>Consumer</b>					
	\$ 1,069,249	\$ 728,274	\$ 882	\$ 729,156	\$ 882

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

Average investment in covered PCI loans for the three months ended March 31, 2014 is summarized by class in the following table (in thousands).

Commercial and industrial:		
Secured	\$	25,381
Unsecured		9,429
Real estate:		
Secured by commercial properties		352,334
Secured by residential properties		193,681
Construction and land development:		
Residential construction loans		3,534
Commercial construction loans and land development		106,183
Consumer		
	\$	690,542

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

	March 31, 2014	December 31, 2013
Commercial and industrial:		
Secured	\$	\$ 91
Unsecured	882	882
Real estate:		
Secured by commercial properties	10,607	40
Secured by residential properties	670	209
Construction and land development:		
Residential construction loans	1,898	575
Commercial construction loans and land development	15	
Consumer		
	\$ 14,072	\$ 1,797

At March 31, 2014, covered non-accrual loans included covered PCI loans of \$11.4 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 recorded on accruing impaired loans and on non-accrual loans for the three months ended March 31, 2014 was nominal. Except as noted above, covered PCI loans are considered to be performing due to the application of the accretion method. Additionally, no acquired covered performing loans have been modified in a TDR.



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(Unaudited)

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

March 31, 2014	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 Past Due 90 Days or More
Commercial and industrial:								
Secured	\$ 218	\$ 56	\$ 168	\$ 442	\$ 13,045	\$ 22,242	\$ 35,729	\$ 168
Unsecured	98	71		169	7,497	8,968	16,634	
Real estate:								
Secured by commercial properties	356		455	811	62,282	339,362	402,455	379
Secured by residential properties	2,190	584	995	3,769	152,240	187,990	343,999	419
Construction and land development:								
Residential construction loans	730	858	1,399	2,987	1,850	2,363	7,200	85
Commercial construction loans and land development	43	66		109	15,320	91,002	106,431	
Consumer								
	\$ 3,635	\$ 1,635	\$ 3,017	\$ 8,287	\$ 252,234	\$ 651,927	\$ 912,448	\$ 1,051

December 31, 2013	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 Past Due 90 Days or More
Commercial and industrial:								
Secured	\$ 3,904	\$ 10	\$ 81	\$ 3,995	\$ 20,918	\$ 28,520	\$ 53,433	\$
Unsecured	10	259		269	3,351	9,890	13,510	
Real estate:								
Secured by commercial properties	999		40	1,039	63,780	365,306	430,125	
Secured by residential properties	1,679	678	209	2,566	155,919	199,372	357,857	
Construction and land development:								
Residential construction loans	1,861		576	2,437	5,026	4,705	12,168	
Commercial construction loans and land development	244	20		264	17,649	121,363	139,276	
Consumer								
	\$ 8,697	\$ 967	\$ 906	\$ 10,570	\$ 266,643	\$ 729,156	\$ 1,006,369	\$

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).

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March 31, 2014	Pass	Special Mention	Substandard	PCI	Total
<b>Commercial and industrial:</b>					
Secured	\$ 13,187	\$	\$ 300	\$ 22,242	\$ 35,729
Unsecured	7,350		316	8,968	16,634
<b>Real estate:</b>					
Secured by commercial properties	52,598	1,702	8,793	339,362	402,455
Secured by residential properties	150,862		5,147	187,990	343,999
<b>Construction and land development:</b>					
Residential construction loans	2,853		1,984	2,363	7,200
Commercial construction loans and land development	14,926		503	91,002	106,431
Consumer	\$ 241,776	\$ 1,702	\$ 17,043	\$ 651,927	\$ 912,448

December 31, 2013	Pass	Special Mention	Substandard	PCI	Total
<b>Commercial and industrial:</b>					
Secured	\$ 24,152	\$	\$ 761	\$ 28,520	\$ 53,433
Unsecured	3,040		580	9,890	13,510
<b>Real estate:</b>					
Secured by commercial properties	59,343	3,310	2,166	365,306	430,125
Secured by residential properties	155,439		3,046	199,372	357,857
<b>Construction and land development:</b>					
Residential construction loans	6,087		1,376	4,705	12,168
Commercial construction loans and land development	17,806		107	121,363	139,276
Consumer	\$ 265,867	\$ 3,310	\$ 8,036	\$ 729,156	\$ 1,006,369

The Bank's impairment methodology for the covered loans is consistent with that of non-covered loans as discussed in Note 5 to the consolidated financial statements. To the extent there is experienced or projected credit deterioration on the acquired covered loan pools subsequent to amounts estimated at the previous quarterly recast date and expected cash flows for a loan or pool decreases, an increase in the allowance for loan losses is made through a charge to the provision for loan losses. If expected cash flows for a loan or pool increase, any previously established allowance for loan losses is

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

reversed and any remaining difference increases the accretable yield which will be taken into income over the remaining life of the loan. Additionally, provision for credit losses will be recorded on advances on covered loans subsequent to the acquisition date in a manner consistent with the allowance for non-covered loan losses. These provisions will be partially offset by an increase to the FDIC Indemnification Asset in an amount equal to the FDIC's loss sharing percentage under the loss-share agreements, which is recognized in noninterest income within the consolidated statement of operations.

Changes in the allowance for covered loan losses for the three months ended March 31, 2014, distributed by portfolio segment, are shown below (in thousands).

	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	\$ 1,053	\$ 8	\$	\$	\$ 1,061
Provision charged to operations	(30)	1,732	152		1,854
Loans charged off	(91)	(44)	(115)		(250)
Recoveries on charged off loans					
Balance, end of period	\$ 932	\$ 1,696	\$ 37	\$	\$ 2,665

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

March 31, 2014	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Loans individually evaluated for impairment	\$	\$	\$ 1,385	\$	\$ 1,385
Loans collectively evaluated for impairment	21,153	219,102	18,881		259,136
PCI Loans	31,210	527,352	93,365		651,927
	\$ 52,363	\$ 746,454	\$ 113,631	\$	\$ 912,448

December 31, 2013	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Loans individually evaluated for impairment	\$	\$	\$	\$	\$
Loans collectively evaluated for impairment	28,533	223,304	25,376		277,213
PCI Loans	38,410	564,678	126,068		729,156
	\$ 66,943	\$ 787,982	\$ 151,444	\$	\$ 1,006,369



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

<b>March 31, 2014</b>	<b>Commercial and Industrial</b>		<b>Real Estate</b>		<b>Construction and Land Development</b>		<b>Consumer</b>		<b>Total</b>	
Loans individually evaluated for impairment	\$		\$		\$		\$		\$	
Loans collectively evaluated for impairment		49		6		37				92
PCI Loans		883		1,690						2,573
	\$	932	\$	1,696	\$	37	\$		\$	2,665

<b>December 31, 2013</b>	<b>Commercial and Industrial</b>		<b>Real Estate</b>		<b>Construction and Land Development</b>		<b>Consumer</b>		<b>Total</b>	
Loans individually evaluated for impairment	\$		\$		\$		\$		\$	
Loans collectively evaluated for impairment		171		8						179
PCI Loans		882								882
	\$	1,053	\$	8	\$		\$		\$	1,061

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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 for the three months ended March 31, 2014 is as follows (in thousands).

Balance, beginning of period	\$	142,833
Additions to covered OREO		23,190
Dispositions of covered OREO		(13,282)
Valuation adjustments in the period		(431)
Balance, end of period	\$	152,310

*FDIC Indemnification Asset*

A summary of the activity in the FDIC Indemnification Asset for the three months ended March 31, 2014 is as follows (in thousands).

Balance, beginning of period	\$	188,291
FDIC Indemnification Asset accretion (amortization)		1,357
Transfers to due from FDIC and other		(912)
Balance, end of period	\$	188,736

**7. Mortgage Servicing Rights**

The following table presents the change in fair value of the Company's MSR (dollars in thousands).

	Three Months Ended March 31,	
	2014	2013
Balance, beginning of period	\$ 20,149	\$ 2,080
Additions	7,432	2,125
Changes in fair value:		
Due to changes in model inputs or assumptions (1)	2,764	300
Due to customer payments	(406)	(75)

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Balance, end of period	\$	29,939	\$	4,430
Mortgage loans serviced for others	\$	2,692,730	\$	602,771
MSR as a percentage of serviced mortgage loans		1.11%		0.73%

(1) Primarily represents 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 were as follows.

	Three Months Ended March 31,	
	2014	2013
Weighted average constant prepayment rate	9.92%	12.53%
Weighted average discount rate	11.58%	20.27%
Weighted average life (in years)	7.4	6.6

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

	March 31, 2014	December 31, 2013
Constant prepayment rate:		
Impact of 10% adverse change	\$ (678)	\$ (601)
Impact of 20% adverse change	(1,313)	(1,170)
Discount rate:		
Impact of 100 basis point adverse change	(792)	(631)
Impact of 200 basis point adverse change	(1,520)	(1,236)

This sensitivity analysis presents the effect of hypothetical changes in key assumptions on the fair value of the MSR. 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 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.

During the three months ended March 31, 2014 and 2013, contractually specified servicing fees, late fees and ancillary fees earned of \$2.2 million and \$0.3 million, respectively, were included in other noninterest income within the consolidated statements of operations.

**8. Deposits**

Deposits are summarized as follows (in thousands).

	March 31, 2014	December 31, 2013
Noninterest-bearing demand	\$ 1,748,391	\$ 1,773,749
Interest-bearing:		
NOW accounts	1,226,645	1,083,596
Money market	932,417	878,578
Brokered - money market	279,733	276,760
Demand	48,703	47,636
Savings	298,082	357,325
Time	1,968,938	2,110,947
Brokered - time	160,267	194,327

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\$ 6,663,176 \$ 6,722,918

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

**9. Short-term Borrowings**

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

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Federal funds purchased	\$ 193,275	\$ 137,225
Securities sold under agreements to repurchase	158,931	107,462
Federal Home Loan Bank notes		
Short-term bank loans	139,200	97,400
	<b>\$ 491,406</b>	<b>\$ 342,087</b>

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 FSC 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, FSC or the dealer.

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Average balance during the period	\$ 343,233	\$ 328,521
Average interest rate during the period	0.18%	0.21%

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Average interest rate at end of period	0.16%	0.16%
Securities underlying the agreements at end of period		
Carrying value	\$ 166,472	\$ 144,991
Estimated fair value	\$ 162,932	\$ 138,719

Federal Home Loan Bank ( FHLB ) notes 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 notes is shown in the following tables (dollars in thousands).

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	Three Months Ended March 31,	
	2014	2013
Average balance during the period	\$ 8	\$ 34,174
Average interest rate during the period	0.13%	0.09%

	March 31,	December 31,
Average interest rate at end of period		

FSC uses short-term bank loans periodically to finance securities owned, customers' margin accounts and underwriting activities. Interest on the borrowings varies with the federal funds rate. The weighted average interest rate on the borrowings at March 31, 2014 and December 31, 2013 was 1.13% and 1.15%, respectively.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

**10. 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 rate was 36.2% and 36.5% for the three months ended March 31, 2014 and 2013, respectively.

GAAP requires the measurement of uncertain tax positions. Uncertain tax positions are the difference between a tax position taken, or expected to be taken in a tax return, and the benefit recognized for accounting purposes. There were no uncertain tax positions at March 31, 2014 and December 31, 2013.

The Company files income tax returns in U.S. federal and several U.S. state jurisdictions. The Company is subject to tax audits in numerous jurisdictions in the U.S. until the applicable statute of limitations expires. Excluding those entities acquired as a part of the PlainsCapital Merger, the Company has been examined by U.S. tax authorities for U.S. federal income tax years prior to 2010, and is under no federal or state tax audits at March 31, 2014. PlainsCapital has been examined by U.S. tax authorities for U.S. federal income tax years prior to 2011, and is under no federal or state tax audits at March 31, 2014.

For the majority of tax jurisdictions, the Company is no longer subject to federal, state or local income tax examinations by tax authorities for years prior to 2010.

**11. 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. Some 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 however, the Company does not take into account the availability of insurance coverage. 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



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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. However, as available information changes, 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. The aggregated estimated amount provided above therefore may not include an estimate for every such matter.

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 its business, 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

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Inquiries, the Company receives document requests, subpoenas and other requests for information. The Inquiries, including those 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.

Hilltop, Peruna LLC (wholly owned subsidiary of Hilltop), SWS and the individual members of the board of directors of SWS, including Gerald J. Ford, have been named as defendants in two purported shareholder class action lawsuits arising out of the proposed acquisition of SWS by Hilltop, which acquisition was announced on April 1, 2014. Both lawsuits were filed in Delaware Chancery Court (Joseph Arceri v. SWS Group, Inc. et al and Chaile Steinberg v. SWS Group, Inc. et al filed April 8, 2014 and April 11, 2014, respectively). The lawsuits allege claims for breach of fiduciary duty by the individual directors of SWS, and claims against Hilltop for aiding and abetting that breach of fiduciary duty. Both actions seek to enjoin the proposed acquisition. Hilltop believes that the claims are without merit and intends to vigorously defend against these actions.

As a part of an industry-wide inquiry, PrimeLending has 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. PrimeLending is cooperating with this Inquiry.

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

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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 March 31, 2014 and December 31, 2013, the mortgage origination segment's indemnification liability reserve totaled \$21.0 million and \$21.1 million, respectively. The provision for indemnification losses was \$0.6 million and \$1.0 million during the three months ended March 31, 2014 and 2013, respectively.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

**Representation and Warranty Specific Claims  
Activity - Origination Loan Balance  
Three Months Ended March 31,**

	2014		2013	
Balance, beginning of period	\$	51,912	\$	39,693
Claims made		10,044		11,620
Claims resolved with no payment		(4,458)		(7,820)
Repurchases		(4,878)		(1,651)
Indemnification payments		(691)		(612)
Balance, end of period	\$	51,929	\$	41,230

**Indemnification Liability Reserve Activity  
Three Months Ended March 31,**

	2014		2013	
Balance, beginning of period	\$	21,121	\$	18,964
Additions for new sales		560		956
Repurchases		(504)		(41)
Early payment defaults		(21)		(95)
Indemnification payments		(181)		(219)
Change in estimate				136
Balance, end of period	\$	20,975	\$	19,701

**Reserve for Indemnification Liability:**

Specific claims	\$	12,482		
Incurred but not reported claims		8,493		
Total	\$	20,975		

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 losses on the first \$240.4 million of losses incurred; (ii) 0% of losses in excess of \$240.4 million up to and including \$365.7 million of losses incurred; and (iii) 80% of losses in excess of \$365.7 million of losses incurred. The Bank has also agreed to reimburse the FDIC for any subsequent recoveries. The loss-share agreements for commercial and single family residential loans are in effect for 5 years and 10 years, respectively, from the Bank Closing Date and the loss recovery provisions to the FDIC

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are in effect for 8 years and 10 years, respectively, from the Bank Closing Date. 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 the FDIC's initial estimate of losses on covered assets is greater than the actual realized losses. The true-up payment is calculated using a defined formula set forth in the P&A Agreement.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

**12. 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 \$1.2 billion at March 31, 2014 and outstanding financial and performance standby letters of credit of \$42.9 million at March 31, 2014.

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, FSC executes, settles, and finances various securities transactions that may expose FSC to off-balance sheet risk in the event that a customer or counterparty does not fulfill its contractual obligations. Examples of such transactions include the sale of securities not yet purchased by customers or for the account of FSC, clearing agreements between FSC and various clearinghouses and broker-dealers, secured financing arrangements that involve pledged securities, and when-issued underwriting and purchase commitments.

**13. Stock-Based Compensation**

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Pursuant to the Hilltop Holdings 2012 Equity Incentive Plan (the 2012 Plan ), the Company may grant nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, 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 March 31, 2014, 3,361,277 shares of common stock remain available for issuance pursuant to the 2012 Plan.

During January 2014 and February 2014, the Compensation Committee of the Board of Directors of the Company awarded certain executives and key employees an aggregate of 156,077 restricted stock units ( RSUs ) pursuant to the 2012 Plan. A total of 86,040 of these RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and the remaining RSUs vest based upon the achievement of certain performance goals over a three-year period. These RSUs are subject to service conditions set forth in the award agreements, with associated costs recognized on a straight-line basis over the respective vesting periods. The weighted average grant date fair value related to these RSUs was \$23.76 per share. At March 31, 2014, unrecognized compensation expense related to these RSUs was \$3.6 million, which will be amortized through February 2017. The RSUs are not transferable, and the shares of common stock issuable upon conversion of vested RSUs are generally subject to transfer restrictions for a period of one year following conversion, subject to certain exceptions. In addition, the applicable RSU award agreements provide for accelerated vesting under certain conditions.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

During 2013, the Compensation Committee of the Board of Directors of the Company awarded certain executives and key employees a total of 471,000 restricted shares of common stock ( Restricted Stock Awards ) pursuant to the 2012 Plan. These Restricted Stock Awards generally cliff vest on the third anniversary of the grant date and are subject to service conditions set forth in the award agreements, with associated costs recognized on a straight-line basis over the respective vesting periods. The weighted average grant date fair value related to these Restricted Stock Awards was \$13.32 per share. At March 31, 2014, unrecognized compensation expense related to these Restricted Stock Awards was \$4.3 million, which will be amortized through September 2016. The award agreements governing these Restricted Stock Awards provide for accelerated vesting under certain conditions.

During the three months ended March 31, 2014, Hilltop granted 2,303 shares of common stock to independent members of the Company's Board of Directors for service rendered to the Company during the respective periods. There were no shares of common stock granted to independent members of the Company's Board of Directors during the three months ended March 31, 2013.

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 outstanding at March 31, 2014. These Stock Option Awards vest in five equal installments beginning on the grant date, with the remainder vesting on each grant date anniversary through 2015. At March 31, 2014, unrecognized compensation expense related to these Stock Option Awards was \$0.1 million, which will be amortized on a straight-line basis through October 2015. Additionally, these Stock Option Awards expire on November 2, 2016.

Compensation expense related to the plans was \$0.7 million and \$0.1 million for the three months ended March 31, 2014 and 2013, respectively.

#### **14. Regulatory Matters**

##### *Bank*

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 us 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.



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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 Tier 1 and total capital (as defined) to risk-weighted assets (as defined).

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(Unaudited)

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 (dollars in thousands), without giving effect to the final Basel III capital rules adopted by the Federal Reserve Board on July 2, 2013.

	Actual		Minimum Capital Requirements		To Be Well Capitalized Minimum Capital Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>March 31, 2014</b>						
Tier 1 capital (to average assets):						
Bank	\$ 780,226	9.53%	\$ 327,545	4%	\$ 409,431	5%
Hilltop	1,137,727	13.12%	346,871	4%	N/A	N/A
Tier 1 capital (to risk-weighted assets):						
Bank	780,226	13.47%	231,644	4%	347,466	6%
Hilltop	1,137,727	18.66%	243,951	4%	N/A	N/A
Total capital (to risk-weighted assets):						
Bank	818,760	14.14%	463,288	8%	579,110	10%
Hilltop	1,178,253	19.32%	487,901	8%	N/A	N/A
<b>December 31, 2013</b>						
Tier 1 capital (to average assets):						
Bank	\$ 762,364	9.29%	\$ 328,275	4%	\$ 410,344	5%
Hilltop	1,112,424	12.81%	347,480	4%	N/A	N/A
Tier 1 capital (to risk-weighted assets):						
Bank	762,364	13.38%	227,984	4%	341,976	6%
Hilltop	1,112,424	18.53%	240,159	4%	N/A	N/A
Total capital (to risk-weighted assets):						
Bank	797,771	14.00%	455,968	8%	569,960	10%
Hilltop	1,148,736	19.13%	480,318	8%	N/A	N/A

To be considered adequately capitalized (as defined) under regulatory requirements, the Bank must maintain minimum Tier 1 capital to total average assets and Tier 1 capital to risk-weighted assets ratios of 4%, 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.

Management continues to evaluate the final Basel III capital rules and their impact, which would apply to reporting periods beginning after January 1, 2015.

*Financial Advisory*

Pursuant to the net capital requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), FSC has elected to determine its net capital requirements using the alternative method. Accordingly, FSC 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 or 2% of aggregate debit balances, as defined in Rule 15c3-3 promulgated under the Exchange Act. At March 31, 2014, FSC had net capital of \$71.5 million (the minimum net capital requirement was \$4.8 million), net capital maintained by FSC was 29.8% of aggregate debits, and net capital in excess of the minimum requirement was \$66.7 million.

Under certain conditions, FSC may be required to segregate cash and securities in a special reserve account for the benefit of customers under Rule 15c3-3 promulgated under the Exchange Act. Assets segregated under the provisions of the Exchange Act are not available for general corporate purposes. At March 31, 2014 and December 31, 2013, FSC was not required to segregate cash and securities.

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(Unaudited)

FSC was not required to segregate cash or securities in a special reserve account for the benefit of proprietary accounts of introducing broker-dealers at March 31, 2014 and December 31, 2013.

*Mortgage Origination*

As a mortgage originator, PrimeLending is subject to minimum net worth requirements established by the United States 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 requirements. In addition, PrimeLending monitors compliance on an ongoing basis and, as of March 31, 2014, 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 National Association of Insurance Commissioners ( NAIC ) statutory accounting practices 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 of each insurance subsidiary is as follows (in thousands).

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>Capital and surplus:</b>		
National Lloyds Insurance Company	\$ 104,599	\$ 98,602
American Summit Insurance Company	27,687	26,452

	<b>Three Months Ended March 31, 2014</b>		<b>2013</b>
<b>Statutory net income:</b>			
National Lloyds Insurance Company	\$	5,986	\$ 3,391
American Summit Insurance Company		1,131	251

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Regulations of the Texas Department of Insurance require insurance companies to maintain minimum levels of statutory surplus to ensure their ability to meet their obligations to policyholders. At March 31, 2014, 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 December 31, 2013, the most recent date for which the RBC calculation was performed, the Company's insurance subsidiaries' RBC ratio exceeded the level at which regulatory action would be required. As of March 31, 2014, management was not aware of any changes in financial condition or structure that would cause the Company's insurance subsidiaries to not be in compliance with the required RBC ratio.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

**15. 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 modifying the re-pricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect 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 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 ). FSC uses 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 and forward commitments are recorded in other assets or other liabilities, as appropriate, and changes in the fair values of these derivative instruments produced a net loss of \$1.6 million for the three months ended March 31, 2014 and a net gain of \$1.9 million for the three months ended March 31, 2013, which were recorded as a component of net gains from sale of loans and other mortgage production income. 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 changes in market interest rates. Changes in market interest rates also conversely affect the value of PrimeLending's mortgage loans held for sale, 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 is discussed in Note 3 to the consolidated financial statements. The fair values of FSC's derivative instruments are recorded in other assets or other liabilities, as appropriate, and changes in the fair values of FSC's derivatives produced net gains of \$2.8 million and \$1.8 million for the three months ended March 31, 2014 and 2013, respectively, which were recorded as a component of other noninterest income.

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

	March 31, 2014		December 31, 2013	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Derivative instruments:				
IRLCs	\$ 797,934	\$ 19,244	\$ 602,467	\$ 12,151
Commitments to purchase MBSs	258,015	1,768	236,305	(109)
Commitments to sell MBSs	1,686,208	2,353	1,645,332	11,383

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Fee Award Option	20,432	(5,950)	20,432	(5,600)
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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

**16. 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
<b>March 31, 2014</b>						
Securities borrowed:						
Institutional counterparties	\$ 144,936	\$	\$ 144,936	\$ (144,936)	\$	\$
Forward MBS sale derivatives:						
Institutional counterparties	3,111	(758)	2,353		13,517	15,870
	\$ 148,047	\$ (758)	\$ 147,289	\$ (144,936)	\$ 13,517	\$ 15,870
<b>December 31, 2013</b>						
Securities borrowed:						
Institutional counterparties	\$ 107,365	\$	\$ 107,365	\$ (107,365)	\$	\$
Forward MBS sale derivatives:						
Institutional counterparties	11,489	(76)	11,413		(286)	11,127
	\$ 118,854	\$ (76)	\$ 118,778	\$ (107,365)	\$ (286)	\$ 11,127

	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
<b>March 31, 2014</b>						
Securities Loaned:						
Institutional counterparties	\$ 91,879	\$	\$ 91,879	\$ (91,879)	\$	\$
Repurchase Agreements:						
Customer counterparties	151,945		151,945	(151,945)		
Institutional counterparties	6,986		6,986	(6,986)		



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\$ 250,810 \$ \$ 250,810 \$ (250,810) \$ \$

**December 31, 2013**

Securities Loaned:

Institutional counterparties \$ 74,913 \$ \$ 74,913 \$ (74,913) \$ \$

Repurchase Agreements:

Customer counterparties 107,462 107,462 (107,462)

Forward MBS Sale

Derivatives:

Institutional counterparties	30	30	(17)	13
\$ 182,405	\$ 182,405	\$ (182,375)	\$ (17)	\$ 13

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

**17. Broker-Dealer and Clearing Organization Receivables and Payables**

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

	March 31, 2014		December 31, 2013
<b>Receivables:</b>			
Securities borrowed	\$ 144,936	\$	107,365
Securities failed to deliver	19,232		7,160
Clearing organizations	10,108		4,698
Due from dealers	166		94
	\$ 174,442	\$	119,317
<b>Payables:</b>			
Securities loaned	\$ 91,879	\$	74,913
Correspondents	50,268		44,852
Securities failed to receive	17,601		5,523
Clearing organizations	2,140		4,390
	\$ 161,888	\$	129,678

**18. Reserves for Unpaid Losses and Loss Adjustment Expenses**

Information regarding the reserve for unpaid losses and losses and loss adjustment expenses ( LAE ) are as follows (in thousands).

	Three Months Ended March 31,	
	2014	2013
Balance, beginning of period	\$ 27,468	\$ 34,012
Less reinsurance recoverables	(4,508)	(10,385)
Net balance, beginning of period	22,960	23,627
<b>Incurred related to:</b>		
Current period	16,087	21,531
Prior periods	2,250	(346)
Total incurred	18,337	21,185
<b>Payments related to:</b>		

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Current period	(8,337)	(9,734)
Prior periods	(7,788)	(9,024)
Total payments	(16,125)	(18,758)
Net balance, end of period	25,172	26,054
Plus reinsurance recoverables	3,086	6,016
Balance, end of period	\$ 28,258	\$ 32,070

The decrease in the reserves at March 31, 2014 as compared to March 31, 2013 of \$3.8 million is primarily due to recovery of reinsurance recoverables outstanding at March 31, 2013. Prior period adverse development of \$2.3 million during the three months ended March 31, 2014 was primarily related to a series of hail storms within the 2012 accident year.

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

**19. Reinsurance Activity**

NLC limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risk. Substantial amounts of business are ceded, and these reinsurance contracts do not relieve NLC from its obligations to policyholders. Such reinsurance includes quota share, excess of loss, catastrophe, and other forms of reinsurance on essentially all property and casualty lines of insurance. Net insurance premiums earned, losses and LAE and policy acquisition and other underwriting expenses are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE and unearned insurance premiums ceded to them are reported as assets. Failure of reinsurers to honor their obligations could result in losses to NLC; consequently, allowances are established for amounts deemed uncollectible as NLC evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. At March 31, 2014, reinsurance receivables have a carrying value of \$4.0 million, which is included in other assets within the consolidated balance sheet. There was no allowance for uncollectible accounts at March 31, 2014, based on NLC's quality requirements.

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

	2014		Three Months Ended March 31,		2013	
	Written	Earned	Written	Earned	Written	Earned
Premiums from direct business	\$ 43,770	\$ 42,759	\$ 41,857	\$ 40,546		
Reinsurance assumed	2,233	2,020	1,754	1,630		
Reinsurance ceded	(4,186)	(4,460)	(4,555)	(4,703)		
Net premiums	\$ 41,817	\$ 40,319	\$ 39,056	\$ 37,473		

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

	Three Months Ended March 31,	
	2014	2013
Loss and LAE incurred	\$ 17,752	\$ 21,412
Reinsurance recoverables	585	(227)
Net loss and LAE incurred	\$ 18,337	\$ 21,185

*Multi-line excess of loss coverage*

In addition to the catastrophe reinsurance noted below, both NLIC and ASIC participate in an excess of loss program placed with various reinsurers. This program is limited to each risk with respect to property and liability in the amount of \$500,000 for each of NLIC and ASIC. Each of NLIC and ASIC retain \$500,000 in this program.

*Catastrophic coverage*

At March 31, 2014, 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; \$25 million in excess of \$25 million loss; \$50 million in excess of \$50 million loss and \$40 million in excess of \$100 million loss. NLIC and ASIC retain no participation in any of the layers, beyond the first \$8 million and \$1.5 million, respectively. At March 31, 2014, total retention for any one catastrophe that affects both NLIC and ASIC was limited to \$8 million in the aggregate.

Additionally, NLC purchased an underlying excess of loss contract that provides \$10 million aggregate coverage for sub-catastrophic events. NLC retains a 34% participation in this coverage.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

**20. 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. During the fourth quarter of 2013, we began presenting certain amounts previously allocated to the four reportable business segments under the heading Corporate to better reflect our internal organizational structure. This change had no impact on the Company's consolidated results of operations. The Company's historical segment disclosures have been revised to conform to the current presentation.

The banking segment includes the operations of the Bank, which, since September 14, 2013, includes the operations acquired in the FNB Transaction. The mortgage origination segment is composed of PrimeLending. The insurance segment is composed of NLC. The financial advisory segment is composed of First Southwest.

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 not allocated to business segments.

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

Three Months Ended March 31, 2014	Banking	Mortgage Origination	Insurance	Financial Advisory	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	\$ 79,572	\$ (4,139)	\$ 980	\$ 2,629	\$ 1,692	\$ 4,687	\$ 85,421
Provision for loan losses	3,228			14			3,242
Noninterest income	16,228	91,763	42,773	24,597		(5,261)	170,100
Noninterest expense	60,677	90,632	32,341	27,365	2,188	(574)	212,629
Income (loss) before income taxes	\$ 31,895	\$ (3,008)	\$ 11,412	\$ (153)	\$ (496)	\$	\$ 39,650

Three Months Ended March 31, 2013	Banking	Mortgage Origination	Insurance	Financial Advisory	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	\$ 67,624	\$ (12,003)	\$ 1,059	\$ 3,244	\$ (131)	\$ 7,468	\$ 67,261
Provision for loan losses	12,966			39			13,005

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Noninterest income	12,253	146,529	39,376	22,778		(7,658)	213,278
Noninterest expense	30,679	122,272	34,267	25,727	2,236	(190)	214,991
Income (loss) before income taxes	\$ 36,232	\$ 12,254	\$ 6,168	\$ 256	\$ (2,367)	\$	\$ 52,543

**March 31, 2014**

Goodwill	\$ 207,741	\$ 13,071	\$ 23,988	\$ 7,008	\$	\$	\$ 251,808
Total assets	\$ 8,018,568	\$ 1,045,935	\$ 315,531	\$ 616,743	\$ 1,364,208	\$ (2,327,553)	\$ 9,033,432

**December 31, 2013**

Goodwill	\$ 207,741	\$ 13,071	\$ 23,988	\$ 7,008	\$	\$	\$ 251,808
Total assets	\$ 7,981,517	\$ 1,249,091	\$ 308,160	\$ 520,412	\$ 1,316,398	\$ (2,471,456)	\$ 8,904,122

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## Hilltop Holdings Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(Unaudited)

**21. 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. In May 2013, as discussed in Note 13 to the consolidated financial statements, Hilltop issued restricted stock awards 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. For the three months ended March 31, 2014, stock options and RSUs are the only potentially dilutive non-participating instruments issued by Hilltop, while potentially dilutive non-participating instruments for the three months ended March 31, 2013 were limited to stock options and the 7.50% Senior Exchangeable Notes due 2025 (the Notes), which were called for redemption during the fourth quarter of 2013. Next, we determine and include 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).

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Basic earnings per share:		
Income applicable to Hilltop common stockholders	\$ 23,760	\$ 32,370
Less: income applicable to participating shares	(124)	
Net earnings available to Hilltop common stockholders	\$ 23,636	\$ 32,370
Weighted average shares outstanding - basic	89,707	83,487
Basic earnings per common share	\$ 0.26	\$ 0.39



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Diluted earnings per share:			
Income applicable to Hilltop common stockholders	\$	23,760	\$ 32,370
Add: interest expense on senior exchangeable notes (net of tax)			
Net earnings available to Hilltop common stockholders	\$	23,760	\$ 32,370
Weighted average shares outstanding - basic		89,707	83,487
Effect of potentially dilutive securities		878	256
Weighted average shares outstanding - diluted		90,585	83,743
Diluted earnings per common share	\$	0.26	\$ 0.39

For the three months ended March 31, 2013, the computation of diluted net earnings per common share did not include 6,208,000 equivalent shares issuable upon conversion of the Notes as the equivalent exchange rate per share was in excess of the average stock price for the noted period.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

**22. Recently Issued Accounting Standards**

In January 2014, the FASB issued ASU No. 2014-04 to clarify that an in substance repossession or foreclosure occurs upon either the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2014 and may be adopted using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The Company is currently evaluating this guidance, but adoption of the amendments is not expected to have a significant effect on its future consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11 to require an entity to present an unrecognized tax benefit, or portion thereof, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. However, to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The amendment became effective for the Company on January 1, 2014, and its adoption did not have any effect on the Company's consolidated financial statements as the amendment is to be applied prospectively to all unrecognized tax benefits that exist at the balance sheet date.

**23. Subsequent Events**

On April 1, 2014, the Company awarded certain executives and key employees a total of 190,641 RSUs pursuant to the 2012 Plan. These RSUs generally cliff vest on the third anniversary of the grant date and are subject to service conditions set forth in the award agreements, with associated costs recognized on a straight-line basis over the vesting period. The grant date fair value related to these RSUs was \$24.06 per share. Total compensation expense related to these RSUs was \$4.6 million, which will be amortized through March 2017. The RSUs are not transferable, and the shares of common stock issuable upon conversion of vested RSUs are subject to transfer restrictions for a period of one year following conversion, subject to certain exceptions. In addition, the applicable RSU award agreements provide for accelerated vesting under certain conditions.

On April 1, 2014, Hilltop filed Articles of Amendment to Hilltop's charter, as approved by the Board of Directors, increasing the number of authorized shares of common stock from 100,000,000 to 125,000,000.



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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 Quarterly Report, references 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 the Bank refer to PlainsCapital Bank (a wholly owned subsidiary of PlainsCapital), references to FNB refer to First National Bank, references to First Southwest refer to First Southwest Holdings, LLC (a wholly owned subsidiary of the Bank) and its subsidiaries as a whole, references to FSC refer to First Southwest Company (a 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 and references to NLC refer to National Lloyds Corporation (a wholly owned subsidiary of Hilltop) and its subsidiaries as a whole.*

**FORWARD-LOOKING STATEMENTS**

This Quarterly Report and the documents incorporated by reference into this report include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, or 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, probable, projects, seeks, should, target, view or would or the negative of these words and phrases or similar words or phrases, including things as our business strategy, our financial condition, our litigation, our efforts to make strategic acquisitions, our pending acquisition of SWS Group, Inc. ( SWS ), our revenue, our liquidity and sources of funding, market trends, operations and business, expectations concerning mortgage loan origination volume, 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, and the collectability of loans 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 related to our pending acquisition of SWS;
- risks associated with merger and acquisition integration;

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- our ability to estimate loan losses;
- changes in the default rate of our loans;
- risks associated with concentration in real estate related loans;
- our ability to obtain reimbursements for losses on acquired loans under loss-share agreements with the Federal Deposit Insurance Corporation (the "FDIC");
- changes in general economic, market and business conditions in areas or markets where we compete;
- severe catastrophic events in our geographic area;
- changes in the interest rate environment;
- cost and availability of capital;

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- changes in state and federal laws, regulations or policies affecting one or more of our business segments, including changes in regulatory fees, deposit insurance premiums, capital requirements and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act );
- our ability to use net operating loss carry forwards to reduce future tax payments;
- approval of new, or changes in, accounting policies and practices;
- changes in key management;
- competition in our banking, mortgage origination, financial advisory and insurance segments from other banks and financial institutions as well as insurance companies, mortgage bankers, investment banking and financial advisory firms, asset-based non-bank lenders and government agencies;
- failure of our insurance segment reinsurers to pay obligations under reinsurance contracts;
- our ability to use excess cash in an effective manner, including the execution of successful acquisitions; and
- our participation in governmental programs, including the Small Business Lending Fund ( SBLF ).

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, please refer to Risk Factors in Part I, Item 1A of our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission (the SEC ) on March 3, 2014, 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**

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We are a financial holding company registered under the Bank Holding Company Act of 1956, as amended by the Gramm-Leach-Bliley Act of 1999. Our primary line of business is to provide business and consumer banking services from offices located throughout Texas. We also provide an array of financial products and services such as mortgage origination, insurance and financial advisory services.

On September 13, 2013 (the "Bank Closing Date"), the Bank assumed substantially all of the liabilities, including all of the deposits, and acquired substantially all of the assets of Edinburg, Texas-based FNB from the Federal Deposit Insurance Corporation (the "FDIC"), as receiver, and reopened former branches of FNB acquired from the FDIC under the PlainsCapital Bank name (the "FNB Transaction"). Pursuant to the Purchase and Assumption Agreement by and among the FDIC as receiver for FNB, the FDIC and the Bank (the "P&A Agreement"), the Bank and the FDIC entered into loss-share agreements whereby the FDIC agreed to share in the losses of certain covered loans and covered other real estate owned ("OREO") that the Bank acquired in the FNB Transaction. The fair value of the assets acquired was \$2.2 billion, including \$1.1 billion in covered loans, \$286.2 million in securities, \$135.2 million in covered OREO and \$42.9 million in non-covered loans. The Bank also assumed \$2.2 billion in liabilities, consisting primarily of deposits.

On March 31, 2014, we entered into a definitive merger agreement with SWS providing for the merger of SWS with and into a subsidiary of Hilltop formed for the purpose of facilitating this transaction. Under the terms of the merger agreement, SWS stockholders will receive per share consideration of 0.2496 shares of Hilltop common stock and \$1.94 of cash, equating to \$7.88 per share based on Hilltop's closing price on March 31, 2014. We intend to fund the cash portion of the consideration through available cash. The merger is subject to customary closing conditions, including regulatory approvals and approval of the stockholders of SWS, and is expected to be completed prior to the end of 2014.

At March 31, 2014, on a consolidated basis, we had total assets of \$9.0 billion, total deposits of \$6.7 billion, total loans, including loans held for sale, of \$5.4 billion and stockholders' equity of \$1.4 billion. Our banking operations include the operations acquired in the FNB Transaction since September 14, 2013.

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***Segment Information***

We have two primary operating business units, PlainsCapital (financial services and products) and NLC (insurance). Within the PlainsCapital unit are three primary wholly owned operating subsidiaries: the Bank, PrimeLending and First Southwest. 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, mortgage origination, insurance and financial advisory. During the fourth quarter of 2013, we began presenting certain amounts previously allocated to the four reportable business segments under the heading Corporate to better reflect our internal organizational structure. This change had no impact on our consolidated results of operations. Our historical segment disclosures and MD&A have been revised to conform to the current presentation. Consistent with the segment operating results during 2013, we anticipate that future revenues will be driven primarily from the banking and mortgage origination segments, with the remainder being generated by our insurance and financial advisory segments. Based on historical results of PlainsCapital Corporation, which we acquired on November 30, 2012, the relative share of total revenue provided by our banking and mortgage origination segments fluctuates depending on market conditions, and operating results for the mortgage origination segment tend to be more volatile than operating results for the banking segment.

The banking segment includes the operations of the Bank and, since September 14, 2013, the operations acquired in the FNB Transaction. The banking segment primarily provides business and consumer banking products and 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 mortgage origination segment includes the operations of PrimeLending, which offers a variety of loan products from offices in 42 states 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, National Lloyds Insurance Company ( NLIC ) and American Summit Insurance Company ( 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.

The financial advisory segment generates a majority of its revenues from fees and commissions earned from investment advisory and securities brokerage services at First Southwest. The principal subsidiaries of First Southwest are FSC, a broker-dealer registered with the SEC and Financial Industry Regulatory Authority, and First Southwest Asset Management, Inc., a registered investment advisor under the Investment Advisors Act of 1940. FSC holds trading securities to support sales, underwriting and other customer activities. These securities are marked to market through other noninterest income. FSC uses derivatives to support mortgage origination programs of certain non-profit housing organization clients. FSC hedges its related exposure to interest rate risk from these programs with U.S. Agency to-be-announced, or TBA, mortgage-backed securities. These derivatives are marked to market through other noninterest income.

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 not allocated to business segments. Balance sheet amounts for remaining subsidiaries not discussed previously and the elimination of intercompany transactions are included in All Other and Eliminations.





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Additional information concerning our reportable segments is presented in Note 20, 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 March 31, 2014	Banking	Mortgage Origination	Insurance	Financial Advisory	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	\$ 79,572	\$ (4,139)	\$ 980	\$ 2,629	\$ 1,692	\$ 4,687	\$ 85,421
Provision for loan losses	3,228			14			3,242
Noninterest income	16,228	91,763	42,773	24,597		(5,261)	170,100
Noninterest expense	60,677	90,632	32,341	27,365	2,188	(574)	212,629
Income (loss) before income taxes	\$ 31,895	\$ (3,008)	\$ 11,412	\$ (153)	\$ (496)	\$	\$ 39,650

Three Months Ended March 31, 2013	Banking	Mortgage Origination	Insurance	Financial Advisory	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	\$ 67,624	\$ (12,003)	\$ 1,059	\$ 3,244	\$ (131)	\$ 7,468	\$ 67,261
Provision for loan losses	12,966			39			13,005
Noninterest income	12,253	146,529	39,376	22,778		(7,658)	213,278
Noninterest expense	30,679	122,272	34,267	25,727	2,236	(190)	214,991
Income (loss) before income taxes	\$ 36,232	\$ 12,254	\$ 6,168	\$ 256	\$ (2,367)	\$	\$ 52,543

***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 \$85.4 million in net interest income during the three months ended March 31, 2014, compared with net interest income of \$67.2 million during the same period in 2013. The year-over-year increase in net interest income was primarily due to the inclusion of those operations acquired as a part of the FNB Transaction within our banking segment.

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

(i) *Income from mortgage operations.* Through our wholly owned subsidiary, PrimeLending, we generate noninterest income by originating and selling mortgage loans. During the three months ended March 31, 2014 and 2013, we generated \$91.5 million and \$146.5 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.

(ii) *Net insurance premiums earned.* Through our wholly owned insurance subsidiary, NLC, we provide fire and limited homeowners insurance for low value dwellings and manufactured homes. We generated \$40.3 million in net insurance premiums earned during the three months ended March 31, 2014, compared with \$37.5 million during the same period in the prior year.

(iii) *Investment advisory fees and commissions and securities brokerage fees and commissions.* Through our wholly owned subsidiary, First Southwest, we provide public finance advisory and various investment banking and brokerage services. We generated \$21.3 million and \$22.0 million in investment advisory fees and commissions and securities brokerage fees and commissions during the three months ended March 31, 2014 and 2013, respectively.

In the aggregate, we generated \$170.1 million and \$213.3 million in noninterest income during the three months ended March 31, 2014 and 2013, respectively. The significant year-over-year decrease in noninterest income was primarily due to the decrease in loan origination volume within our mortgage origination segment.

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.

Table of Contents**Consolidated Operating Results**

Net income applicable to common stockholders for the three months ended March 31, 2014 was \$23.8 million, or \$0.26 per diluted share, compared to net income applicable to common stockholders of \$32.4 million, or \$0.39 per diluted share, for the three months ended March 31, 2013.

Certain items included in net income for 2013 and 2014 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) and the FNB Transaction. Income before taxes for the three months ended March 31, 2014 includes net accretion of \$10.0 million and \$9.5 million on earning assets and liabilities acquired in the PlainsCapital Merger and FNB Transaction, respectively, offset by amortization of identifiable intangibles of \$2.3 million and \$0.3 million, respectively. During the three months ended March 31, 2013, income before taxes includes net accretion of \$16.1 million on earning assets and liabilities acquired in the PlainsCapital Merger, offset by amortization of identifiable intangibles of \$2.5 million.

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

	Three Months Ended March 31, 2014	2013	Year Ended December 31, 2013
<b>Performance Ratios:</b>			
Return on average stockholders' equity	7.65%	11.46%	10.48%
Return on average assets	1.14%	1.87%	1.66%
Net interest margin (taxable equivalent) (1)	4.62%	4.35%	4.47%

(1) Taxable equivalent net interest income divided by average interest-earning assets.

During the three months ended March 31, 2014, the consolidated taxable equivalent net interest margin of 4.62% was impacted by PlainsCapital Merger related accretion of discount on loans of \$10.8 million, amortization of premium on acquired securities of \$1.0 million and amortization of premium on acquired time deposits of \$0.2 million. Additionally, FNB Transaction related accretion of discount on loans of \$7.2 million and amortization of premium on acquired time deposits of \$2.3 million also impacted the consolidated taxable equivalent net interest margin during the three months ended March 31, 2014. These items increased the consolidated taxable equivalent net interest margin by 95 basis points for the three months ended March 31, 2014. The consolidated taxable equivalent net interest margin was 4.35% for the three months ended March 31, 2013. The taxable equivalent net interest margin for the first quarter of 2013 was impacted by PlainsCapital Merger related accretion of discount on loans of \$16.9 million, amortization of premium on acquired securities of \$1.9 million and amortization of premium on acquired time deposits of \$1.1 million. These items increased the consolidated taxable equivalent interest margin by 95 basis points for the three months ended March 31, 2013.

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

	Three Months Ended March 31,					
	Average Outstanding Balance	2014 Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	2013 Interest Earned or Paid	Annualized Yield or Rate
<b>Assets</b>						
Interest-earning assets Loans, gross (1)	\$ 5,068,892	\$ 79,744	6.29%	\$ 4,207,871	\$ 64,886	6.17%
Investment securities - taxable	1,122,241	7,588	2.71%	900,422	5,863	2.64%
Investment securities - non-taxable (2)	183,143	1,861	4.06%	218,343	2,024	3.71%
Federal funds sold and securities purchased under agreements to resell	26,336	19	0.29%	10,195	21	0.84%
Interest-bearing deposits in other financial institutions	966,921	595	0.25%	747,242	333	0.25%
Other	188,276	2,640	5.67%	154,560	2,105	5.52%
Interest-earning assets, gross	7,555,809	92,447	4.90%	6,238,633	75,232	4.84%
Allowance for loan losses	(36,861)			(6,776)		
Interest-earning assets, net	7,518,948			6,231,857		
Noninterest-earning assets	1,432,519			882,998		
<b>Total assets</b>	<b>\$ 8,951,467</b>			<b>\$ 7,114,855</b>		
<b>Liabilities and Stockholders Equity</b>						
<b>Interest-bearing liabilities</b>						
Interest-bearing deposits	\$ 4,949,212	\$ 3,759	0.31%	\$ 3,558,091	\$ 3,450	0.39%
Notes payable and other borrowings	664,072	2,648	1.60%	850,418	3,893	1.85%
Total interest-bearing liabilities	5,613,284	6,407	0.46%	4,408,509	7,343	0.67%
<b>Noninterest-bearing liabilities</b>						
Noninterest-bearing deposits	1,721,403			1,190,779		
Other liabilities	285,121			356,538		
Total liabilities	7,619,808			5,955,826		
Stockholders equity	1,331,243			1,158,292		
Noncontrolling interest	416			737		
<b>Total liabilities and stockholders equity</b>	<b>\$ 8,951,467</b>			<b>\$ 7,114,855</b>		
<b>Net interest income (2)</b>		<b>\$ 86,040</b>			<b>\$ 67,889</b>	
<b>Net interest spread (2)</b>			<b>4.44%</b>			<b>4.17%</b>
<b>Net interest margin (2)</b>			<b>4.62%</b>			<b>4.35%</b>

(1) Average balance includes non-accrual loans.

(2) Annualized taxable equivalent adjustments are based on a 35% tax rate. The adjustment to interest income was \$0.6 million and \$0.7 million for the three months ended March 31, 2014 and 2013, respectively.

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On a consolidated basis, net interest income increased \$18.2 million during the three months ended March 31, 2014, compared with the same period in 2013. This increase was primarily due to the inclusion of those operations acquired as a part of the FNB Transaction 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, primarily in the banking segment, was \$3.2 million and \$13.0 million during the three months ended March 31, 2014 and 2013, respectively. During the three months ended March 31, 2014 and 2013, the provision for loan losses was comprised of charges relating to newly originated loans and acquired loans without credit impairment at acquisition of \$1.3 million and \$12.6 million, respectively, and purchased credit impaired (PCI) loans of \$1.9 million and \$0.4 million, respectively.

Consolidated noninterest income decreased \$43.2 million during the three months ended March 31, 2014, compared with the same period in 2013. This decrease was primarily related to the reduction in net gains from sale of loans, other mortgage production income and mortgage loan origination fees within our mortgage origination segment of \$55.0 million, slightly offset by increases in noninterest income in our banking, insurance and financial advisory segments.

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Our consolidated noninterest expense during the three months ended March 31, 2014 decreased \$2.4 million, compared with the same period in 2013. This year-over-year decrease included a significant decrease in noninterest expenses within our mortgage origination segment of \$31.6 million primarily due to variable compensation tied to mortgage loan originations, which was offset by a significant increase in noninterest expenses within our banking segment of \$30.0 million primarily due to the inclusion of those operations acquired as part of the FNB Transaction. Changes between periods within the major components of noninterest expense included decreases of \$9.8 million in employees compensation and benefits and \$2.8 million in loss and loss adjustment expenses, significantly offset by increases of \$6.9 million in occupancy and equipment and \$2.4 million in other expenses.

Consolidated income tax expense during the three months ended March 31, 2014 and 2013 was \$14.4 million and \$19.2 million, respectively, reflecting effective rates of 36.2% and 36.5%, respectively. The year-over-year decrease in income tax expense was primarily due to the reduction in operating income generated by our mortgage origination segment.

**Segment Results****Banking Segment**

Income before income taxes in our banking segment for the three months ended March 31, 2014 and 2013 was \$31.9 million and \$36.2 million, respectively, and was primarily driven by net interest income of \$79.6 million and \$67.6 million, respectively, offset by noninterest expenses of \$60.7 million and \$30.7 million, respectively.

At March 31, 2014, the Bank exceeded all regulatory capital requirements with a total capital to risk weighted assets ratio of 14.14%, Tier 1 capital to risk weighted assets ratio of 13.47% and a Tier 1 capital to average assets, or leverage, ratio of 9.53%. At March 31, 2014, the Bank was also considered to be well-capitalized under regulatory requirements without giving effect to the final Basel III capital rules adopted by the Federal Reserve Board on July 2, 2013.

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

	Three Months Ended March 31,		Year Ended
	2014	2013	December 31, 2013
<b>Performance Ratios:</b>			
Efficiency ratio (1)	63.34%	38.41%	42.58%
Return on average assets	1.04%	1.60%	1.78%
Net interest margin (taxable equivalent) (2)	4.80%	5.30%	5.17%

(1) Noninterest expenses divided by the sum of total noninterest income and net interest income for the period.

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(2) Taxable equivalent net interest income divided by average interest-earning assets.

During the three months ended March 31, 2014, the banking segment's taxable equivalent net interest margin of 4.80% was impacted by PlainsCapital Merger related accretion of discount on loans of \$10.8 million, amortization of premium on acquired securities of \$1.0 million and amortization of premium on acquired time deposits of \$0.2 million. Additionally, FNB Transaction related accretion of discount on loans of \$7.2 million and amortization of premium on acquired time deposits of \$2.3 million also impacted the banking segment's taxable equivalent net interest margin during the three months ended March 31, 2014. These items increased the banking segment's taxable equivalent net interest margin by 106 basis points for the three months ended March 31, 2014. The banking segment's taxable equivalent net interest margin for the three months ended March 31, 2013 of 5.30% was impacted by PlainsCapital Merger related accretion of discount on loans of \$16.9 million, amortization of premium on acquired securities of \$1.9 million and amortization of premium on acquired time deposits of \$1.1 million. These items increased the banking segment's taxable equivalent interest margin by 124 basis points for three months ended March 31, 2013.



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

	Three Months Ended March 31,					
	Average Outstanding Balance	2014 Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	2013 Interest Earned or Paid	Annualized Yield or Rate
<b>Assets</b>						
Interest-earning assets Loans, gross (1)	\$ 4,246,133	\$ 70,721	6.66%	\$ 2,899,961	\$ 53,809	7.42%
Subsidiary warehouse lines of credit	636,700	6,932	4.35%	981,524	13,887	5.66%
Investment securities - taxable	896,669	4,395	1.96%	686,942	2,717	1.58%
Investment securities - non-taxable (2)	154,064	1,496	3.88%	166,552	1,429	3.43%
Federal funds sold and securities purchased under agreements to resell	26,336	19	0.29%	8,566	6	0.28%
Interest-bearing deposits in other financial institutions	797,304	513	0.26%	485,292	312	0.26%
Other	29,085	400	5.50%	20,112	165	3.28%
Interest-earning assets, gross	6,786,291	84,476	4.98%	5,248,949	72,325	5.51%
Allowance for loan losses	(36,710)			(6,639)		
Interest-earning assets, net	6,749,581			5,242,310		
Noninterest-earning assets	1,270,934			814,106		
<b>Total assets</b>	<b>\$ 8,020,515</b>			<b>\$ 6,056,416</b>		
<b>Liabilities and Stockholders Equity</b>						
<b>Interest-bearing liabilities</b>						
Interest-bearing deposits	\$ 4,949,973	\$ 3,785	0.31%	\$ 3,497,258	\$ 3,434	0.40%
Notes payable and other borrowings	350,248	326	0.37%	366,315	353	0.39%
Total interest-bearing liabilities (3)	5,300,221	4,111	0.31%	3,863,573	3,787	0.40%
<b>Noninterest-bearing liabilities</b>						
Noninterest-bearing deposits	1,699,817			1,263,716		
Other liabilities	18,518			82,613		
Total liabilities	7,018,556			5,209,902		
Stockholders' equity	1,001,959			846,514		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 8,020,515</b>			<b>\$ 6,056,416</b>		
<b>Net interest income (2)</b>		<b>\$ 80,365</b>			<b>\$ 68,538</b>	
<b>Net interest spread (2)</b>			<b>4.67%</b>			<b>5.11%</b>
<b>Net interest margin (2)</b>			<b>4.80%</b>			<b>5.30%</b>

(1) Average balance includes non-accrual loans.

(2) Annualized taxable equivalent adjustments are based on a 35% tax rate. The adjustment to interest income was \$0.5 million for each of the three months ended March 31, 2014 and 2013.

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(3) Excludes the allocation of interest expense on PlainsCapital debt of \$0.3 million for each of the three months ended March 31, 2014 and 2013.

The banking segment's net interest margin shown above exceeds our consolidated net interest margin. Our consolidated net interest margin includes the yields and costs associated with certain items within interest-earning assets and interest-bearing liabilities in the financial advisory segment, as well as the borrowing costs of Hilltop and PlainsCapital, both of which reduce our consolidated net interest margin. In addition, the banking segment's interest earning assets include lines of credit extended to subsidiaries, the yields on which increase the banking segment's net interest margin. Such yields and costs 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).

	<b>Three Months Ended March 31, 2014 v. 2013</b>		
	<b>Change Due To (1)</b>		<b>Change</b>
	<b>Volume</b>	<b>Yield/Rate</b>	
<b>Interest income</b>			
Loans, gross	\$ 24,982	\$ (8,070)	\$ 16,912
Subsidiary warehouse lines of credit	(4,879)	(2,076)	(6,955)
Investment securities - taxable	830	848	1,678
Investment securities - non-taxable (2)	(107)	174	67
Federal funds sold and securities purchased under agreements to resell	13		13
Interest-bearing deposits in other financial institutions	203	(2)	201
Other	74	161	235
<b>Total interest income (2)</b>	<b>21,116</b>	<b>(8,965)</b>	<b>12,151</b>
<b>Interest expense</b>			
Deposits	\$ 1,446	\$ (1,095)	\$ 351
Notes payable and other borrowings	(16)	(11)	(27)
<b>Total interest expense</b>	<b>1,430</b>	<b>(1,106)</b>	<b>324</b>
<b>Net interest income (2)</b>	<b>\$ 19,686</b>	<b>\$ (7,859)</b>	<b>\$ 11,827</b>

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

(2) Annualized taxable equivalent.

Taxable equivalent net interest income increased \$11.8 million during the three months ended March 31, 2014, compared with the same period in 2013. Increases in the volume of interest-earning assets, primarily loans acquired in the FNB Transaction, increased taxable equivalent net interest income by \$21.1 million, while increases in the volume of interest-bearing liabilities, primarily deposits assumed in the FNB Transaction, reduced taxable equivalent interest income by \$1.4 million. Changes in the yields earned on interest-earning assets decreased taxable equivalent net interest income by \$9.0 million, primarily due to lower yields on the loan portfolio and the subsidiary warehouse lines of credit. Changes in rates paid on interest-bearing liabilities increased taxable equivalent interest income by \$1.1 million, primarily due to the acquisition of savings deposits in the FNB Transaction that carry lower average rates than the average rate on the Bank's savings deposits prior to the FNB Transaction, and the amortization of premiums on time deposits acquired in the FNB Transaction.

The banking segment's noninterest income was \$16.2 million and \$12.3 million during the three months ended March 31, 2014 and 2013, respectively. This year-over-year increase in noninterest income was primarily due to the accretion on the amounts receivable under the loss-share agreements with the FDIC ( FDIC Indemnification Asset ) associated with the FNB Transaction. Noninterest income was also negatively affected by changes in intercompany financing charges associated with the lending commitment on the PrimeLending warehouse line of credit.

The banking segment's noninterest expenses were \$60.7 million and \$30.7 million during the three months ended March 31, 2014 and 2013, respectively, and were primarily comprised of employees' compensation and benefits, and occupancy expenses. The significant year-over-year increase in noninterest expenses was primarily due to the inclusion of the operations acquired in the FNB Transaction.

Table of Contents**Mortgage Origination Segment**

Loss before income taxes in our mortgage origination segment for the three months ended March 31, 2014 was \$3.0 million, compared with income before income taxes of \$12.3 million during the three months ended March 31, 2013. During the three months ended March 31, 2014 and 2013, operating results for the mortgage origination segment were primarily driven by noninterest income of \$91.8 million and \$146.5 million, respectively, offset by noninterest expense of \$90.6 million and \$122.3 million, respectively. Additionally, net interest expense of \$4.1 million and \$12.0 million during the three months ended March 31, 2014 and 2013, respectively, resulted from interest incurred on a warehouse line of credit held at the Bank as well as related intercompany financing costs, partially offset by interest income earned on loans held for sale.

The mortgage origination segment originates all of its mortgage loans through a retail channel. The following table provides certain details regarding our mortgage loan originations (dollars in thousands).

	Three Months Ended March 31, 2014	% of Total	Three Months Ended March 31, 2013	% of Total
Mortgage Loan Originations - units	9,152		14,446	
Mortgage Loan Originations - volume	\$ 1,866,153		\$ 3,046,263	
<b>Mortgage Loan Originations:</b>				
Conventional	\$ 1,194,137	63.99%	\$ 1,924,771	63.18%
Government	552,328	29.60%	923,719	30.32%
Jumbo	116,734	6.25%	185,388	6.09%
Other	2,954	0.16%	12,385	0.41%
	\$ 1,866,153	100.00%	\$ 3,046,263	100.00%
Home purchases	\$ 1,468,710	78.70%	\$ 1,609,861	52.85%
Refinancings	397,443	21.30%	1,436,402	47.15%
	\$ 1,866,153	100.00%	\$ 3,046,263	100.00%
Texas	\$ 430,154	23.05%	\$ 657,262	21.58%
California	291,571	15.62%	551,819	18.11%
Florida	93,374	5.00%	110,173	3.62%
North Carolina	91,733	4.92%	174,841	5.74%
Arizona	79,485	4.26%	107,261	3.52%
Ohio	67,080	3.60%	85,615	2.81%
Washington	58,259	3.12%	88,672	2.91%
Missouri	52,246	2.80%	45,615	1.50%
Virginia	50,879	2.73%	132,486	4.35%
All other states	651,372	34.90%	1,092,519	35.86%
	\$ 1,866,153	100.00%	\$ 3,046,263	100.00%

The mortgage lending business is subject to variables that can impact loan origination volume, including seasonal and interest rate fluctuations. Historically, we have typically experienced increased loan origination volume from purchases of homes during the spring and summer, when more people tend to move and buy or sell homes. An increase in mortgage interest rates tends to result in decreased loan origination volume from refinancings, while a decrease in mortgage interest rates tends to result in increased refinancings. Changes in interest rates have historically had a lesser impact on home purchases volume than on refinancing volume.

Beginning in May 2013 and continuing through the fourth quarter of 2013, mortgage interest rates increased at a pace that, along with other factors, resulted in a 38.7% decrease in the mortgage origination segment's total loan origination volume during the three months ended March 31, 2014 when compared to the same period in 2013. Home purchases volume during the three months ended March 31, 2014 and 2013 was \$1.5 billion and \$1.6 billion, respectively, an 8.8% decrease, while refinancing volume decreased from \$1.4 billion (47.2% of total loan origination volume) to \$397.4 million (21.3% of total loan origination volume) between the same periods. We anticipate that the decrease in refinancing volume as a percentage of total loan origination volume during the three months ended March 31, 2014 compared to the same period in 2013 will continue throughout 2014 and therefore anticipate our mortgage loan origination volumes in 2014 will more closely follow seasonal trends historically experienced by the mortgage origination segment.

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While the mortgage origination segment's total loan origination volume decreased 38.7% during the three months ended March 31, 2014, compared to the same period in 2013, income before income taxes decreased 124.5% between the same periods (\$3.0 million loss compared to \$12.3 million income). Income before income taxes decreased at a greater rate primarily because segment operating costs included in noninterest expenses, such as employee related (salaries and benefits), occupancy, and administrative expenses, decreased at a lesser rate, approximately 13%, than loan origination volume decreased between the two periods. To address negative trends in loan origination volume resulting from changes in interest rates that began in May 2013, the mortgage origination segment reduced its non-origination employee headcount approximately 22% during the third and fourth quarters of 2013. Salaries and benefits expenses decreased approximately 15% between the first quarters of 2014 and 2013, as the benefits of the headcount reductions in the third and fourth quarters of 2013 were realized. We also engaged in other initiatives to reduce segment operating costs during the third and fourth quarters of 2013 that were primarily responsible for the decrease of approximately 10% in non-employee related expenses between the first quarters of 2014 and 2013. The benefits of the employee reductions and other cost savings initiatives include a decrease in recurring quarterly operating costs of approximately \$8 million since the third quarter of 2013. Also impacting the trend in income before taxes, to a lesser extent, was a decrease in loan revenue margins resulting from increased pricing competition.

The mortgage origination segment sells substantially all mortgage loans it originates to various investors in the secondary market, the majority servicing released. During the first quarter of 2013, the mortgage origination segment retained servicing on approximately 8% of loans sold. This rate was increased to approximately 22% during the third and fourth quarters of 2013, and approximately 37% during the first quarter of 2014. The related mortgage servicing rights (MSR) asset was valued at \$29.9 million on \$2.7 billion of serviced loan volume at March 31, 2014, compared to a value of \$20.1 million on \$2.0 billion of serviced loan volume at December 31, 2013. All income related to retained servicing, including changes in the value of the MSR asset, is included in noninterest income. The mortgage origination segment's determination on whether to retain or release servicing on mortgage loans it sells is impacted by changes in mortgage interest rates, and refinancing and market activity. We may, from time to time, manage our MSR asset through different strategies, including varying the percentage of mortgage loans sold servicing released and opportunistically selling MSR assets.

Noninterest income of \$91.8 million and \$146.5 million for the three months ended March 31, 2014 and 2013, respectively, was comprised of net gains on the sale of loans and other mortgage production income, and mortgage origination fees. Noninterest income decreased 37.4% during the three months ended March 31, 2014 when compared to the same period in 2013, which approximated the 38.7% decrease in loan origination volume experienced during the same periods. Noninterest income included \$3.4 million of net gains and \$3.5 million of net losses during the three months ended March 31, 2014 and 2013, respectively, resulting from changes in the fair value of the mortgage origination segment's interest rate lock commitments (IRLCs) and loans held for sale, and the related activity associated with forward commitments used by the mortgage origination segment to mitigate interest rate risk associated with its IRLCs and mortgage loans held for sale. Since the total volume of IRLCs and mortgage loans held for sale was relatively unchanged between December 31, 2013 and March 31, 2014, the gain during the three months ended March 31, 2014 was primarily the result of an increase in the average value of individual IRLCs and mortgage loans held for sale since December 31, 2013.

Noninterest expenses were \$90.6 million and \$122.3 million for the three months ended March 31, 2014 and 2013, respectively. Employees compensation and benefits accounted for the majority of the noninterest expenses incurred. Compensation that varies with the volume of mortgage loan originations and overall segment profitability decreased \$16.2 million during the three months ended March 31, 2014, as compared to the same period in 2013, and comprised approximately 52% and 58% of the total employees' compensation and benefits expenses during the three months ended March 31, 2014 and 2013, respectively. In addition, employee salaries and benefits decreased \$5.1 million during the three months ended March 31, 2014, as compared to the same period in 2013, primarily as a result of headcount reductions in the third and fourth quarters of 2013. The mortgage origination segment records unreimbursed closing costs when it pays a customer's closing costs in return for the customer choosing to accept a higher interest rate on the customer's mortgage loan. Unreimbursed closing costs during the three months ended March 31, 2014 and 2013 were \$5.2 million and \$10.4 million, respectively.

Between January 1, 2005, and March 31, 2014, the mortgage origination segment sold mortgage loans totaling \$58.3 billion. These loans were sold under sales contracts that generally include provisions which hold the mortgage origination segment responsible for errors or omissions

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relating to its representations and warranties that loans sold meet certain requirements, including representations as to underwriting standards and the validity of certain borrower representations in connection with the loan. In addition, the sales contracts typically require the refund of purchased servicing rights plus certain investor



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servicing costs if a loan experiences an early payment default. While the mortgage origination segment sold loans prior to 2005, it has not experienced, nor does it anticipate experiencing, significant losses on loans originated prior to 2005 as a result of investor claims under these provisions of its sales contracts.

When an investor claim for indemnification of a loan sold is made, we evaluate the claim and determine if the claim can be satisfied through additional documentation or other deliverables. If the claim cannot be satisfied in that matter, we negotiate with the investor to reach a settlement of the claim. Settlements typically result in either the repurchase of a loan or reimbursement to the investor for losses incurred on the loan. Following is a summary of the mortgage origination segment's claims resolution activity relating to loans sold between January 1, 2005, and March 31, 2014 (dollars in thousands).

	Original Loan Balance		Loss Recognized	
	Amount	% of Loans Sold	Amount	% of Loans Sold
Claims resolved with no payment	\$ 133,843	0.23%	\$ 0.00%	
Claims resolved as a result of a loan repurchase or payment to an investor for losses incurred (1)	178,137	0.31%	22,880	0.04%
	\$ 311,980	0.54%	\$ 22,880	0.04%

(1) Losses incurred include refunded purchased servicing rights.

At March 31, 2014 and December 31, 2013, the mortgage origination segment's indemnification liability reserve totaled \$21.0 million and \$21.1 million, respectively. The related provision for indemnification losses was \$0.6 million and \$1.0 million for the three months ended March 31, 2014 and 2013, respectively.

**Insurance Segment**

Income before income taxes in our insurance segment was \$11.4 million during the three months ended March 31, 2014, compared with income before income taxes of \$6.2 million during the three months ended March 31, 2013. The insurance segment is subject to claims arising out of severe weather, the incidence and severity of which are inherently unpredictable. Generally, the insurance segment's insured risks exhibit higher losses in the second and third calendar quarters due to a seasonal concentration of weather-related events in its primary geographic markets. Although weather-related losses (including hail, high winds, tornadoes and hurricanes) can occur in any calendar quarter, the second calendar quarter, historically, has experienced the highest frequency of losses associated with these events. Hurricanes, however, are more likely to occur in the third calendar quarter of the year.

The insurance segment's results during the three months ended March 31, 2014 and 2013 resulted in combined ratios of 77.5% and 88.7%, respectively. The year-over-year improvement in the combined ratio was primarily driven by the increase in earned premiums and improvement in our claims loss experience. The combined ratio is a measure of overall insurance underwriting profitability, and represents the sum of the loss and LAE ratio and the underwriting expense ratio, which are discussed in more detail below.

Noninterest income of \$42.8 million and \$39.4 million during the three months ended March 31, 2014 and 2013, respectively, included net insurance premiums earned of \$40.3 million and \$37.5 million, respectively. The increase in earned premiums is primarily attributable to volume and, to a lesser extent, rate increases in homeowners and mobile home products.

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

	Three Months Ended March 31,		Variance
	2014	2013	2014 vs 2013
<b>Direct Insurance Premiums Written:</b>			
Homeowners	\$ 18,583	\$ 18,543	\$ 40
Fire	13,835	13,052	783
Mobile Home	10,219	9,083	1,136
Commercial	1,087	1,135	(48)
Other	46	44	2
	\$ 43,770	\$ 41,857	\$ 1,913

Total direct insurance premiums written for our three largest insurance product lines increased by \$2.0 million during the three months ended March 31, 2014, compared to the same period in 2013. These increases were due to growth in our core insurance products.

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

	Three Months Ended March 31,		Variance
	2014	2013	2014 vs 2013
<b>Net Insurance Premiums Earned:</b>			
Homeowners	\$ 17,118	\$ 16,601	\$ 517
Fire	12,745	11,685	1,060
Mobile Home	9,413	8,132	1,281
Commercial	1,001	1,016	(15)
Other	42	39	3
	\$ 40,319	\$ 37,473	\$ 2,846

Net insurance premiums earned during the three months ended March 31, 2014 increased compared to the same period in 2013, primarily due to the increases in direct insurance premiums written of \$1.9 million and premiums assumed of \$0.5 million, while also improving due to a decrease in ceded insurance premiums during the same periods.

Noninterest expenses of \$32.3 million and \$34.3 million during the three months ended March 31, 2014 and 2013, respectively, include both loss and LAE expenses and policy acquisition and other underwriting expenses, as well as other noninterest expenses. Loss and LAE are recognized based on formula and case basis estimates for losses reported with respect to direct business, estimates of unreported losses based on past experience and deduction of amounts for reinsurance placed with reinsurers. Loss and LAE during the three months ended March 31, 2014 was \$18.3 million, compared to \$21.2 million during the same period in 2013. As a result, the loss and LAE ratio during the three months ended March 31, 2014 and 2013 was 45.5% and 56.5%, respectively. The year-over-year ratio improvement was primarily a result of growth of earned premium and improved claims loss experience.

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

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Policy acquisition and other underwriting expenses were as follows (dollars in thousands).

	Three Months Ended March 31,		Variance	
	2014	2013	2014 vs 2013	
Amortization of deferred policy acquisition costs	\$ 10,197	\$ 9,614	\$	583
Other underwriting expenses	3,380	3,025		355
Total	13,577	12,639		938
Agency expenses	(690)	(569)		(121)
Total less agency expenses	\$ 12,887	\$ 12,070	\$	817
Net insurance premiums earned	\$ 40,319	\$ 37,473	\$	2,846
Expense ratio	32.0%	32.2%		-0.2%

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During 2013, the insurance segment initiated a review of the pricing of its primary products in each state of operation utilizing a consulting actuarial firm to supplement normal review processes. Rate filings have been made for certain products in several states for increases effective in 2014, and the process will continue through the remainder of the insurance segment's products and states in which it operates. Concurrently, business concentrations were reviewed and actions initiated, including cancellation of agents, non-renewal of policies and cessation of new business writing on certain products in problematic geographic areas. We expect that these actions will reduce the rate of premium growth for 2014 when compared with the patterns exhibited in prior years. However, we expect the reduced exposure to volatile weather to improve our loss experience during 2014.

**Financial Advisory Segment**

Loss before income taxes in our financial advisory segment for the three months ended March 31, 2014 was \$0.2 million, compared with income before income taxes of \$0.3 million during the three months ended March 31, 2013. Higher interest rates along with increased volatility in fixed income markets have resulted in reduced sales of fixed income securities to institutional customers.

The financial advisory segment had net interest income of \$2.6 million and \$3.2 million during the three months ended March 31, 2014 and 2013, respectively, consisting of securities lending activity, customer margin loan balances and investment securities used to support sales, underwriting and other customer activities.

The majority of the financial advisory segment's noninterest income for the three months ended March 31, 2014 and 2013 of \$24.6 million and \$22.8 million, respectively, was generated from fees and commissions earned from investment advisory and securities brokerage activities of \$21.3 million and \$22.0 million, respectively. The financial advisory segment participates in programs in which it issues forward purchase commitments of mortgage-backed securities to certain clients and sells TBAs. Changes in the fair values of these derivative instruments during the three months ended March 31, 2014 and 2013 produced net gains of \$2.8 million and \$1.8 million, respectively. Changes in the fair value of the financial advisory segment's trading portfolio, which is used to support sales, underwriting and other customer activities, produced gains of \$0.4 million during the three months ended March 31, 2014 and losses of \$1.0 million during the three months ended March 31, 2013.

Noninterest expenses were \$27.4 million and \$25.7 million for the three months ended March 31, 2014 and 2013, respectively. Employees compensation and benefits accounted for the majority of the increase in noninterest expenses primarily due to increases in compensation costs that vary with noninterest income.

**Corporate**

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 not allocated to business segments.

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As a holding company, Hilltop's primary investment objectives are to preserve capital and have available cash resources to utilize in making acquisitions. Investment and interest income earned, primarily from available cash and available-for-sale securities, including our note receivable from SWS, was \$1.7 million and \$1.6 million during the three months ended March 31, 2014 and 2013, respectively.

Interest expense of \$1.7 million during the three months ended March 31, 2013 was due to interest costs associated with the 7.50% Senior Exchangeable Notes due 2025 of HTH Operating Partnership LP, a wholly owned subsidiary of Hilltop, which were called for redemption during the fourth quarter of 2013.

Noninterest expenses of \$2.2 million during each of the three months ended March 31, 2014 and 2013 primarily include compensation and benefits and professional fees.

Table of Contents**Financial Condition**

The following discussion contains a more detailed analysis of our financial condition at March 31, 2014 as compared to December 31, 2013.

**Securities Portfolio**

At March 31, 2014, investment securities consisted of securities of the U.S. Treasury, U.S. government and its agencies, obligations of municipalities and other political subdivisions, primarily in the State of Texas, mortgage-backed, corporate debt, and equity securities, a note receivable and a warrant. We have the ability to categorize investments as trading, available for sale, and held to maturity.

Our securities portfolio consists of two major components: trading securities and securities available for sale. Trading securities are bought and held principally for the purpose of selling them in the near term and are carried at fair value, marked to market through operations and held at the Bank and First Southwest. Securities that may be sold in response to changes in market interest rates, changes in securities prepayment risk, increases in loan demand, general liquidity needs and other similar factors are classified as available for sale and are carried at estimated fair value, with unrealized gains and losses recorded in accumulated other comprehensive income (loss). Securities are classified as held to maturity based on the intent and ability of our management, at the time of purchase, to hold such securities to maturity. These securities are carried at amortized cost.

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

	March 31, 2014	December 31, 2013
<b>Trading securities, at fair value</b>	\$ 53,350	\$ 58,846
<b>Securities available for sale, at fair value</b>		
U.S. Treasury securities	63,670	43,528
U.S. government agencies:		
Bonds	667,128	662,732
Residential mortgage-backed securities	58,545	60,087
Collateralized mortgage obligations	113,832	120,461
Corporate debt securities	100,151	76,608
States and political subdivisions	152,585	156,835
Commercial mortgage-backed securities	687	760
Equity securities	24,663	22,079
Note receivable	48,582	47,909
Warrant	15,516	12,144
	1,245,359	1,203,143
<b>Securities held to maturity, at amortized cost</b>		
U.S. government agencies:		
Residential mortgage-backed securities	29,582	
States and political subdivisions	1,399	
	30,981	

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<b>Total securities portfolio</b>	\$	1,329,690	\$	1,261,989
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We had net unrealized losses of \$25.3 million and \$53.7 million related to the available for sale investment portfolio at March 31, 2014 and December 31, 2013, respectively. The significant decrease in the net unrealized loss position of our available for sale investment portfolio during the first quarter of 2014 was due to the effects of a decrease in market interest rates since December 31, 2013 that resulted in an increase in the fair value of our debt securities.

The market value of securities held to maturity at March 31, 2014 approximated book value.



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*Banking Segment*

The banking segment's securities portfolio plays a role in the management of our interest rate sensitivity and generates additional interest income. In addition, the securities portfolio is used to meet collateral requirements for public and trust deposits, securities sold under agreements to repurchase and other purposes. The available for sale securities portfolio serves as a source of liquidity. Historically, the Bank's policy has been to invest primarily in securities of the U.S. government and its agencies, obligations of municipalities in the State of Texas and other high grade fixed income securities to minimize credit risk. At March 31, 2014, the banking segment's securities portfolio of \$1.1 billion was comprised of trading securities of \$20.9 million, available for sale securities of \$1.1 billion and held to maturity securities of \$31.0 million.

*Insurance Segment*

Our insurance segment's primary investment objective is to preserve capital and manage for a total rate of return. NLC's strategy is to purchase securities in sectors that represent the most attractive relative value. Our insurance segment invests the premiums it receives from policyholders until they are needed to pay policyholder claims or other expenses. At March 31, 2014, the insurance segment's securities portfolio was comprised of \$151.8 million in available for sale securities and \$5.5 million of other investments included in other assets within the consolidated balance sheet.

*Financial Advisory Segment*

Our financial advisory segment holds securities to support sales, underwriting and other customer activities. Because FSC is a broker-dealer, it is required to carry its securities at fair value and record changes in the fair value of the portfolio in operations. Accordingly, FSC classifies its securities portfolio of \$32.4 million at March 31, 2014 as trading.

*Corporate*

Available for sale securities of Hilltop at March 31, 2014 include the note receivable from, and warrant to purchase shares of SWS, of \$64.1 million, and equity securities of \$11.0 million representing those shares of SWS common stock held by Hilltop.

**Non-Covered Loan Portfolio**

Consolidated non-covered loans held for investment are detailed in the table below, classified by portfolio segment and segregated between those considered to be PCI loans and all other originated or acquired loans (in thousands). PCI loans showed evidence of credit deterioration that makes it probable that all contractually required principal and interest payments will not be collected.

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<b>March 31, 2014</b>	<b>Loans, excluding PCI Loans</b>	<b>PCI Loans</b>	<b>Total Loans</b>
Commercial and industrial	\$ 1,636,241	\$ 33,846	\$ 1,670,087
Real estate	1,503,160	32,201	1,535,361
Construction and land development	371,764	15,618	387,382
Consumer	50,385	3,731	54,116
Non-covered loans, gross	3,561,550	85,396	3,646,946
Allowance for loan losses	(31,293)	(3,352)	(34,645)
Non-covered loans, net of allowance	\$ 3,530,257	\$ 82,044	\$ 3,612,301

<b>December 31, 2013</b>	<b>Loans, excluding PCI Loans</b>	<b>PCI Loans</b>	<b>Total Loans</b>
Commercial and industrial	\$ 1,600,450	\$ 36,816	\$ 1,637,266
Real estate	1,418,003	39,250	1,457,253
Construction and land development	344,734	19,817	364,551
Consumer	51,067	4,509	55,576
Non-covered loans, gross	3,414,254	100,392	3,514,646
Allowance for loan losses	(30,104)	(3,137)	(33,241)
Non-covered loans, net of allowance	\$ 3,384,150	\$ 97,255	\$ 3,481,405

Table of Contents*Banking Segment*

The loan portfolio constitutes the major earning asset of the banking segment and typically offers the best alternative for obtaining the maximum interest spread above the banking segment's cost of funds. The overall economic strength of the banking segment generally parallels the quality and yield of its loan portfolio. The banking segment's loan portfolio is presented below in two sections, Non-Covered Loan Portfolio and Covered Loan Portfolio. The Covered Loan Portfolio consists of loans acquired in the FNB Transaction that are subject to loss-share agreements with the FDIC and is discussed below. The Non-Covered Loan Portfolio includes all other loans held by the Bank, which we refer to as non-covered loans, and is discussed herein.

The banking segment's total non-covered loans, net of the allowance for non-covered loan losses, were \$4.1 billion and \$4.3 billion at March 31, 2014 and December 31, 2013, respectively. The banking segment's non-covered loan portfolio includes a \$1.3 billion warehouse line of credit extended to PrimeLending, of which \$0.8 billion and \$1.0 billion was drawn at March 31, 2014 and December 31, 2013, respectively, as well as term loans to First Southwest that had an outstanding balance of \$23.0 million at March 31, 2014 and December 31, 2013. Amounts advanced against the warehouse line of credit and the First Southwest term loans are eliminated from net loans on our consolidated balance sheets. The decrease in the non-covered loan portfolio is primarily due to the decrease in the amount drawn under PrimeLending's warehouse line of credit.

The banking segment does not generally participate in syndicated loan transactions and has no foreign loans in its portfolio. At March 31, 2014, the banking segment's only non-covered loan concentration (loans to borrowers engaged in similar activities) that exceeded 10% of its total non-covered loans was non-construction commercial real estate loans within the non-covered real estate portfolio. At March 31, 2014, non-construction commercial real estate loans were 28.75% of the banking segment's total non-covered loans. The banking segment's non-covered loan concentrations were within regulatory requirements at March 31, 2014.

*Mortgage Origination Segment*

The loan portfolio of the mortgage origination segment consists of loans held for sale, primarily single-family residential mortgages funded through PrimeLending, and pipeline loans, which are loans in various stages of the application process, but not yet closed and funded. Pipeline loans may not close if potential borrowers elect in their sole discretion not to proceed with the loan application. Total loans held for sale were \$0.9 billion and \$1.1 billion at March 31, 2014 and December 31, 2013, respectively.

The components of the mortgage origination segment's loans held for sale and pipeline loans are as follows (in thousands).

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Loans held for sale:		
Unpaid principal balance	\$ 860,527	\$ 1,066,850
Fair value adjustment	26,073	21,555
	\$ 886,600	\$ 1,088,405

Pipeline loans:

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Unpaid principal balance	\$	797,934	\$	602,467
Fair value adjustment		19,244		12,151
	\$	817,178	\$	614,618

*Financial Advisory Segment*

The loan portfolio of the financial advisory segment consists primarily of margin loans to customers and correspondents. These loans are collateralized by the securities purchased or by other securities owned by the clients and, because of collateral coverage ratios, are believed to present minimal collectability exposure. Additionally, these loans are subject to a number of regulatory requirements as well as FSC's internal policies. The financial advisory segment's total non-covered loans, net of the allowance for non-covered loan losses, were \$315.0 million and \$281.6 million at March 31, 2014 and December 31, 2013, respectively. This increase was primarily attributable to increased borrowings in margin accounts held by FSC customers and correspondents.

Table of Contents**Covered Loan Portfolio***Banking Segment*

Loans acquired in the FNB Transaction that are subject to loss-share agreements with the FDIC are referred to as covered loans and reported separately in our consolidated balance sheets. Under the terms of the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets (including covered loans): (i) 80% of losses on the first \$240.4 million of losses incurred; (ii) 0% of losses in excess of \$240.4 million up to and including \$365.7 million of losses incurred; and (iii) 80% of losses in excess of \$365.7 million of losses incurred. The Bank has also agreed to reimburse the FDIC for any subsequent recoveries. The loss-share agreements for commercial and single family residential loans are in effect for 5 years and 10 years, respectively, and the loss recovery provisions to the FDIC are in effect for 8 years and 10 years, respectively, from the Bank Closing Date. 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 the FDIC's initial estimate of losses on covered assets is greater than the actual realized losses. The true-up payment is calculated using a defined formula set forth in the P&A Agreement.

In connection with the FNB Transaction, the Bank acquired loans both with and without evidence of credit quality deterioration since origination. The banking segment's portfolio of acquired covered loans had a fair value of \$1.1 billion as of the Bank Closing Date, with no carryover of any allowance for loan losses.

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

<b>March 31, 2014</b>	<b>Loans, excluding PCI Loans</b>		<b>PCI Loans</b>		<b>Total Loans</b>	
Commercial and industrial	\$	21,153	\$	31,210	\$	52,363
Real estate		219,102		527,352		746,454
Construction and land development		20,266		93,365		113,631
Consumer						
Covered loans, gross		260,521		651,927		912,448
Allowance for loan losses		(92)		(2,573)		(2,665)
Covered loans, net of allowance	\$	260,429	\$	649,354	\$	909,783

<b>December 31, 2013</b>	<b>Loans, excluding PCI Loans</b>		<b>PCI Loans</b>		<b>Total Loans</b>	
Commercial and industrial	\$	28,533	\$	38,410	\$	66,943
Real estate		223,304		564,678		787,982
Construction and land development		25,376		126,068		151,444
Consumer						
Covered loans, gross		277,213		729,156		1,006,369
Allowance for loan losses		(179)		(882)		(1,061)
Covered loans, net of allowance	\$	277,034	\$	728,274	\$	1,005,308

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At March 31, 2014, the banking segment had covered loan concentrations (loans to borrowers engaged in similar activities) that exceeded 10% of total covered loans in its real estate portfolio. The areas of concentration within our covered real estate portfolio were construction and land development loans, non-construction residential real estate loans, and non-construction commercial real estate loans. At March 31, 2014, construction and land development loans, non-construction residential real estate loans, and non-construction commercial real estate loans were 12.45%, 31.58% and 38.88%, respectively, of the banking segment's total covered loans. The banking segment's covered loan concentrations were within regulatory requirements at March 31, 2014.

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**Allowance for Loan Losses**

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses inherent in our existing non-covered and covered loan portfolios. Our management has responsibility for determining the level of the allowance for loan losses, subject to review by the Audit Committee of our Board of Directors and the Loan Review Committee of the Bank's board of directors.

It is our management's responsibility at the end of each quarter, or more frequently as deemed necessary, to analyze the level of the allowance for loan losses to ensure that it is appropriate for the estimated credit losses in the portfolio consistent with the Interagency Policy Statement on the Allowance for Loan and Lease Losses and the Receivables and Contingencies Topics of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). Estimated credit losses are the probable current amount of loans that we will be unable to collect given facts and circumstances as of the evaluation date. When management determines that a loan, or portion thereof, is uncollectible, the loan, or portion thereof, is charged-off against the allowance for loan losses, or for acquired loans accounted for in pools, charged against the pool discount. Recoveries on charge-offs that occurred prior to the PlainsCapital Merger represent contractual cash flows not expected to be collected and are recorded as accretion income. Recoveries on loans charged-off subsequent to the PlainsCapital Merger are credited to the allowance for loan loss, except for recoveries on loans accounted for in pools, which are credited to the pool discount.

We have developed a methodology that seeks to determine an allowance within the scope of the Receivables and Contingencies Topics of the ASC. Each of the loans that has been determined to be impaired is within the scope of the Receivables Topic. Impaired loans that are equal to or greater than \$0.5 million are individually evaluated for impairment using one of three impairment measurement methods as of the evaluation date: (1) the present value of expected future discounted cash flows on the loan, (2) the loan's observable market price, or (3) the fair value of the collateral if the loan is collateral dependent. Specific reserves are provided in our estimate of the allowance based on the measurement of impairment under these three methods, except for collateral dependent loans, which require the fair value method. All non-impaired loans are within the scope of the Contingencies Topic. Estimates of loss for the Contingencies Topic are calculated based on historical loss experience by collateral type adjusted for changes in trends, conditions, and other relevant factors that affect repayment of loans as of the evaluation date. While historical loss experience provides a reasonable starting point for the analysis, historical losses, or recent trends in losses, are not the sole basis upon which to determine the appropriate level for the allowance for loan losses. Management considers recent qualitative or environmental factors that are likely to cause estimated credit losses associated with the existing portfolio to differ from historical loss experience, including but not limited to: changes in lending policies and procedures; changes in underwriting standards; changes in economic and business conditions and developments that affect the collectability of the portfolio; the condition of various market segments; changes in the nature and volume of the portfolio and in the terms of loans; changes in lending management and staff; changes in the volume and severity of past due loans, the volume of non-accrual loans, and the volume and severity of adversely classified or graded loans; changes in the loan review system; changes in the value of underlying collateral for collateral-dependent loans; and any concentrations of credit and changes in the level of such concentrations.

We design our loan review program to identify and monitor problem loans by maintaining a credit grading process, requiring that timely and appropriate changes are made to reviewed loans and coordinating the delivery of the information necessary to assess the appropriateness of the allowance for loan losses. Loans are evaluated for impaired status when: (i) payments on the loan are delayed, typically by 90 days or more (unless the loan is both well secured and in the process of collection), (ii) the loan becomes classified, (iii) the loan is being reviewed in the normal course of the loan review scope, or (iv) the loan is identified by the servicing officer as a problem. We review on an individual basis all loan relationships over \$0.5 million that exhibit probable or observed credit weaknesses, the top 25 loan relationships by dollar amount in each market we serve, and additional relationships necessary to achieve adequate coverage of our various lending markets.

Homogeneous loans, such as consumer installment loans, residential mortgage loans and home equity loans, are not individually reviewed and are generally risk graded at the same levels. The risk grade and reserves are established for each homogeneous pool of loans based on the

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expected net charge-offs from current trends in delinquencies, losses or historical experience and general economic conditions. At March 31, 2014, we had no material delinquencies in these types of loans.

The allowance is subject to regulatory examination and determination as to adequacy, which may take into account such factors as the methodology used to calculate the allowance and the size of the allowance. While we believe we have an appropriate allowance for our existing non-covered and covered portfolios at March 31, 2014, additional provisions for



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losses on existing loans may be necessary in the future. Within our non-covered portfolio, we recorded net recoveries of \$16 thousand and \$0.2 million for the three months ended March 31, 2014 and 2013, respectively. Our allowance for non-covered loan losses totaled \$34.6 million and \$33.2 million at March 31, 2014 and December 31, 2013, respectively. The ratio of the allowance for non-covered loan losses to total non-covered loans held for investment at both March 31, 2014 and December 31, 2013 was 0.95%.

In connection with the PlainsCapital Merger and the FNB Transaction, we acquired loans both with and without evidence of credit quality deterioration since origination. PCI loans acquired in the PlainsCapital Merger are accounted for on an individual loan basis, while PCI loans acquired in the FNB Transaction are accounted for in pools as well as on an individual loan basis. We have established under our PCI accounting policy a framework to aggregate certain acquired loans into various loan pools based on a minimum of two layers of common risk characteristics for the purpose of determining their respective fair values as of their acquisition dates, and for applying the subsequent recognition and measurement provisions for income accretion and impairment testing. The common risk characteristics used for the pooling of the FNB PCI loans are risk grade and loan collateral type. The acquired loans were initially recorded at fair value with no carryover of any allowance for loan losses. Within our covered portfolio, we recorded net charge-offs of \$0.3 million for the three months ended March 31, 2014. Our allowance for covered loan losses totaled \$2.7 million and \$1.1 million at March 31, 2014 and December 31, 2013, respectively. The ratio of the allowance for covered loan losses to total covered loans held for investment at March 31, 2014 and December 31, 2013 was 0.29% and 0.11%, respectively.

Provisions for loan losses are charged to operations to record the total allowance for loan losses at a level deemed appropriate by the banking segment's management based on such factors as the volume and type of lending it conducted, the amount of non-performing loans and related collateral security, the present level of the allowance for loan losses, the results of recent regulatory examinations, generally accepted accounting principles, general economic conditions and other factors related to the ability to collect loans in its portfolio. The provision for loan losses, primarily in the banking segment, within our non-covered and covered portfolios was \$3.2 million and \$13.0 million for the three months ended March 31, 2014 and 2013, respectively.

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

Non-Covered Portfolio	Three Months Ended March 31,	
	2014	2013
Balance, beginning of period	\$ 33,241	\$ 3,409
Provisions charged to operating expenses	1,388	13,005
Recoveries of non-covered loans previously charged off:		
Commercial and industrial	725	494
Real estate	32	139
Construction and land development	122	107
Consumer	18	8
Total recoveries	897	748
Non-covered loans charged off:		
Commercial and industrial	807	438
Real estate		31
Construction and land development		
Consumer	74	56
Total charge-offs	881	525
Net recoveries	16	223
Balance, end of period	\$ 34,645	\$ 16,637



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	<b>Three Months Ended March 31, 2014</b>	
<b>Covered Portfolio</b>		
Balance, beginning of period	\$	1,061
Provisions charged to operating expenses		1,854
Recoveries of covered loans previously charged off:		
Commercial and industrial		
Real estate		
Construction and land development		
Consumer		
Total recoveries		
Covered loans charged off:		
Commercial and industrial		91
Real estate		159
Construction and land development		
Consumer		
Total charge-offs		250
Net charge-offs		(250)
Balance, end of period	\$	2,665

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

	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Reserve</b>	<b>% of Gross Non-Covered Loans</b>	<b>Reserve</b>	<b>% of Gross Non-Covered Loans</b>
<b>Non-Covered Portfolio</b>				
Commercial and industrial	\$ 16,726	45.80%	\$ 16,865	46.58%
Real estate (including construction and land development)	17,778	52.72%	16,288	51.84%
Consumer	141	1.48%	88	1.58%
Total	\$ 34,645	100.00%	\$ 33,241	100.00%

	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Reserve</b>	<b>% of Gross Covered Loans</b>	<b>Reserve</b>	<b>% of Gross Covered Loans</b>
<b>Covered Portfolio</b>				
Commercial and industrial	\$ 932	5.74%	\$ 1,053	6.65%
Real estate (including construction and land development)	1,733	94.26%	8	93.35%
Consumer		0.00%		0.00%
Total	\$ 2,665	100.00%	\$ 1,061	100.00%

*Potential Problem Loans*

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor's potential operating or financial difficulties. Management monitors these loans and reviews their performance on a regular basis. Potential problem loans contain potential weaknesses that

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could improve, persist or further deteriorate. If such potential weaknesses persist without improving, the loan is subject to downgrade, typically to substandard, in three to six months. Within our non-covered loan portfolio at March 31, 2014, we had 12 credit relationships totaling \$35.2 million of potential problem loans, which are assigned a grade of special mention within our risk grading matrix. At December 31, 2013, we had ten credit relationships totaling \$24.7 million of non-covered potential problem loans. Within our covered loan portfolio at March 31, 2014, we had one credit relationship totaling \$1.7 million of potential problem loans assigned a grade of special mention within our risk grading matrix, compared with two credit relationships totaling \$3.3 million at December 31, 2013.

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

	March 31, 2014	December 31, 2013
Non-covered loans accounted for on a non-accrual basis:		
Commercial and industrial	\$ 15,575	\$ 16,730
Real estate	7,213	6,511
Construction and land development	142	112
Consumer	\$ 22,930	\$ 23,353
Non-covered non-performing loans as a percentage of total non-covered loans	0.51%	0.51%
Non-covered other real estate owned	\$ 5,774	\$ 4,805
Other repossessed assets	\$ 250	\$ 13
Non-covered non-performing assets	\$ 28,954	\$ 28,171
Non-covered non-performing assets as a percentage of total assets	0.32%	0.32%
Non-covered loans past due 90 days or more and still accruing	\$ 2	\$ 534
Troubled debt restructurings included in accruing non-covered loans	\$ 776	\$ 1,055

At March 31, 2014, total non-covered non-performing assets increased \$0.8 million to \$29.0 million, compared with \$28.2 million at December 31, 2013, primarily due to an increase in non-covered OREO of \$1.0 million. Non-covered non-performing loans totaled \$22.9 million at March 31, 2014 and \$23.4 million at December 31, 2013. At March 31, 2014, non-covered non-accrual loans included four commercial and industrial relationships with loans totaling \$12.1 million secured by accounts receivable, inventory, oil and gas properties, aircraft and life insurance, and a total of \$1.3 million in lease financing receivables. Non-covered non-accrual loans at March 31, 2014 also included \$7.2 million characterized as real estate loans, including three commercial real estate loan relationships totaling \$3.0 million and loans secured by residential real estate totaling \$3.7 million, substantially all of which were classified as loans held for sale, as well as construction and land development loans of \$0.1 million. At December 31, 2013, non-covered non-accrual loans included five commercial and industrial relationships with loans totaling \$14.0 million secured by accounts receivable, inventory, aircraft and life insurance, and a total of \$1.0 million in lease financing receivables. Non-covered non-accrual loans at December 31, 2013 also included \$6.5 million characterized as real estate loans, including three commercial real estate loan relationships totaling \$2.5 million and loans secured by residential real estate totaling \$3.5 million, substantially all of which were classified as loans held for sale, as well as construction and land development loans of \$0.1 million.

Non-covered OREO increased \$1.0 million to \$5.8 million at March 31, 2014, compared with \$4.8 million at December 31, 2013. The increase was primarily due to the addition of two properties totaling \$2.0 million, partially offset by the disposal of three properties totaling \$0.7 million. At March 31, 2014, non-covered OREO included commercial properties of \$1.8 million, commercial real estate property consisting of parcels of unimproved land of \$2.1 million and residential lots under development of \$1.9 million. At December 31, 2013, non-covered OREO included commercial properties of \$4.2 million, commercial real estate property consisting of parcels of unimproved land of \$0.5 million and residential lots under development of \$0.1 million.

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At March 31, 2014, troubled debt restructurings ( TDRs ) granted on non-covered loans totaled \$11.2 million, of which \$0.8 million relate to non-covered PCI loans that are considered to be performing due to the application of the accretion method and non-covered non-performing loans of \$10.4 million for which discount accretion has been suspended. At December 31, 2013, TDRs granted on non-covered loans totaled \$11.4 million. These TDRs were comprised of \$1.1 million of non-covered PCI loans that are considered to be performing due to the application of the accretion method and non-covered non-performing loans of \$10.3 million for which discount accretion has been suspended.

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Non-covered loans past due 90 days or more and still accruing totaled \$2 thousand at March 31, 2014 and included a secured commercial and industrial loan and consumer loans, compared to a total of \$0.5 million at December 31, 2013 that included secured commercial and industrial loans, and a real estate loan.

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

	March 31, 2014	December 31, 2013
Covered loans accounted for on a non-accrual basis:		
Commercial and industrial	\$ 882	\$ 973
Real estate	11,277	249
Construction and land development	1,913	575
Consumer		
	\$ 14,072	\$ 1,797
Covered non-performing loans as a percentage of total covered loans	1.54%	0.18%
Covered other real estate owned	\$ 152,310	\$ 142,833
Other repossessed assets	\$	\$
Covered non-performing assets	\$ 166,382	\$ 144,630
Covered non-performing assets as a percentage of total assets	1.84%	1.62%
Covered loans past due 90 days or more and still accruing	\$ 1,051	\$
Troubled debt restructurings included in accruing covered loans	\$	\$

At March 31, 2014, covered non-performing assets increased by \$21.8 million to \$166.4 million, compared with \$144.6 million at December 31, 2013, due to increases in covered non-accrual loans of \$12.3 million and covered OREO of \$9.5 million. Covered non-performing loans totaled \$14.1 million at March 31, 2014 and \$1.8 million at December 31, 2013. At March 31, 2014, covered non-performing loans included one commercial and industrial relationship with loans totaling \$0.9 million secured by accounts receivable and inventory, two commercial real estate loan relationships totaling \$11.3 million, as well as construction and land development loans of \$1.9 million. At December 31, 2013, covered non-performing loans of \$1.8 million included one commercial and industrial relationship with loans totaling \$1.0 million secured by accounts receivable, inventory and equipment. Covered non-accrual loans at December 31, 2013 also included one commercial real estate loan relationship totaling \$0.2 million, as well as construction and land development loans of \$0.6 million.

OREO acquired in the FNB Transaction that is subject to the FDIC loss-share agreements is referred to as covered OREO and reported separately in our consolidated balance sheets. Covered OREO increased \$9.5 million to \$152.3 million at March 31, 2014, compared with \$142.8 million at December 31, 2013. The increase was primarily due to the addition of 41 properties totaling \$23.2 million, partially offset by the disposal of 70 properties totaling \$13.4 million. At March 31, 2014, covered OREO included commercial properties of \$103.1 million, commercial real estate property consisting of parcels of unimproved land of \$24.5 million and residential lots under development of \$24.7 million. At December 31, 2013, covered OREO included commercial properties of \$90.5 million, commercial real estate property consisting of parcels of unimproved land of \$21.4 million and residential lots under development of \$30.9 million.

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Covered loans past due 90 days or more and still accruing totaled \$1.1 million at March 31, 2014 and included secured commercial and industrial loans, a construction and land development loan, and commercial and residential real estate loans.



Table of Contents**Insurance Losses and Loss Adjustment Expenses**

At March 31, 2014 and December 31, 2013, our reserves for unpaid losses and LAE were \$28.3 million and \$27.5 million, respectively. The liability for insurance losses and LAE represents estimates of the ultimate unpaid cost of all losses incurred, including losses for claims that have not yet been reported. Separately for each of NLIC and ASIC and each line of business, our actuaries estimate the liability for unpaid losses and LAE by first estimating ultimate losses and LAE amounts for each year, prior to recognizing the impact of reinsurance.

Insured losses for a given accident year change in value over time as additional information on claims is received, as claim conditions change and as new claims are reported. This process is commonly referred to as loss development. To project ultimate losses and LAE, our actuaries examine the paid and reported losses and LAE for each accident year and multiply these values by a loss development factor. The selected loss development factors are based upon a review of the loss development patterns indicated in the companies' historical loss triangles and applicable insurance industry loss development factors.

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

**Deposits**

The banking segment's major source of funds and liquidity is its deposit base. Deposits provide funding for its investment in loans and securities. Interest paid for deposits must be managed carefully to control the level of interest expense and overall net interest margin. The composition of the deposit base (time deposits versus interest-bearing demand deposits and savings) is constantly changing due to the banking segment's needs and market conditions. Overall, average deposits totaled \$6.7 billion for the three months ended March 31, 2014, an increase from average deposits of \$4.7 billion for the three months ended March 31, 2013. The significant year-over-year increase in average deposits was primarily due to those deposits assumed as a part of the FNB Transaction. The table below presents the average balance of deposits and the average rate paid on those deposits (dollars in thousands).

	Three Months Ended March 31,				Year Ended	
	2014		2013		December 31, 2013	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
Noninterest-bearing demand deposits	\$ 1,721,403	0.00%	\$ 1,190,779	0.00%	\$ 1,370,029	0.00%
Interest-bearing demand deposits	2,355,333	0.22%	1,831,554	0.25%	1,930,622	0.24%
Savings deposits	312,675	0.25%	178,770	0.37%	247,789	0.32%
Certificates of deposit	2,281,205	0.40%	1,547,766	0.56%	1,745,483	0.54%
	\$ 6,670,616	0.23%	\$ 4,748,869	0.29%	\$ 5,293,923	0.28%

**Borrowings**

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

	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Balance</b>	<b>Average Rate Paid</b>	<b>Balance</b>	<b>Average Rate Paid</b>
Short-term borrowings	\$ 491,406	0.36%	\$ 342,087	0.36%
Notes payable	55,465	4.68%	56,327	6.33%
Junior subordinated debentures	67,012	3.53%	67,012	3.59%
	\$ 613,883	1.16%	\$ 465,426	2.10%

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Short-term borrowings consist of federal funds purchased, securities sold under agreements to repurchase and short-term bank loans. The \$149.3 million increase in short-term borrowings at March 31, 2014 compared with December 31, 2013 included increases of \$56.1 million in federal funds purchased, \$51.5 million in securities sold under agreements to repurchase and \$41.8 million in short-term bank loans. These increases were primarily the result of increases in customer borrowings and the cyclical nature of certain other short-term borrowing components. Notes payable at March 31, 2014 of \$55.5 million is comprised of insurance segment term notes and nonrecourse notes owed by First Southwest.

*Liquidity and Capital Resources*

Hilltop is a financial holding company whose assets primarily consist of the stock of its subsidiaries and invested assets. Hilltop's primary investment objectives, as a holding company, are to preserve capital and have available cash resources to utilize in making acquisitions. At March 31, 2014, Hilltop had approximately \$157 million in freely available cash and cash equivalents. If necessary or appropriate, we may also finance acquisitions with the proceeds from equity or debt issuances. The current short-term liquidity needs of Hilltop include operating expenses and dividends on preferred stock.

*Recent Event*

On March 31, 2014, we entered into a definitive merger agreement with SWS providing for the merger of SWS with and into a subsidiary of Hilltop formed for the purpose of facilitating this transaction. Under the terms of the merger agreement, SWS stockholders will receive per share consideration of 0.2496 shares of Hilltop common stock and \$1.94 of cash, equating to \$7.88 per share based on Hilltop's closing price on March 31, 2014. We intend to fund the cash portion of the consideration, currently estimated at approximately \$78 million in the aggregate, through available cash. The merger is subject to customary closing conditions, including regulatory approvals and approval of the stockholders of SWS, and is expected to be completed prior to the end of 2014.

*Series B Preferred Stock*

As a result of the PlainsCapital Merger, the outstanding shares of PlainsCapital Corporation's Non-Cumulative Perpetual Preferred Stock, Series C, all of which were held by the U.S. Treasury, were converted on a one-for-one basis into shares of Hilltop Series B Preferred Stock. The terms of our Series B Preferred Stock provide for the payment of non-cumulative dividends on a quarterly basis. The dividend rate, as a percentage of the liquidation amount, fluctuated until December 31, 2013 based upon changes in the level of qualified small business lending (QSBL) by the Bank. The shares of Hilltop Series B Preferred Stock are senior to shares of our common stock with respect to dividends and liquidation preference, and qualify as Tier 1 Capital for regulatory purposes. At both March 31, 2014 and December 31, 2013, \$114.1 million of our Series B Preferred Stock was outstanding. During the three months ended March 31, 2014, we accrued dividends of \$1.4 million on the Hilltop Series B Preferred Stock.

The dividend rate on the Hilltop Series B Preferred Stock is fixed at 5.0% from January 1, 2014 until March 26, 2016, based upon our level of QSBL at September 30, 2013. Beginning March 27, 2016, the dividend rate on any outstanding shares of Hilltop Series B Preferred Stock will be fixed at nine percent (9%) per annum.

*Loss-Share Agreements*

In connection with the FNB Transaction, the Bank entered into two loss-share agreements with the FDIC that collectively cover \$1.2 billion of loans and OREO acquired in the FNB Transaction, which we refer to as covered assets. Pursuant to the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets: (i) 80% of losses on the first \$240.4 million of losses incurred; (ii) 0% of losses in excess of \$240.4 million up to and including \$365.7 million of losses incurred; and (iii) 80% of losses in excess of \$365.7 million of losses incurred. The Bank has also agreed to reimburse the FDIC for any subsequent recoveries. The loss-share agreements for commercial and single family residential loans are in effect for 5 years and 10 years, respectively, from the Bank Closing Date and the loss recovery provisions to the FDIC are in effect for 8 years and 10 years, respectively, from the Bank Closing Date. 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 the FDIC's initial estimate of losses on covered assets is greater than the actual realized losses. The true-up payment is calculated using a defined formula set forth in the P&A Agreement.

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*Regulatory Capital*

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

At March 31, 2014, Hilltop exceeded all regulatory capital requirements with a total capital to risk weighted assets ratio of 19.32%, Tier 1 capital to risk weighted assets ratio of 18.66% and a Tier 1 capital to average assets, or leverage, ratio of 13.12%. At March 31, 2014, the Bank was also considered to be well-capitalized under regulatory requirements. We discuss regulatory capital requirements in more detail in Note 14 to our consolidated financial statements.

*Cash Flow Activities*

Cash and cash equivalents (consisting of cash and due from banks and federal funds sold), totaled \$917.4 million at March 31, 2014, an increase of \$171.4 million from \$746.0 million at December 31, 2013. Deposit flows, calls of investment securities and borrowed funds, and prepayments of loans and mortgage-backed securities are strongly influenced by interest rates, general and local economic conditions and competition in the marketplace. These factors reduce the predictability of the timing of these sources of funds.

Cash provided by operations during the three months ended March 31, 2014 was \$154.3 million, a decrease in cash flow of \$5.7 million compared with the same period in 2013. Cash provided by operations decreased primarily due to reductions in cash provided by our mortgage loan origination activities.

Cash used in our investment activities during the three months ended March 31, 2014 was \$39.4 million, primarily including net purchases of securities in our investment portfolio of \$45.2 million and net purchases of premises and equipment and other assets of \$8.7 million, partially offset by \$14.7 million from sales of premises and equipment and other real estate owned. Cash used in our investment activities during the three months ended March 31, 2013 of \$192.1 million primarily included net purchases of securities for investment of \$155.7 million, \$41.9 million for the origination of loans held for investment and net purchases of premises and equipment and other assets of \$5.0 million. The decrease in cash used in investing activities during the three months ended March 31, 2014, compared to the same period in 2013, was primarily due to reduced net purchases of securities driven by market conditions.

Cash used in financing activities during the three months ended March 31, 2014 was \$56.5 million, an increase in cash provided of \$141.6 million compared with the same period in 2013. The increase in cash provided was due primarily to an increase in short-term borrowings during the first quarter of 2014, partially offset by a decrease in deposits during the three months ended March 31, 2014 compared with a decrease in short-term borrowings partially offset by an increase in deposits during the same period in 2013.

*Banking Segment*

Within our banking segment, liquidity refers to the measure of our ability to meet our customers' short-term and long-term deposit withdrawals and anticipated and unanticipated increases in loan demand without penalizing earnings. Interest rate sensitivity involves the relationships between rate-sensitive assets and liabilities and is an indication of the probable effects of interest rate fluctuations on our net interest income.

Our asset and liability group is responsible for continuously monitoring our liquidity position to ensure that assets and liabilities are managed in a manner that will meet our short-term and long-term cash requirements. Funds invested in short-term marketable instruments, the continuous maturing of other interest-earning assets, cash flows from self-liquidating investments such as mortgage-backed securities and collateralized mortgage obligations, the possible sale of available for sale securities, and the ability to securitize certain types of loans provide sources of liquidity from an asset perspective. The liability base provides sources of liquidity through deposits and the maturity structure of short-term borrowed funds. For short-term liquidity needs, we utilize federal fund lines of credit with correspondent banks, securities sold under agreements to repurchase, borrowings from the Federal Reserve and borrowings under lines of credit with

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other financial institutions. For intermediate liquidity needs, we utilize advances from the FHLB. To supply liquidity over the longer term, we have access to brokered certificates of deposit, term loans at the FHLB and borrowings under lines of credit with other financial institutions.

We had deposits of \$6.7 billion at both March 31, 2014 and December 31, 2013. Deposit flows are affected by the level of market interest rates, the interest rates and products offered by competitors, the volatility of equity markets and other factors. At March 31, 2014, money market deposits, including brokered deposits, were \$1.2 billion; time deposits, including brokered deposits, were \$2.1 billion; and noninterest bearing demand deposits were \$1.7 billion. Money market deposits, including brokered deposits, increased by \$56.8 million from \$1.2 billion and time deposits, including brokered deposits, decreased \$176.1 million from \$2.3 billion at December 31, 2013.

The Bank's 15 largest depositors, excluding Hilltop and First Southwest, accounted for 17.48% of the Bank's total deposits, and the Bank's five largest depositors, excluding First Southwest, accounted for 10.89% of the Bank's total deposits at March 31, 2014. The loss of one or more of our largest Bank customers, or a significant decline in our deposit balances due to ordinary course fluctuations related to these customers' businesses, could adversely affect our liquidity and might require us to raise deposit rates to attract new deposits, purchase federal funds or borrow funds on a short-term basis to replace such deposits. We have not experienced any liquidity issues to date with respect to brokered deposits or our other large balance deposits, and we believe alternative sources of funding are available to more than compensate for the loss of one or more of these customers.

*Mortgage Origination Segment*

PrimeLending funds the mortgage loans it originates through a warehouse line of credit of up to \$1.3 billion maintained with the Bank. At March 31, 2014, PrimeLending had outstanding borrowings of \$0.8 billion against the warehouse line of credit. PrimeLending sells substantially all mortgage loans it originates to various investors in the secondary market, the majority with servicing released. As these mortgage loans are sold in the secondary market, PrimeLending pays down its warehouse line of credit with the Bank. In addition, PrimeLending has an available line of credit with JPMorgan Chase Bank, NA (JPMorgan Chase) of up to \$1.0 million. At March 31, 2014, PrimeLending had no borrowings under the JPMorgan Chase line of credit.

*Insurance Segment*

Our insurance operating subsidiary's primary investment objectives is to preserve capital and manage for a total rate of return. NLC's strategy is to purchase securities in sectors that represent the most attractive relative value. Bonds, cash and short-term investments of \$205.3 million, or 91.5%, equity investments of \$13.6 million and other investments of \$5.5 million comprised NLC's \$224.4 million in total cash and investments at March 31, 2014. NLC does not currently have any significant concentration in both direct and indirect guarantor exposure or any investments in subprime mortgages. NLC has custodial agreements with Wells Fargo and an investment management agreement with DTF Holdings, LLC.

*Financial Advisory Segment*

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FSC relies on its equity capital, short-term bank borrowings, interest-bearing and non-interest-bearing client credit balances, correspondent deposits, securities lending arrangements, repurchase agreement financings and other payables to finance its assets and operations. FSC has credit arrangements with three unaffiliated banks of up to \$255.0 million, which are used to finance securities owned, securities held for correspondent accounts, receivables in customer margin accounts and underwriting activities. These credit arrangements are provided on an as offered basis and are not committed lines of credit. At March 31, 2014, FSC had borrowed \$139.2 million under these credit arrangements.

### *Impact of Inflation and Changing Prices*

Our consolidated financial statements included herein have been prepared in accordance with GAAP, which presently require us to measure financial position and operating results primarily in terms of historic dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on our operations is reflected in increased operating costs. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the



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inflation rate. Interest rates are highly sensitive to many factors that are beyond our control, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the U.S. government, its agencies and various other governmental regulatory authorities.

***Off-Balance Sheet Arrangements; Commitments; Guarantees***

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

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

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

In the aggregate, the Bank had outstanding unused commitments to extend credit of \$1.2 billion at March 31, 2014 and outstanding financial and performance standby letters of credit of \$42.9 million at March 31, 2014.

In the normal course of business, FSC executes, settles and finances various securities transactions that may expose FSC to off-balance sheet risk in the event that a customer or counterparty does not fulfill its contractual obligations. Examples of such transactions include the sale of securities not yet purchased by customers or for the account of FSC, clearing agreements between FSC and various clearinghouses and broker-dealers, secured financing arrangements that involve pledged securities, and when-issued underwriting and purchase commitments.

***Critical Accounting Policies and Estimates***

Our accounting policies are fundamental to understanding our management's discussion and analysis of our results of operations and financial condition. We have identified certain significant accounting policies which involve a higher degree of judgment and complexity in making certain estimates and assumptions that affect amounts reported in our consolidated financial statements. The significant accounting policies which we believe to be the most critical in preparing our consolidated financial statements relate to Allowance for Loan Losses, FDIC

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Indemnification Asset, Reserve for Losses and Loss Adjustment Expenses, Goodwill and Identifiable Intangible Assets, Loan Indemnification Liability, Mortgage Servicing Rights and Acquisition Accounting. Since December 31, 2013, there have been no changes in critical accounting policies as further described under Critical Accounting Policies and Estimates and Note 1 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

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

Our assessment of market risk as of March 31, 2014 indicates there are no material changes in the quantitative and qualitative disclosures from those previously reported in our Annual Report on Form 10-K for the year ended December 31, 2013, except as discussed below.

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

*Banking Segment*

The banking segment is engaged primarily in the business of investing funds obtained from deposits and borrowings in interest-earning loans and investments, and our primary component of market risk is sensitivity to changes in interest rates. Consequently, our earnings depend to a significant extent on our net interest income, which is the difference between interest income on loans and investments and our interest expense on deposits and borrowings. To the extent that our interest-bearing liabilities do not reprice or mature at the same time as our interest-bearing assets, we are subject to interest rate risk and corresponding fluctuations in net interest income.

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

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

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. The management of interest rate risk is performed by analyzing the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at specific points in time ( *GAP* ) and by analyzing the effects of interest rate changes on net interest income over specific periods of time by projecting the performance of the mix of assets and liabilities in varied interest rate environments. Interest rate sensitivity reflects the potential effect on net interest income resulting from a movement in interest rates. A company is considered to be asset sensitive, or have a positive *GAP*, when the amount of its interest-earning assets maturing or repricing within a given period exceeds the amount of its interest-bearing liabilities also maturing or repricing within that time period. Conversely, a company is considered to be liability sensitive, or have a negative *GAP*, when the amount of its interest-bearing liabilities maturing or repricing within a

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given period exceeds the amount of its interest-earning assets also maturing or repricing within that time period. During a period of rising interest rates, a negative GAP would tend to affect net interest income adversely, while a positive GAP would tend to result in an increase in net interest income. During a period of falling interest rates, a negative GAP would tend to result in an increase in net interest income, while a positive GAP would tend to affect net interest income adversely. However, it is our intent to remain relatively balanced so that changes in rates do not have a significant impact on earnings.

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

	March 31, 2014					
	3 Months or Less	> 3 Months to 1 Year	> 1 Year to 3 Years	> 3 Years to 5 Years	> 5 Years	Total
<b><u>Interest sensitive assets:</u></b>						
Loans	\$ 2,814,586	\$ 619,010	\$ 689,354	\$ 286,085	\$ 663,953	\$ 5,072,988
Securities	200,426	386,373	220,841	70,862	191,774	1,070,276
Federal funds sold and securities purchased under agreements to resell	27,460					27,460
Other interest sensitive assets	551,496					551,496
Total interest sensitive assets	3,593,968	1,005,383	910,195	356,947	855,727	6,722,220
<b><u>Interest sensitive liabilities:</u></b>						
Interest bearing checking	\$ 2,480,977	\$	\$	\$	\$	\$ 2,480,977
Savings	298,082					298,082
Time deposits	627,598	1,074,976	257,901	140,942	27,788	2,129,205
Notes payable & other borrowings	345,380	494	1,405	754	5,352	353,385
Total interest sensitive liabilities	3,752,037	1,075,470	259,306	141,696	33,140	5,261,649
Interest sensitivity gap	\$ (158,069)	\$ (70,087)	\$ 650,889	\$ 215,251	\$ 822,587	\$ 1,460,571
Cumulative interest sensitivity gap	\$ (158,069)	\$ (228,156)	\$ 422,733	\$ 637,984	\$ 1,460,571	
Percentage of cumulative gap to total interest sensitive assets	-2.35%	-3.39%	6.29%	9.49%	21.73%	

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

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The table below shows the estimated impact of increases of 1%, 2% and 3% and a decrease of 0.5% in interest rates on net interest income and on economic value of equity for the banking segment at March 31, 2014 (dollars in thousands).

Change in Interest Rates (basis points)	Changes in Net Interest Income		Changes in Economic Value of Equity	
	Amount	Percent	Amount	Percent
+300	\$ 4,782	1.91%	\$ (76,551)	-6.35%
+200	\$ (4,798)	-1.92%	\$ (64,630)	-5.36%
+100	\$ (10,492)	-4.20%	\$ (40,132)	-3.33%
-50	\$ 2,543	1.02%	\$ 15,699	1.30%

The projected changes in net interest income and market value of equity to changes in interest rates at March 31, 2014 were in compliance with established internal policy guidelines. These projected changes are based on numerous assumptions of growth and changes in the mix of assets or liabilities.

The historically low level of interest rates, combined with the existence of rate floors that are in effect for a significant portion of the loan portfolio, are projected to cause yields on our earning assets to rise more slowly than increases in market

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interest rates. As a result, in a rising interest rate environment, our interest rate margins are projected to compress until the rise in market interest rates is sufficient to allow our loan portfolio to reprice above applicable rate floors.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

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

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

*Changes in Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

For a description of material pending legal proceedings, see the discussion set forth under the heading "Legal Matters" in Note 11 to our Consolidated Financial Statements, which is incorporated by reference herein.

**Item 1A. Risk Factors.**

*The pending merger with SWS Group, Inc. is subject to closing conditions, the failure of any of which could result in our inability to consummate the transaction.*

On March 31, 2014, we entered into an Agreement and Plan of Merger with SWS. The closing of the transaction is subject to the satisfaction of certain conditions, including the receipt of all necessary or advisable regulatory approvals and the approval of SWS's stockholders. No assurance can be given as to when or whether these approvals will be received.

Furthermore, the merger agreement contains certain termination rights for Hilltop and SWS, as the case may be, applicable upon, among other events, (i) final, non-appealable denial of a required regulatory approval, (ii) the Closing having not been completed on or prior to the first anniversary of the date of the Merger Agreement, (iii) a material breach of the Merger Agreement by the other party that cannot be cured within 30 days' notice and would cause the closing conditions not to be satisfied, (iv) if SWS stockholders fail to approve the Merger, or (v) by Hilltop if the SWS board of directors withdraws its recommendation of the Merger to the SWS stockholders or if a governmental entity imposes a materially burdensome regulatory condition. The Merger Agreement further provides that, in connection with the termination of the Merger Agreement under specified circumstances, including if the SWS board of directors withdraws its recommendation in favor of the Merger, SWS will be required to pay Hilltop a termination fee of \$8,000,000.



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*We may fail to realize all of the anticipated benefits of our pending acquisition of SWS.*

The success of our pending acquisition of SWS will depend on, among other things, the ability to achieve certain operating results at SWS. If the financial condition or result of operations of SWS is materially different than those that we forecasted, the anticipated benefits of the acquisition may not be realized fully, or at all, or may take longer to realize than expected.

Hilltop and SWS have operated and, until the completion of the merger, will continue to operate, independently. The companies may have difficulty addressing possible differences in corporate cultures and management philosophies. It is also possible that clients, customers, depositors and counterparties of SWS could choose to discontinue their relationships with the company post-merger, which would adversely affect our future performance.

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

On January 17, 2014, we issued an aggregate of 2,303 shares of common stock under the Hilltop Holdings 2012 Equity Incentive Plan to certain non-employee directors as compensation for their service on our Board of Directors during the fourth quarter of 2013. The shares were issued pursuant to the exemption from registration under Section 4(2) of the Securities Act.

**Item 6. Exhibits**

A list of exhibits filed herewith is contained in the Exhibit Index that immediately precedes such exhibits and is incorporated by reference herein.

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**SIGNATURES**

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

**HILLTOP HOLDINGS INC.**

Date: May 5, 2014

By:

/s/ Darren Parmenter  
Darren Parmenter  
Executive Vice President    Principal Financial Officer

(Principal Financial and Accounting Officer and duly  
authorized officer)

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
2.1	Agreement and Plan of Merger by and among SWS Group, Inc., Hilltop Holdings Inc. and Peruna LLC, dated as of March 31, 2014 (filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on April 1, 2014 (File No. 001-31987) and incorporated herein by reference).
3.1	Articles of Amendment, dated March 31, 2014 (filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on April 1, 2014 (File No. 001-31987) and incorporated herein by reference).
10.1	Form of Restricted Stock Unit Award Agreement (Time-Based Vesting) (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on February 28, 2014 (File No. 001-31987) and incorporated herein by reference).
10.2	Form of Restricted Stock Unit Award Agreement (Performance-Based Vesting) (filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on February 28, 2014 (File No. 001-31987) and incorporated herein by reference).
10.3	Compensation Arrangement with Jeremy B. Ford (filed as Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on February 28, 2014 (File No. 001-31987) and incorporated herein by reference).
10.4	Compensation Arrangement with Darren Parmenter (filed as Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on February 28, 2014 (File No. 001-31987) and incorporated herein by reference).
31.1*	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2*	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1*	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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\*Filed herewith.