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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2021

**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.)

**6565 Hillcrest Avenue**  
**Dallas, TX**  
(Address of principal executive offices)

**75205**  
(Zip Code)

**(214) 855-2177**

(Registrant's telephone number, including area code)

Securities registered pursuant to section 12(b) of the Act:

<u>Title of each class</u>	<u>Trading symbol</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$0.01 per share	HTH	New York Stock Exchange

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

The number of shares of the registrant's common stock outstanding at July 23, 2021 was 81,154,608.

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**HILLTOP HOLDINGS INC.**  
**FORM 10-Q**  
**FOR THE QUARTER ENDED JUNE 30, 2021**

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**HILLTOP HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share data)  
(Unaudited)

	<u>June 30,</u> <u>2021</u>	<u>December 31,</u> <u>2020</u>
<b>Assets</b>		
Cash and due from banks	\$ 1,372,818	\$ 1,062,560
Federal funds sold	387	386
Assets segregated for regulatory purposes	207,284	290,357
Securities purchased under agreements to resell	202,638	80,319
Securities:		
Trading, at fair value	682,483	694,255
Available for sale, at fair value, net (amortized cost of \$1,810,032 and \$1,435,919, respectively)	1,817,807	1,462,205
Held to maturity, at amortized cost, net (fair value of \$301,161 and \$326,671, respectively)	288,776	311,944
Equity, at fair value	193	140
	<u>2,789,259</u>	<u>2,468,544</u>
Loans held for sale	2,885,458	2,788,386
Loans held for investment, net of unearned income	7,645,227	7,693,141
Allowance for credit losses	(115,269)	(149,044)
Loans held for investment, net	<u>7,529,958</u>	<u>7,544,097</u>
Broker-dealer and clearing organization receivables	1,403,447	1,404,727
Premises and equipment, net	212,402	211,595
Operating lease right-of-use assets	115,698	105,757
Mortgage servicing rights	124,497	143,742
Other assets	535,536	555,983
Goodwill	267,447	267,447
Other intangible assets, net	17,705	20,364
Total assets	<u>\$ 17,664,534</u>	<u>\$ 16,944,264</u>
<b>Liabilities and Stockholders' Equity</b>		
Deposits:		
Noninterest-bearing	\$ 4,231,082	\$ 3,612,384
Interest-bearing	7,502,703	7,629,935
Total deposits	<u>11,733,785</u>	<u>11,242,319</u>
Broker-dealer and clearing organization payables	1,439,620	1,368,373
Short-term borrowings	915,919	695,798
Securities sold, not yet purchased, at fair value	132,950	79,789
Notes payable	396,653	381,987
Operating lease liabilities	134,019	125,450
Junior subordinated debentures	67,012	67,012
Other liabilities	348,200	632,889
Total liabilities	<u>15,168,158</u>	<u>14,593,617</u>
Commitments and contingencies (see Notes 14 and 15)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, \$0.01 par value, 125,000,000 shares authorized; 81,153,185 and 82,184,893 shares issued and outstanding at June 30, 2021 and December 31, 2020, respectively	812	822
Additional paid-in capital	1,302,439	1,317,929
Accumulated other comprehensive income	7,093	17,763
Retained earnings	1,159,304	986,792
Deferred compensation employee stock trust, net	754	771
Employee stock trust (6,060 and 6,930 shares, at cost, at June 30, 2021 and December 31, 2020, respectively)	(121)	(138)
Total Hilltop stockholders' equity	<u>2,470,281</u>	<u>2,323,939</u>
Noncontrolling interests	<u>26,095</u>	<u>26,708</u>
Total stockholders' equity	<u>2,496,376</u>	<u>2,350,647</u>
Total liabilities and stockholders' equity	<u>\$ 17,664,534</u>	<u>\$ 16,944,264</u>

*See accompanying notes.*

**HILLTOP HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)  
(Unaudited)

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Interest income:				
Loans, including fees	\$ 104,162	\$ 107,860	\$ 208,439	\$ 219,028
Securities borrowed	15,586	12,883	44,558	26,210
Securities:				
Taxable	11,125	11,698	21,376	27,393
Tax-exempt	2,338	1,539	4,440	3,149
Other	1,607	951	2,927	4,026
Total interest income	<u>134,818</u>	<u>134,931</u>	<u>281,740</u>	<u>279,806</u>
Interest expense:				
Deposits	6,176	11,947	13,917	27,071
Securities loaned	12,345	10,796	37,831	22,073
Short-term borrowings	2,374	2,367	4,386	7,111
Notes payable	5,253	3,768	10,050	6,186
Junior subordinated debentures	577	705	1,139	1,555
Other	177	790	819	916
Total interest expense	<u>26,902</u>	<u>30,373</u>	<u>68,142</u>	<u>64,912</u>
Net interest income	107,916	104,558	213,598	214,894
Provision for (reversal of) credit losses	<u>(28,720)</u>	<u>66,026</u>	<u>(33,829)</u>	<u>100,575</u>
Net interest income after provision for (reversal of) credit losses	136,636	38,532	247,427	114,319
Noninterest income:				
Net gains from sale of loans and other mortgage production income	199,625	295,317	466,705	445,803
Mortgage loan origination fees	42,146	45,341	85,301	73,895
Securities commissions and fees	38,300	34,234	76,614	74,303
Investment and securities advisory fees and commissions	32,268	29,120	59,963	52,300
Other	27,560	64,113	68,901	93,537
Total noninterest income	<u>339,899</u>	<u>468,125</u>	<u>757,484</u>	<u>739,838</u>
Noninterest expense:				
Employees' compensation and benefits	248,486	276,893	518,839	473,249
Occupancy and equipment, net	25,004	26,174	49,433	45,696
Professional services	16,239	15,737	29,824	30,535
Other	53,639	51,405	111,934	102,630
Total noninterest expense	<u>343,368</u>	<u>370,209</u>	<u>710,030</u>	<u>652,110</u>
Income from continuing operations before income taxes	133,167	136,448	294,881	202,047
Income tax expense	<u>31,234</u>	<u>31,808</u>	<u>69,004</u>	<u>46,956</u>
Income from continuing operations	101,933	104,640	225,877	155,091
Income from discontinued operations, net of income taxes	<u>—</u>	<u>30,775</u>	<u>—</u>	<u>33,926</u>
Net income	101,933	135,415	225,877	189,017
Less: Net income attributable to noncontrolling interest	2,873	6,939	6,473	10,905
Income attributable to Hilltop	<u>\$ 99,060</u>	<u>\$ 128,476</u>	<u>\$ 219,404</u>	<u>\$ 178,112</u>
Earnings per common share:				
Basic:				
Earnings from continuing operations	\$ 1.21	\$ 1.08	\$ 2.68	\$ 1.60
Earnings from discontinued operations	—	0.34	—	0.37
	<u>\$ 1.21</u>	<u>\$ 1.42</u>	<u>\$ 2.68</u>	<u>\$ 1.97</u>
Diluted:				
Earnings from continuing operations	\$ 1.21	\$ 1.08	\$ 2.66	\$ 1.60
Earnings from discontinued operations	—	0.34	—	0.37
	<u>\$ 1.21</u>	<u>\$ 1.42</u>	<u>\$ 2.66</u>	<u>\$ 1.97</u>
Weighted average share information:				
Basic	81,663	90,164	81,914	90,337
Diluted	<u>82,199</u>	<u>90,164</u>	<u>82,407</u>	<u>90,337</u>

*See accompanying notes.*

**HILLTOP HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in thousands)  
(Unaudited)

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Net income	\$ 101,933	\$ 135,415	\$ 225,877	\$ 189,017
Other comprehensive income:				
Change in fair value of cash flow and fair value hedges, net of tax of \$(71), \$(110), \$434 and \$(1,043), respectively	(2,391)	(377)	3,644	(3,577)
Net unrealized gains (losses) on securities available for sale, net of tax of \$1,799, \$927, \$(4,175) and \$4,653, respectively	5,999	3,245	(14,242)	15,850
Reclassification adjustment for gains (losses) included in net income, net of tax of \$0, \$2, \$(21) and \$36, respectively	(1)	6	(72)	121
Comprehensive income	<u>105,540</u>	<u>138,289</u>	<u>215,207</u>	<u>201,411</u>
Less: comprehensive income attributable to noncontrolling interest	<u>2,873</u>	<u>6,939</u>	<u>6,473</u>	<u>10,905</u>
Comprehensive income applicable to Hilltop	<u>\$ 102,667</u>	<u>\$ 131,350</u>	<u>\$ 208,734</u>	<u>\$ 190,506</u>

*See accompanying notes.*

**HILLTOP HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(in thousands)  
(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Deferred Compensation Employee Stock Trust, Net	Employee Stock Trust	Total Hilltop Stockholders' Equity	Noncontrolling Interest	Total Stockholders' Equity
	Shares	Amount	Income	Earnings	Trust, Net	Shares	Equity	Interest	Equity
Balance, March 31, 2020	90,108	\$ 1,437,301	\$ 20,939	\$ 676,946	\$ 774	8	\$ 2,136,711	\$ 27,022	\$ 2,163,733
Net income	—	—	—	128,476	—	—	128,476	6,939	135,415
Other comprehensive income	—	—	2,874	—	—	—	2,874	—	2,874
Stock-based compensation expense	—	—	—	—	—	—	—	—	—
Common stock issued to board members	8	146	—	—	—	—	3,117	—	3,117
Issuance of common stock related to share-based awards, net	126	(556)	—	—	—	—	146	—	146
Repurchases of common stock	(20)	(322)	—	30	—	—	(555)	—	(555)
Dividends on common stock (\$0.09 per share)	—	—	—	(8,121)	4	—	(292)	—	(292)
Deferred compensation plan	—	—	—	—	—	—	(8,121)	—	(8,121)
Net cash distributed to noncontrolling interest	—	—	—	—	—	—	4	—	4
Balance, June 30, 2020	90,222	\$ 1,439,686	\$ 23,813	\$ 797,331	\$ 778	8	\$ 2,262,360	\$ 29,773	\$ 2,292,133
Balance, March 31, 2021	82,261	\$ 1,319,518	\$ 3,486	\$ 1,094,727	\$ 752	6	\$ 2,419,185	\$ 26,830	\$ 2,446,015
Net income	—	—	—	99,060	—	—	99,060	2,873	101,933
Other comprehensive income	—	—	3,607	—	—	—	3,607	—	3,607
Stock-based compensation expense	—	—	—	—	—	—	—	—	—
Common stock issued to board members	4	150	—	—	—	—	4,192	—	4,192
Issuance of common stock related to share-based awards, net	129	(1,505)	—	—	—	—	150	—	150
Repurchases of common stock	(1,241)	(19,916)	—	(24,594)	—	—	(1,504)	—	(1,504)
Dividends on common stock (\$0.12 per share)	—	—	—	(9,889)	2	—	(44,522)	—	(44,522)
Deferred compensation plan	—	—	—	(9,889)	—	—	(9,889)	—	(9,889)
Net cash distributed to noncontrolling interest	—	—	—	—	—	—	2	—	2
Balance, June 30, 2021	81,153	\$ 1,302,439	\$ 7,093	\$ 1,159,304	\$ 754	6	\$ 2,470,281	\$ (3,608)	\$ 2,496,376

**HILLTOP HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (continued)**  
(in thousands)  
(Unaudited)

	Common Stock		Additional Paid-in Capital		Accumulated Other Comprehensive Income		Retained Earnings		Deferred Compensation Employee Stock Trust, Net		Employee Stock Trust		Total Hilltop Stockholders' Equity		Noncontrolling Interest		Total Stockholders' Equity	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance, December 31, 2019	90,641	\$ 906	\$ 1,445,233	\$ 11,419	\$ 644,860	\$ 776	8	\$ (155)	\$ 2,103,039	\$ 25,757								
Net income	—	—	—	12,394	178,112	—	—	—	—	—	—	—	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	6,759	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Common stock issued to board members	18	—	292	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Issuance of common stock related to share-based awards, net	284	3	(1,027)	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Repurchases of common stock	(721)	(7)	(1,571)	—	(3,671)	—	—	—	—	—	—	—	—	—	—	—	—	—
Dividends on common stock (\$0.18 per share)	—	—	—	—	(16,279)	—	—	—	—	—	—	—	—	—	—	—	—	—
Deferred compensation plan	—	—	—	—	—	—	5	—	7	—	—	—	—	—	—	—	—	—
Adoption of accounting standards	—	—	—	—	(5,691)	—	—	—	—	—	—	—	—	—	—	—	—	—
Net cash distributed to noncontrolling interest	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Balance, June 30, 2020	90,222	\$ 902	\$ 1,439,686	\$ 23,813	\$ 797,331	\$ 778	8	\$ (150)	\$ 2,262,360	\$ 29,773								
Balance, December 31, 2020	82,185	\$ 822	\$ 1,317,929	\$ 17,763	\$ 986,792	\$ 771	7	\$ (138)	\$ 2,323,939	\$ 26,708								
Net income	—	—	—	—	219,404	—	—	—	—	—	—	—	—	—	—	—	—	—
Other comprehensive loss	—	—	—	(10,670)	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	8,786	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Common stock issued to board members	8	—	297	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Issuance of common stock related to share-based awards, net	351	3	(2,253)	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Repurchases of common stock	(1,391)	(13)	(22,320)	—	(27,138)	—	—	—	—	—	—	—	—	—	—	—	—	—
Dividends on common stock (\$0.24 per share)	—	—	—	—	(19,754)	—	—	—	—	—	—	—	—	—	—	—	—	—
Deferred compensation plan	—	—	—	—	—	—	(1)	—	(17)	—	—	—	—	—	—	—	—	—
Net cash distributed to noncontrolling interest	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Balance, June 30, 2021	81,153	\$ 812	\$ 1,302,439	\$ 7,093	\$ 1,159,304	\$ 754	6	\$ (121)	\$ 2,470,281	\$ 26,095								

See accompanying notes.

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

	<b>Six Months Ended June 30,</b>	
	<b>2021</b>	<b>2020</b>
<b>Operating Activities</b>		
Net income	\$ 225,877	\$ 189,017
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for (reversal of) credit losses	(33,829)	100,575
Depreciation, amortization and accretion, net	10,531	8,111
Deferred income taxes	2,380	742
Other, net	10,077	644
Net change in securities purchased under agreements to resell	(122,319)	(102,426)
Net change in trading securities	11,772	41,539
Net change in broker-dealer and clearing organization receivables	(190,385)	711,290
Net change in other assets	(45,972)	(136,942)
Net change in broker-dealer and clearing organization payables	44,751	(364,631)
Net change in other liabilities	(105,218)	30,443
Net change in securities sold, not yet purchased	53,161	11,523
Proceeds from sale of mortgage servicing rights asset	84,633	18,650
Change in valuation of mortgage servicing rights asset	(15,273)	19,505
Net gains from sales of loans	(466,705)	(445,803)
Loans originated for sale	(13,539,646)	(11,035,100)
Proceeds from loans sold	13,750,233	10,850,695
Net cash used in operating activities for continuing operations	(325,932)	(102,168)
Net cash used in operating activities for discontinued operations	—	(28,533)
Net cash used in operating activities	(325,932)	(130,701)
<b>Investing Activities</b>		
Proceeds from maturities and principal reductions of securities held to maturity	22,887	49,918
Proceeds from sales, maturities and principal reductions of securities available for sale	385,411	194,336
Purchases of securities held to maturity	—	(7,080)
Purchases of securities available for sale	(764,283)	(357,307)
Net change in loans held for investment	249,069	(632,976)
Purchases of premises and equipment and other assets	(16,696)	(21,005)
Proceeds from sales of premises and equipment and other real estate owned	3,263	17,591
Net cash received from (paid to) Federal Home Loan Bank and Federal Reserve Bank stock	(72)	22,905
Net cash used in investing activities for continuing operations	(120,421)	(733,618)
Net cash provided by investing activities for discontinued operations	—	1,941
Net cash received from disposal of discontinued operations	—	84,763
Net cash used in investing activities	(120,421)	(646,914)
<b>Financing Activities</b>		
Net change in deposits	517,962	2,535,125
Net change in short-term borrowings	220,024	(703,846)
Proceeds from notes payable	488,341	860,484
Payments on notes payable	(473,891)	(666,681)
Payments to repurchase common stock	(49,471)	(15,249)
Dividends paid on common stock	(19,754)	(16,279)
Net cash distributed to noncontrolling interest	(7,086)	(6,889)
Other, net	(2,586)	(1,336)
Net cash provided by financing activities	673,539	1,985,329
Net change in cash, cash equivalents and restricted cash	227,186	1,207,714
Cash, cash equivalents and restricted cash, beginning of period	1,353,303	642,789
Cash, cash equivalents and restricted cash, end of period	\$ 1,580,489	\$ 1,850,503
<b>Reconciliation of Cash, Cash Equivalents and Restricted Cash to Consolidated Balance Sheets</b>		
Cash and due from banks	\$ 1,372,818	\$ 1,655,492
Federal funds sold	387	385
Assets segregated for regulatory purposes	207,284	194,626
Total cash, cash equivalents and restricted cash	\$ 1,580,489	\$ 1,850,503
<b>Supplemental Disclosures of Cash Flow Information</b>		
Cash paid for interest	\$ 69,479	\$ 64,621
Cash paid for income taxes, net of refunds	\$ 55,498	\$ 5,976
<b>Supplemental Schedule of Non-Cash Activities</b>		
Conversion of loans to other real estate owned	\$ 1,805	\$ 12,455
Additions to mortgage services rights	\$ 50,115	\$ 63,915

*See accompanying notes.*



Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
(Unaudited)

## 1. Summary of Significant Accounting and Reporting Policies

### Nature of Operations

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

On June 30, 2020, Hilltop completed the sale of all of the outstanding capital stock of National Lloyds Corporation (“NLC”), which comprised the operations of the former insurance segment, for cash proceeds of \$154.1 million, and was subject to post-closing adjustments. Accordingly, NLC’s results for the three and six months ended June 30, 2020 have been presented as discontinued operations in the consolidated financial statements. For further details, see Note 3 to the consolidated financial statements.

The Company, headquartered in Dallas, Texas, provides its products and services through two primary business units within continuing operations, PlainsCapital Corporation (“PCC”) and Hilltop Securities Holdings LLC (“Securities Holdings”). PCC is a financial holding company that provides, through its subsidiaries, traditional banking, wealth and investment management and treasury management services primarily in Texas and residential mortgage lending throughout the United States. Securities Holdings is a holding company that provides, through its subsidiaries, investment banking and other related financial services, including municipal advisory, sales, trading and underwriting of taxable and tax-exempt fixed income securities, clearing, securities lending, structured finance and retail brokerage services throughout the United States. Unless otherwise noted, the Company’s notes to the consolidated financial statements present information limited to continuing operations.

As a result of the spread of the novel coronavirus (“COVID-19”) pandemic, economic uncertainties have contributed to significant volatility in the global economy, as well as banking and other financial activity in the areas in which the Company operates. The effects of COVID-19 have had, and may continue to have, an adverse effect on the financial markets and overall economic conditions on an unprecedented scale. The Company’s business is dependent upon the willingness and ability of its employees and customers to conduct banking and other financial transactions. The rapid development and fluidity of this situation precludes any prediction as to the ultimate adverse impact of COVID-19. COVID-19 presents material uncertainty which could have a material adverse effect on the Company’s business, financial condition, results of operations and cash flows.

### 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, 2020 (“2020 Form 10-K”). Results for interim periods are not necessarily indicative of results to be expected for a full year or any future period.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates regarding the allowance for credit losses, the fair values of financial instruments, the mortgage loan indemnification liability, and the potential impairment of goodwill and identifiable intangible 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. Actual amounts

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and values as of the balance sheet dates may be materially different than the amounts and values reported due to the inherent uncertainty in the estimation process. Also, future amounts and values could differ materially from those estimates due to changes in values and circumstances after the balance sheet date.

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

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

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

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

In addition, Hilltop owns 100% of the membership interest in each of HTH Hillcrest Project LLC (“HTH Project LLC”) and Hilltop Investments I, LLC. Hilltop Investments I, LLC owns 50% of the membership interest in HTH Diamond Hillcrest Land LLC (“Hillcrest Land LLC”) which is consolidated under the aforementioned VIE Subsections of the ASC. These entities are related to the Hilltop Plaza investment discussed in detail in Note 20 to the consolidated financial statements included in the Company’s 2020 Form 10-K and are collectively referred to as the “Hilltop Plaza Entities.”

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

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

Significant accounting policies are detailed in Note 1 to the consolidated financial statements included in the Company’s 2020 Form 10-K.

Hilltop Holdings Inc. and Subsidiaries  
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## 2. Recently Issued Accounting Standards

### *Accounting Standards Adopted During 2021*

In January 2020, FASB issued ASU 2020-01 to clarify the interaction among ASC 321, ASC 323, and ASC 815 for equity securities, equity method investments, and certain financial instruments to acquire equity securities. ASU 2020-01 clarifies whether re-measurement of equity investments is appropriate when observable transactions cause the equity method to be triggered or discontinued. ASU 2020-01 also provides that certain forward contracts and purchased options to acquire equity securities will be measured under ASC 321 without an assessment of subsequent accounting upon settlement or exercise. The amendment is effective in periods beginning after December 15, 2020. The Company adopted the provisions of this amendment as of January 1, 2021. The adoption of these provisions did not have a material impact on its consolidated financial statements.

## 3. Discontinued Operations

### *NLC Sale*

On June 30, 2020, Hilltop completed the sale of all of the outstanding capital stock of NLC, which comprised the operations of the insurance segment, for cash proceeds of \$154.1 million. During 2020, Hilltop recognized an aggregate gain associated with this transaction of \$36.8 million, net of customary transaction costs of \$5.1 million and was subject to post-closing adjustments. The resulting book gain from this sale transaction was not recognized for tax purposes due to the excess tax basis over book basis being greater than the recorded book gain. Any tax loss related to this transaction is deemed disallowed pursuant to the rules under the Internal Revenue Code.

During the first quarter of 2020, management determined that the then-pending sale of NLC met the criteria to be presented as discontinued operations. All related notes to the consolidated financial statements for discontinued operations have been included in this note. The following table presents the results of discontinued operations for NLC for the periods indicated (in thousands).

	<u>Three Months Ended June 30, 2020</u>	<u>Six Months Ended June 30, 2020</u>
Interest income:		
Securities:		
Taxable	\$ 814	\$ 1,752
Other	4	71
Total interest income	<u>818</u>	<u>1,823</u>
Interest expense:		
Notes payable	369	775
Noninterest income:		
Net insurance premiums earned	32,440	65,077
Other	<u>5,297</u>	<u>3,051</u>
Total noninterest income	<u>37,737</u>	<u>68,128</u>
Noninterest expense:		
Employees' compensation and benefits	3,225	6,002
Occupancy and equipment, net	217	464
Professional services	9,674	18,201
Loss and loss adjustment expenses	25,470	38,419
Other	<u>1,511</u>	<u>3,987</u>
Total noninterest expense	<u>40,097</u>	<u>67,073</u>
Income (loss) from discontinued operations before income taxes	(1,911)	2,103
Gain on disposal of discontinued operations	32,341	32,341
Income tax expense (benefit)	<u>(345)</u>	<u>518</u>
Income from discontinued operations, net of income taxes	<u>\$ 30,775</u>	<u>\$ 33,926</u>

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*Reinsurance Activity*

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

	<b>Three Months Ended June 30, 2020</b>		<b>Six Months Ended June 30, 2020</b>	
	<b>Written</b>	<b>Earned</b>	<b>Written</b>	<b>Earned</b>
Premiums from direct business	\$ 33,831	\$ 30,638	\$ 63,811	\$ 61,384
Reinsurance assumed	3,444	3,208	6,396	6,452
Reinsurance ceded	<u>(1,406)</u>	<u>(1,406)</u>	<u>(2,759)</u>	<u>(2,759)</u>
Net premiums	<u>\$ 35,869</u>	<u>\$ 32,440</u>	<u>\$ 67,448</u>	<u>\$ 65,077</u>

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

	<b>Three Months Ended June 30, 2020</b>	<b>Six Months Ended June 30, 2020</b>
	Losses and LAE incurred	\$ 25,462
Reinsurance recoverables	8	194
Net loss and LAE incurred	<u>\$ 25,470</u>	<u>\$ 38,419</u>

#### 4. Fair Value Measurements

*Fair Value Measurements and Disclosures*

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

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

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

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*Fair Value Option*

The Company has elected to measure substantially all of PrimeLending’s mortgage loans held for sale and the retained mortgage servicing rights (“MSR”) asset at fair value, under the provisions of the Fair Value Option. The Company elected to apply the provisions of the Fair Value Option to these items so that it would have the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. At June 30, 2021 and December 31, 2020, the aggregate fair value of PrimeLending’s mortgage loans held for sale accounted for under the Fair Value Option was \$2.61 billion and \$2.52 billion, respectively, and the unpaid principal balance of those loans was \$2.52 billion and \$2.41 billion, respectively. The interest component of fair value is reported as interest income on loans in the accompanying consolidated statements of operations.

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

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

<b>June 30, 2021</b>	<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>	<b>Total Fair Value</b>
Trading securities	\$ 6,189	\$ 676,294	\$ —	\$ 682,483
Available for sale securities	—	1,817,807	—	1,817,807
Equity securities	193	—	—	193
Loans held for sale	—	2,537,601	71,433	2,609,034
Derivative assets	—	84,480	—	84,480
MSR asset	—	—	124,497	124,497
Securities sold, not yet purchased	109,571	23,379	—	132,950
Derivative liabilities	—	38,282	—	38,282
<b>December 31, 2020</b>	<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>	<b>Total Fair Value</b>
Trading securities	\$ 45,390	\$ 648,865	\$ —	\$ 694,255
Available for sale securities	—	1,462,205	—	1,462,205
Equity securities	140	—	—	140
Loans held for sale	—	2,449,588	71,816	2,521,404
Derivative assets	—	126,898	—	126,898
MSR asset	—	—	143,742	143,742
Securities sold, not yet purchased	54,494	25,295	—	79,789
Derivative liabilities	—	74,598	—	74,598

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

	Balance, Beginning of Period	Purchases/ Additions	Sales/ Reductions	Transfers to (from) Level 3	Total Gains or Losses (Realized or Unrealized)		Balance, End of Period
					Included in Net Income	Included in Other Comprehensive Income (Loss)	
<b>Three months ended June 30, 2021</b>							
Loans held for sale	\$ 77,275	\$ 18,962	\$ (22,272)	\$ (2,549)	\$ 17	\$ —	\$ 71,433
MSR asset	142,125	15,815	(31,850)	—	(1,593)	—	124,497
Total	<u>\$ 219,400</u>	<u>\$ 34,777</u>	<u>\$ (54,122)</u>	<u>\$ (2,549)</u>	<u>\$ (1,576)</u>	<u>\$ —</u>	<u>\$ 195,930</u>
<b>Six months ended June 30, 2021</b>							
Loans held for sale	\$ 71,816	\$ 31,456	\$ (29,511)	\$ (1,808)	\$ (520)	\$ —	\$ 71,433
MSR asset	143,742	50,115	(84,633)	—	15,273	—	124,497
Total	<u>\$ 215,558</u>	<u>\$ 81,571</u>	<u>\$ (114,144)</u>	<u>\$ (1,808)</u>	<u>\$ 14,753</u>	<u>\$ —</u>	<u>\$ 195,930</u>
<b>Three months ended June 30, 2020</b>							
Loans held for sale	\$ 79,588	\$ 34,339	\$ (26,768)	\$ 2,746	\$ 2,031	\$ —	\$ 91,936
MSR asset	30,299	59,440	—	—	(8,475)	—	81,264
Total	<u>\$ 109,887</u>	<u>\$ 93,779</u>	<u>\$ (26,768)</u>	<u>\$ 2,746</u>	<u>\$ (6,444)</u>	<u>\$ —</u>	<u>\$ 173,200</u>
<b>Six months ended June 30, 2020</b>							
Loans held for sale	\$ 67,195	\$ 48,623	\$ (30,943)	\$ 8,967	\$ (1,906)	\$ —	\$ 91,936
MSR asset	55,504	63,915	(18,650)	—	(19,505)	—	81,264
Total	<u>\$ 122,699</u>	<u>\$ 112,538</u>	<u>\$ (49,593)</u>	<u>\$ 8,967</u>	<u>\$ (21,411)</u>	<u>\$ —</u>	<u>\$ 173,200</u>

All net realized and unrealized gains (losses) in the tables above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at June 30, 2021.

For Level 3 financial instruments measured at fair value on a recurring basis at June 30, 2021 and December 31, 2020, the significant unobservable inputs used in the fair value measurements were as follows.

Financial instrument	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)	
			June 30, 2021	December 31, 2020
Loans held for sale	Market comparable	Projected price	91 - 95 % ( 95%)	91 - 94 % ( 94 %)
MSR asset	Discounted cash flows	Constant prepayment rate	12.60 %	12.15 %
		Discount rate	13.77 %	14.60 %

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

The MSR asset is reported at fair value using Level 3 inputs. The MSR asset is valued by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair value of the MSR asset is impacted by a variety of factors. Prepayment and discount rates, the most significant unobservable inputs, are discussed further in Note 8 to the consolidated financial statements. The decrease in the discount rates used to value the MSR asset at June 30, 2021, compared to December 31, 2020, reflect the effect of increased mortgage rates reducing consumer refinancing activity and an increase in third-party servicing outlets.

The Company had no transfers between Levels 1 and 2 during the periods presented. Any transfers are based on changes in the observability and/or significance of the valuation inputs and are assumed to occur at the beginning of the quarterly reporting period in which they occur.

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

	Three Months Ended June 30, 2021			Three Months Ended June 30, 2020		
	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	\$ 45,439	\$ —	\$ 45,439	\$ 24,499	\$ —	\$ 24,499
MSR asset	(1,593)	—	(1,593)	(8,475)	—	(8,475)

  

	Six Months Ended June 30, 2021			Six Months Ended June 30, 2020		
	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	\$ (22,517)	\$ —	\$ (22,517)	\$ 58,478	\$ —	\$ 58,478
MSR asset	15,273	—	15,273	(19,505)	—	(19,505)

The Fair Value of Financial Instruments Subsection of the ASC requires disclosure of the fair value of financial assets and liabilities, including the financial assets and liabilities previously discussed. There have been no changes to the methods for determining estimated fair value for financial assets and liabilities as described in detail in Note 5 to the consolidated financial statements included in the Company's 2020 Form 10-K.

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

June 30, 2021	Carrying Amount	Estimated Fair Value			
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Financial assets:					
Cash and cash equivalents	\$ 1,373,205	\$ 1,373,205	\$ —	\$ —	\$ 1,373,205
Assets segregated for regulatory purposes	207,284	207,284	—	—	207,284
Securities purchased under agreements to resell	202,638	—	202,638	—	202,638
Held to maturity securities	288,776	—	301,161	—	301,161
Loans held for sale	276,424	—	276,424	—	276,424
Loans held for investment, net	7,529,958	—	628,672	7,137,187	7,765,859
Broker-dealer and clearing organization receivables	1,403,447	—	1,403,447	—	1,403,447
Other assets	75,832	—	74,054	1,778	75,832
Financial liabilities:					
Deposits	11,733,785	—	11,741,434	—	11,741,434
Broker-dealer and clearing organization payables	1,439,620	—	1,439,620	—	1,439,620
Short-term borrowings	915,919	—	915,919	—	915,919
Debt	463,665	—	463,665	—	463,665
Other liabilities	5,543	—	5,543	—	5,543

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December 31, 2020	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Financial assets:					
Cash and cash equivalents	\$ 1,062,946	\$ 1,062,946	\$ —	\$ —	\$ 1,062,946
Assets segregated for regulatory purposes	290,357	290,357	—	—	290,357
Securities purchased under agreements to resell	80,319	—	80,319	—	80,319
Held to maturity securities	311,944	—	326,671	—	326,671
Loans held for sale	266,982	—	266,982	—	266,982
Loans held for investment, net	7,544,097	—	437,007	7,351,411	7,788,418
Broker-dealer and clearing organization receivables	1,404,727	—	1,404,727	—	1,404,727
Other assets	74,881	—	73,111	1,770	74,881
Financial liabilities:					
Deposits	11,242,319	—	11,256,629	—	11,256,629
Broker-dealer and clearing organization payables	1,368,373	—	1,368,373	—	1,368,373
Short-term borrowings	695,798	—	695,798	—	695,798
Debt	448,999	—	448,999	—	448,999
Other liabilities	6,133	—	6,133	—	6,133

The Company held equity investments other than securities of \$64.8 million and \$63.6 million at June 30, 2021 and December 31, 2020, respectively, which are included within other assets in the consolidated balance sheets. Of the \$64.8 million of such equity investments held at June 30, 2021, \$27.0 million do not have readily determinable fair values and each is measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The following table presents the adjustments to the carrying value of these investments during the periods presented (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Balance, beginning of period	\$ 22,905	\$ 19,088	\$ 22,844	\$ 19,771
Upward adjustments	5,763	1,525	5,884	1,631
Impairments and downward adjustments	(704)	—	(764)	(789)
Dispositions	(975)	—	(975)	—
Balance, end of period	\$ 26,989	\$ 20,613	\$ 26,989	\$ 20,613

## 5. Securities

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

	June 30, 2021	December 31, 2020
U.S. Treasury securities	\$ 1,289	\$ 40,491
U.S. government agencies:		
Bonds	15,764	40
Residential mortgage-backed securities	187,488	336,081
Commercial mortgage-backed securities	—	876
Collateralized mortgage obligations	117,257	69,172
Corporate debt securities	82,379	62,481
States and political subdivisions	266,707	171,573
Private-label securitized product	6,624	8,571
Other	4,975	4,970
Totals	\$ 682,483	\$ 694,255



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In addition to the securities shown above, the Hilltop Broker-Dealers enter into transactions that represent commitments to purchase and deliver securities at prevailing future market prices to facilitate customer transactions and satisfy such commitments. Accordingly, the Hilltop Broker-Dealers' ultimate obligations may exceed the amount recognized in the financial statements. These securities, which are carried at fair value and reported as securities sold, not yet purchased in the consolidated balance sheets, had a value of \$133.0 million and \$79.8 million at June 30, 2021 and December 31, 2020, respectively.

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

	Available for Sale			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>June 30, 2021</b>				
U.S. Treasury securities	\$ 4,970	\$ 4	\$ —	\$ 4,974
U.S. government agencies:				
Bonds	49,273	934	(308)	49,899
Residential mortgage-backed securities	917,373	12,107	(4,993)	924,487
Commercial mortgage-backed securities	152,607	520	(4,292)	148,835
Collateralized mortgage obligations	639,721	4,903	(3,166)	641,458
States and political subdivisions	46,088	2,191	(125)	48,154
Totals	<u>\$1,810,032</u>	<u>\$ 20,659</u>	<u>\$(12,884)</u>	<u>\$1,817,807</u>
	Available for Sale			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>December 31, 2020</b>				
U.S. government agencies:				
Bonds	\$ 82,036	\$ 1,095	\$ (325)	\$ 82,806
Residential mortgage-backed securities	624,863	17,194	(446)	641,611
Commercial mortgage-backed securities	124,929	768	(1,159)	124,538
Collateralized mortgage obligations	559,362	6,916	(370)	565,908
States and political subdivisions	44,729	2,613	—	47,342
Totals	<u>\$1,435,919</u>	<u>\$ 28,586</u>	<u>\$ (2,300)</u>	<u>\$1,462,205</u>
	Held to Maturity			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>June 30, 2021</b>				
U.S. government agencies:				
Residential mortgage-backed securities	\$ 11,637	\$ 570	\$ —	\$ 12,207
Commercial mortgage-backed securities	151,812	7,620	—	159,432
Collateralized mortgage obligations	56,737	1,380	—	58,117
States and political subdivisions	68,590	2,817	(2)	71,405
Totals	<u>\$ 288,776</u>	<u>\$ 12,387</u>	<u>\$ (2)</u>	<u>\$ 301,161</u>
	Held to Maturity			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>December 31, 2020</b>				
U.S. government agencies:				
Residential mortgage-backed securities	\$ 13,547	\$ 708	\$ —	\$ 14,255
Commercial mortgage-backed securities	152,820	9,205	—	162,025
Collateralized mortgage obligations	74,932	2,036	—	76,968
States and political subdivisions	70,645	2,778	—	73,423
Totals	<u>\$ 311,944</u>	<u>\$ 14,727</u>	<u>\$ —</u>	<u>\$ 326,671</u>

Additionally, the Company had unrealized net gains of \$0.1 million at both June 30, 2021 and December 31, 2020 from equity securities with fair values of \$0.2 million and \$0.1 million held at June 30, 2021 and December 31, 2020, respectively. The Company recognized nominal net gains and net losses during the three and six months ended June 30,

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2021 and 2020, respectively, due to changes in the fair value of equity securities still held at the balance sheet date. During the three and six months ended June 30, 2021 and 2020, net gains recognized from equity securities sold were nominal.

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

	June 30, 2021			December 31, 2020		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
<b>Available for Sale</b>						
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	4	\$ 27,586	\$ 308	8	\$ 60,298	\$ 325
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	4	27,586	308	8	60,298	325
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	50	530,979	4,908	15	86,287	429
Unrealized loss for twelve months or longer	1	4,878	85	—	—	—
	51	535,857	4,993	15	86,287	429
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	14	142,151	4,292	10	105,386	1,176
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	14	142,151	4,292	10	105,386	1,176
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	33	325,737	3,137	10	101,990	324
Unrealized loss for twelve months or longer	3	3,605	29	5	13,611	46
	36	329,342	3,166	15	115,601	370
States and political subdivisions:						
Unrealized loss for less than twelve months	11	4,520	125	—	—	—
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	11	4,520	125	—	—	—
Total available for sale:						
Unrealized loss for less than twelve months	112	1,030,973	12,770	43	353,961	2,254
Unrealized loss for twelve months or longer	4	8,483	114	5	13,611	46
	116	\$ 1,039,456	\$ 12,884	48	\$ 367,572	\$ 2,300
	June 30, 2021			December 31, 2020		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
<b>Held to Maturity</b>						
States and political subdivisions:						
Unrealized loss for less than twelve months	2	\$ 620	\$ 2	2	\$ 578	\$ —
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	2	620	2	2	578	—
Total held to maturity:						
Unrealized loss for less than twelve months	2	620	2	2	578	—
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	2	\$ 620	\$ 2	2	\$ 578	\$ —

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Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The amortized cost and fair value of securities, excluding trading and equity securities, at June 30, 2021 are shown by contractual maturity below (in thousands).

	Available for Sale		Held to Maturity	
	Amortized		Amortized	
	Cost	Fair Value	Cost	Fair Value
Due in one year or less	\$ 5,087	\$ 5,117	\$ 853	\$ 877
Due after one year through five years	36,001	37,187	1,182	1,206
Due after five years through ten years	14,616	15,202	10,596	11,024
Due after ten years	<u>44,627</u>	<u>45,521</u>	<u>55,959</u>	<u>58,298</u>
	100,331	103,027	68,590	71,405
Residential mortgage-backed securities	917,373	924,487	11,637	12,207
Collateralized mortgage obligations	639,721	641,458	56,737	58,117
Commercial mortgage-backed securities	<u>152,607</u>	<u>148,835</u>	<u>151,812</u>	<u>159,432</u>
	<u>\$ 1,810,032</u>	<u>\$ 1,817,807</u>	<u>\$ 288,776</u>	<u>\$ 301,161</u>

The Company recognized net gains of \$11.1 million and \$13.5 million from its trading portfolio during the three months ended June 30, 2021 and 2020, respectively, and \$19.8 million and \$20.5 million during the six months ended June 30, 2021 and 2020, respectively. In addition, the Hilltop Broker-Dealers realized net losses from structured product trading activities of \$8.9 million and net gains from structured product trading activities of \$20.8 million during the three months ended June 30, 2021 and 2020, respectively, and net gains from structured product trading activities of \$35.1 million and \$42.2 million during the six months ended June 30, 2021 and 2020, respectively. The Company had nominal other realized gains on securities during the three months ended June 30, 2021 and 2020, respectively. Other realized losses on securities during the six months ended June 30, 2021 were \$0.1 million, compared with other realized gains on securities of \$0.2 million during the six months ended June 30, 2020. All such realized gains and losses are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of \$551.8 million and \$712.3 million (with a fair value of \$569.7 million and \$733.8 million, respectively) at June 30, 2021 and December 31, 2020, respectively, were pledged by the Bank to secure public and trust deposits, federal funds purchased and securities sold under agreements to repurchase, and for other purposes as required or permitted by law. Substantially all of these pledged securities were included in the available for sale and held to maturity securities portfolios at June 30, 2021 and December 31, 2020.

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

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## 6. Loans Held for Investment

The Bank originates loans to customers primarily in Texas. Although the Bank has diversified loan and leasing portfolios and, generally, holds collateral against amounts advanced to customers, its debtors' ability to honor their contracts is substantially dependent upon the general economic conditions of the region and of the industries in which its debtors operate, which consist primarily of agribusiness, construction, energy, real estate and wholesale/retail trade. The Hilltop Broker-Dealers make loans to customers and correspondents through transactions originated by both employees and independent retail representatives throughout the United States. The Hilltop Broker-Dealers control risk by requiring customers to maintain collateral in compliance with various regulatory and internal guidelines, which may vary based upon market conditions. Securities owned by customers and held as collateral for loans are not included in the consolidated financial statements.

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

	June 30, 2021	December 31, 2020
Commercial real estate	\$ 3,090,480	\$ 3,133,903
Commercial and industrial <sup>(1)</sup>	2,232,035	2,627,774
Construction and land development	770,779	828,852
1-4 family residential	893,243	629,938
Consumer	30,018	35,667
Broker-dealer <sup>(2)</sup>	628,672	437,007
	<u>7,645,227</u>	<u>7,693,141</u>
Allowance for credit losses	(115,269)	(149,044)
Total loans held for investment, net of allowance	<u>\$ 7,529,958</u>	<u>\$ 7,544,097</u>

(1) Included loans totaling \$261.2 million and \$486.7 million at June 30, 2021 and December 31, 2020, respectively, funded through the Paycheck Protection Program.

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

The following table provides details associated with non-accrual loans, excluding those classified as held for sale (in thousands).

	Non-accrual Loans						Interest Income Recognized			
	June 30, 2021			December 31, 2020			Three Months Ended June 30,		Six Months Ended June 30,	
	With Allowance	With No Allowance	Total	With Allowance	With No Allowance	Total	2021	2020	2021	2020
Commercial real estate:										
Non-owner occupied	\$ 965	\$ 366	\$ 1,331	\$ 1,213	\$ 445	\$ 1,658	\$ 54	\$ 86	\$ 128	\$ (11)
Owner occupied	3,103	2,777	5,880	3,473	6,002	9,475	139	69	229	85
Commercial and industrial	10,077	22,956	33,033	10,821	23,228	34,049	331	102	474	402
Construction and land development	100	374	474	102	405	507	20	31	35	53
1-4 family residential	1,254	19,672	20,926	4,726	16,651	21,377	1,106	182	2,030	1,165
Consumer	26	—	26	28	—	28	(121)	2	(121)	(3)
Broker-dealer	—	—	—	—	—	—	—	—	—	—
	<u>\$ 15,525</u>	<u>\$ 46,145</u>	<u>\$ 61,670</u>	<u>\$ 20,363</u>	<u>\$ 46,731</u>	<u>\$ 67,094</u>	<u>\$ 1,529</u>	<u>\$ 472</u>	<u>\$ 2,775</u>	<u>\$ 1,691</u>

At June 30, 2021 and December 31, 2020, \$6.2 million and \$10.9 million, respectively, of real estate loans secured by residential properties and classified as held for sale were in non-accrual status.

Loans accounted for on a non-accrual basis decreased \$5.4 million from December 31, 2020 to June 30, 2021, primarily due to decreases in commercial real estate owner occupied loans of \$3.6 million and in commercial and industrial loans of \$1.0 million. The respective decreases in both commercial real estate owner occupied loans and commercial and industrial loans in non-accrual status since December 31, 2020 were primarily due to principal paydowns associated with two relationships.

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The Company considers non-accrual loans to be collateral-dependent unless there are underlying mitigating circumstances. The practical expedient to measure the allowance using the fair value of the collateral has been implemented.

The Bank classifies loan modifications as troubled debt restructurings (“TDRs”) when it concludes that it has both granted a concession to a debtor and that the debtor is experiencing financial difficulties. Loan modifications are typically structured to create affordable payments for the debtor and can be achieved in a variety of ways. The Bank modifies loans by reducing interest rates and/or lengthening loan amortization schedules. The Bank may also reconfigure a single loan into two or more loans (“A/B Note”). The typical A/B Note restructure results in a “bad” loan which is charged off and a “good” loan or loans, the terms of which comply with the Bank’s customary underwriting policies. The debt charged off on the “bad” loan is not forgiven to the debtor.

In March 2020, the CARES Act was passed, which, among other things, allows the Bank to suspend the requirements for certain loan modifications to be categorized as a TDR, including the related impairment for accounting purposes. On December 27, 2020, the Consolidated Appropriations Act 2021 was signed into law. Section 541 of this legislation, “Extension of Temporary Relief From Troubled Debt Restructurings and Insurer Clarification,” extends certain relief provisions from the March CARES Act that were set to expire at the end of 2020. This new legislation extends the relief to financial institutions to suspend TDR assessment and reporting requirements under GAAP for loan modifications to the earlier of 60 days after the national emergency termination date or January 1, 2022. The Bank’s COVID-19 payment deferral programs allow for a deferral of principal and/or interest payments with such deferred principal payments due and payable on maturity date of the existing loan. The Bank’s actions included approval of approximately \$1.0 billion in COVID-19 related loan modifications as of December 31, 2020. During 2021, the Bank continued to support its impacted banking clients through the approval of COVID-19 related loan modifications, which resulted in an additional \$14 million of new COVID-19 related loan modifications since December 31, 2020. The portfolio of active deferrals that have not reached the end of their deferral period was approximately \$76 million as of June 30, 2021. While the majority of the portfolio of COVID-19 related loan modifications no longer require deferral, such loans may represent elevated risk, and therefore management continues to monitor these loans. The extent to which these measures will impact the Bank remains uncertain, and any progression of loans, whether receiving COVID-19 payment deferrals or not, into non-accrual status during future periods is uncertain and will depend on future developments that cannot be predicted.

There was one TDR granted during the three and six months ended June 30, 2021 with a balance at date of extension and at June 30, 2021 of \$0.7 million that do not qualify for the CARES Act exemption. During the three months ended June 30, 2020 there was one TDR granted with a balance at date of extension of \$6.8 million and a balance at June 30, 2020 of \$2.0 million, while there were two TDRs granted during the six months ended June 30, 2020 with an aggregate balance at date of extension of \$7.8 million and an aggregate balance at June 30, 2020 of \$3.2 million. The Bank had \$0.1 million of unadvanced commitments to borrowers whose loans had been restructured in TDRs at June 30, 2021 and nominal commitments to such borrowers at December 31, 2020. There were no TDRs granted during the twelve months preceding June 30, 2021 and June 30, 2020, for which a payment was at least 30 days past due.

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

<u>June 30, 2021</u>	<u>Loans Past Due 30-59 Days</u>	<u>Loans Past Due 60-89 Days</u>	<u>Loans Past Due 90 Days or More</u>	<u>Total Past Due Loans</u>	<u>Current Loans</u>	<u>Total Loans</u>	<u>Accruing Loans Past Due 90 Days or More</u>
Commercial real estate:							
Non-owner occupied	\$ 877	\$ —	\$ 614	\$ 1,491	\$ 1,749,941	\$ 1,751,432	\$ —
Owner occupied	389	586	3,481	4,456	1,334,592	1,339,048	—
Commercial and industrial	112	11,514	6,501	18,127	2,213,908	2,232,035	—
Construction and land development	186	92	—	278	770,501	770,779	—
1-4 family residential	3,825	1,765	9,055	14,645	878,598	893,243	—
Consumer	72	15	26	113	29,905	30,018	—
Broker-dealer	—	—	—	—	628,672	628,672	—
	<u>\$ 5,461</u>	<u>\$ 13,972</u>	<u>\$ 19,677</u>	<u>\$ 39,110</u>	<u>\$ 7,606,117</u>	<u>\$ 7,645,227</u>	<u>\$ —</u>

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<b>December 31, 2020</b>	<b>Loans Past Due 30-59 Days</b>	<b>Loans Past Due 60-89 Days</b>	<b>Loans Past Due 90 Days or More</b>	<b>Total Past Due Loans</b>	<b>Current Loans</b>	<b>Total Loans</b>	<b>Accruing Loans Past Due 90 Days or More</b>
Commercial real estate:							
Non-owner occupied	\$ 1,919	\$ —	\$ 199	\$ 2,118	\$ 1,786,193	\$ 1,788,311	\$ —
Owner occupied	195	522	8,328	9,045	1,336,547	1,345,592	—
Commercial and industrial	3,114	407	7,318	10,839	2,616,935	2,627,774	6
Construction and land development	19	—	—	19	828,833	828,852	—
1-4 family residential	8,110	3,040	12,420	23,570	606,368	629,938	—
Consumer	172	123	26	321	35,346	35,667	—
Broker-dealer	—	—	—	—	437,007	437,007	—
	<u>\$ 13,529</u>	<u>\$ 4,092</u>	<u>\$ 28,291</u>	<u>\$ 45,912</u>	<u>\$ 7,647,229</u>	<u>\$ 7,693,141</u>	<u>\$ 6</u>

In addition to the loans shown in the tables above, PrimeLending had \$245.8 million and \$243.6 million of loans included in loans held for sale (with an aggregate unpaid principal balance of \$247.5 million and \$245.5 million, respectively) that were 90 days past due and accruing interest at June 30, 2021 and December 31, 2020, respectively. These loans are guaranteed by U.S. government agencies and include loans that are subject to repurchase, or have been repurchased, by PrimeLending.

In response to the COVID-19 pandemic, the Company allowed modifications, such as payment deferrals for up to 90 days and temporary forbearance, to credit-worthy borrowers who are experiencing temporary hardship due to the effects of COVID-19. These short-term modifications generally meet the criteria of the CARES Act and, therefore, they are not reported as past due or placed on non-accrual status (provided the loans were not past due or on non-accrual status prior to the deferral). The Company elected to accrue and recognize interest income on these modifications during the payment deferral period.

Additionally, the Company granted temporary forbearance to borrowers of a federally backed mortgage loan experiencing financial hardship due, directly or indirectly, to the COVID-19 pandemic. The CARES Act, which among other things, established the ability for financial institutions to grant a forbearance for up to 180 days, which can be extended for an additional 180-day period upon the request of the borrower. During that time, no fees, penalties or interest beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the mortgage contract will accrue on the borrower's account. As of June 30, 2021, PrimeLending had \$145.1 million of loans subject to repurchase under a forbearance agreement related to delinquencies on or after April 1, 2020.

Management tracks credit quality trends on a quarterly basis related to: (i) past due levels, (ii) non-performing asset levels, (iii) classified loan levels, and (iv) general economic conditions in state and local markets. The Company defines classified loans as loans with a risk rating of substandard, doubtful or loss. There have been no changes to the risk rating internal grades utilized for commercial loans as described in detail in Note 7 to the consolidated financial statements in the Company's 2020 Form 10-K.

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The following table presents loans held for investment grouped by asset class and credit quality indicator, segregated by year of origination or renewal (in thousands).

June 30, 2021	Amortized Cost Basis by Origination Year					2016 and		Total
	2021	2020	2019	2018	2017	Prior	Revolving	
<b>Commercial real estate: non-owner occupied</b>								
Internal Grade 1-3 (Pass low risk)	\$ 6,265	\$ 17,804	\$ 24,294	\$ 10,316	\$ 2,392	\$ 19,772	\$ 613	\$ 81,456
Internal Grade 4-7 (Pass normal risk)	131,558	190,921	113,187	103,111	50,322	100,061	28,644	717,804
Internal Grade 8-11 (Pass high risk and watch)	77,697	249,597	145,589	94,046	68,835	158,090	2,480	796,334
Internal Grade 12 (Special mention)	—	—	941	1,227	3,127	3,451	—	8,746
Internal Grade 13 (Substandard accrual)	21,809	15,922	13,914	25,130	18,913	49,967	106	145,761
Internal Grade 14 (Substandard non-accrual)	—	—	—	—	—	1,331	—	1,331
<b>Commercial real estate: owner occupied</b>								
Internal Grade 1-3 (Pass low risk)	\$ 92,453	\$ 58,760	\$ 17,562	\$ 20,835	\$ 36,471	\$ 37,245	\$ 1	\$ 263,327
Internal Grade 4-7 (Pass normal risk)	59,804	161,620	130,146	107,245	51,786	117,746	25,094	653,441
Internal Grade 8-11 (Pass high risk and watch)	31,372	104,569	56,115	98,448	24,546	40,277	5,166	360,493
Internal Grade 12 (Special mention)	—	—	—	—	—	—	—	—
Internal Grade 13 (Substandard accrual)	3,181	14,768	5,368	10,563	6,895	15,132	—	55,907
Internal Grade 14 (Substandard non-accrual)	743	349	1,260	355	2,291	882	—	5,880
<b>Commercial and industrial</b>								
Internal Grade 1-3 (Pass low risk)	\$ 16,708	\$ 31,298	\$ 29,838	\$ 10,859	\$ 9,651	\$ 2,862	\$ 78,883	\$ 180,099
Internal Grade 4-7 (Pass normal risk)	67,493	118,654	37,872	35,098	17,248	29,173	269,711	575,249
Internal Grade 8-11 (Pass high risk and watch)	56,379	93,993	42,675	18,077	8,596	7,745	297,246	524,711
Internal Grade 12 (Special mention)	—	27	—	—	—	—	2,004	2,031
Internal Grade 13 (Substandard accrual)	1,676	11,751	1,537	7,730	4,241	5,308	18,404	50,647
Internal Grade 14 (Substandard non-accrual)	6,468	18,279	3,266	1,541	248	91	3,140	33,033
<b>Construction and land development</b>								
Internal Grade 1-3 (Pass low risk)	\$ 5,047	\$ 11,957	\$ 2,838	\$ 3,894	\$ 244	\$ 4,204	\$ 1,456	\$ 29,640
Internal Grade 4-7 (Pass normal risk)	120,398	202,026	64,753	14,615	1,943	3,540	39,268	446,543
Internal Grade 8-11 (Pass high risk and watch)	63,216	99,810	60,073	12,951	545	3,887	23,411	263,893
Internal Grade 12 (Special mention)	—	—	—	—	—	—	—	—
Internal Grade 13 (Substandard accrual)	—	—	29	5,741	5,369	—	—	11,139
Internal Grade 14 (Substandard non-accrual)	391	—	—	—	—	83	—	474
<b>Construction and land development - individuals</b>								
FICO less than 620	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
FICO between 620 and 720	626	416	—	1,235	—	—	—	2,277
FICO greater than 720	6,404	10,194	—	—	—	—	—	16,598
Substandard non-accrual	—	—	—	—	—	—	—	—
Other (1)	215	—	—	—	—	—	—	215
<b>1-4 family residential</b>								
FICO less than 620	\$ 478	\$ 1,423	\$ 754	\$ 3,654	\$ 54	\$ 28,067	\$ 304	\$ 34,734
FICO between 620 and 720	13,174	13,132	8,257	9,015	7,589	39,970	913	92,050
FICO greater than 720	324,320	150,129	66,263	43,803	21,882	74,180	4,929	685,506
Substandard non-accrual	161	14	1,572	—	123	19,056	—	20,926
Other (1)	33,199	7,504	8,969	5,458	798	2,561	1,538	60,027
<b>Consumer</b>								
FICO less than 620	\$ 840	\$ 660	\$ 488	\$ 65	\$ 77	\$ 55	\$ 311	\$ 2,496
FICO between 620 and 720	3,015	2,285	1,602	276	496	97	1,876	9,647
FICO greater than 720	2,489	3,919	1,151	603	79	23	3,362	11,626
Substandard non-accrual	—	—	—	—	25	1	—	26
Other (1)	2,801	2,327	562	70	24	33	406	6,223
Total loans with credit quality measures	\$ 1,150,380	\$ 1,594,108	\$ 840,875	\$ 645,961	\$ 344,810	\$ 764,890	\$ 809,266	\$ 6,150,290
Commercial and industrial (mortgage warehouse lending)								\$ 605,047
Commercial and industrial (Paycheck Protection Program loans)								\$ 261,218
Broker-Dealer (margin loans and correspondent receivables)								\$ 628,672
<b>Total loans held for investment</b>								<b>\$ 7,645,227</b>

(1) Loans classified in this category were assigned a FICO score based on various factors specific to the borrower for credit modeling purposes.

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## 7. Allowance for Credit Losses

### *Available for Sale Securities and Held to Maturity Securities*

The Company has evaluated available for sale debt securities that are in an unrealized loss position and has determined that any decline in value is unrelated to credit loss and related to changes in market interest rates since purchase. None of the available for sale debt securities held were past due at June 30, 2021. In addition, as of June 30, 2021, the Company had not made a decision to sell any of its debt securities held, nor did the Company consider it more likely than not that it would be required to sell such securities before recovery of their amortized cost basis. The Company does not expect to have credit losses associated with the debt securities and no allowance was recognized on the debt securities portfolio at transition.

### *Loans Held for Investment*

The allowance for credit losses for loans held for investment represents management's best estimate of all expected credit losses over the expected contractual life of our existing portfolio. Management revised its methodology for determining the allowance for credit losses upon the implementation of the current expected credit losses ("CECL") standard. Management considers the level of allowance for credit losses to be a reasonable and supportable estimate of expected credit losses inherent within the loans held for investment portfolio as of June 30, 2021. While the Company believes it has an appropriate allowance for the existing loan portfolio at June 30, 2021, additional provision for losses on existing loans may be necessary in the future. Future changes in the allowance for credit losses are expected to be volatile given dependence upon, among other things, the portfolio composition and quality, as well as the impact of significant drivers, including prepayment assumptions and macroeconomic conditions and forecasts. In addition to the allowance for credit losses, the Company maintains a separate allowance for credit losses related to off-balance sheet credit exposures, including unfunded loan commitments, and this amount is included in other liabilities within the consolidated balance sheets. For further information on the policies that govern the estimation of the allowances for credit losses levels, see Note 1 to the consolidated financial statements in the Company's 2020 Form 10-K.

One of the most significant judgments involved in estimating the Company's allowance for credit losses relates to the macroeconomic forecasts used to estimate credit losses over the reasonable and supportable forecast period. To determine our best estimate of expected credit losses as of June 30, 2021, the Company utilized a single macroeconomic alternative baseline, or S7, scenario published by Moody's Analytics in June 2021 that was updated to reflect the U.S. economic outlook. This alternative baseline scenario reflects the initial continuing recovery of the economy, as in the baseline scenario published by Moody's Analytics, in addition to the risk of acceleration of inflation followed by a Federal Reserve policy response that would tighten credit and cause the economy to fall into recession. Significant variables that impact the modeled losses across our loan portfolios are the U.S. Real Gross Domestic Product, or GDP, growth rates and unemployment rate assumptions. Changes in these assumptions and forecasts of economic conditions could significantly affect the estimate of expected credit losses at the balance sheet date or between reporting periods.

The COVID-19 pandemic disrupted financial markets and overall economic conditions that have affected borrowers across our lending portfolios. Significant judgment is required to estimate the severity and duration of the current economic uncertainties, as well as its potential impact on borrower defaults and loss severity. In particular, macroeconomic conditions and forecasts are rapidly changing and remain highly uncertain as COVID-19 cases and vaccine effectiveness, as well as government stimulus and policy measures, evolve nationally and in key geographies.

During the first quarter of 2020, the Company adopted the new CECL standard and recorded transition adjustment entries that resulted in an allowance for credit losses of \$73.7 million as of January 1, 2020, an increase of \$12.6 million. This increase included an increase in credit losses of \$18.9 million from the expansion of the loss horizon to life of loan, partially offset by the elimination of the non-credit component within the historical allowance related to previously categorized PCI loans of \$6.3 million.

During the three and six months ended June 30, 2020, the significant build in the allowance included provision for credit losses on individually evaluated loans of \$6.2 million and \$23.8 million, respectively, while the provision for credit



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losses on expected losses of collectively evaluated loans accounted for \$59.9 million and \$76.6 million, respectively, of the total respective provision primarily due to the increase in the expected lifetime credit losses under CECL attributable to the deteriorating economic outlook associated with the impact of the market disruption caused by the COVID-19 pandemic. The changes in the allowance for credit losses during the noted periods were also attributable to other factors including, but not limited to, loan growth, loan mix and changes in risk rating grades. The change in the allowance during the three and six months ended June 30, 2020 was also impacted by net charge-offs of \$16.4 million and \$17.9 million, respectively, primarily associated with loans specifically reserved for during the first quarter of 2020.

During the three and six months ended June 30, 2021, the decreases in the allowance reflect improvement in both realized economic results and the macroeconomic outlook and were significantly comprised of net reversals of credit losses on expected losses of collectively evaluated loans of \$27.7 million and \$34.2 million, respectively. Such reversals were primarily due to improvements in the macroeconomic forecast assumptions and positive risk rating grade migration, including a high concentration of credits within the restaurant and commercial real estate industry sectors. The net impact to the allowance of changes associated with individually evaluated loans during the three months ended June 30, 2021 was a reversal of credit losses of \$1.0 million, while the six months ended June 30, 2021 included a provision of credit losses of \$0.4 million. The changes in the allowance for credit losses during the noted periods were primarily attributable to the Bank and also reflected other factors including, but not limited to, loan mix, and changes in loan balances and qualitative factors from the prior quarter. The changes in the allowance during the three months ended June 30, 2021 were also impacted by net charge-offs of \$0.5 million, while the six months ended June 30, 2021 included net recoveries of \$0.1 million.

Changes in the allowance for credit losses for loans held for investment, distributed by portfolio segment, are shown below (in thousands).

<b>Three Months Ended June 30, 2021</b>	<b>Balance, Beginning of Period</b>	<b>Transition Adjustment CECL</b>	<b>Provision for (Reversal of) Credit Losses</b>	<b>Loans Charged Off</b>	<b>Recoveries on Charged Off Loans</b>	<b>Balance, End of Period</b>
Commercial real estate	\$ 104,126	\$ —	\$ (26,527)	\$ (186)	\$ 220	\$ 77,633
Commercial and industrial	28,513	—	(106)	(1,242)	701	27,866
Construction and land development	7,249	—	(2,064)	—	—	5,185
1-4 family residential	3,388	—	269	(51)	53	3,659
Consumer	944	—	(347)	(74)	69	592
Broker-dealer	279	—	55	—	—	334
<b>Total</b>	<b>\$ 144,499</b>	<b>\$ —</b>	<b>\$ (28,720)</b>	<b>\$ (1,553)</b>	<b>\$ 1,043</b>	<b>\$ 115,269</b>

<b>Six Months Ended June 30, 2021</b>	<b>Balance, Beginning of Period</b>	<b>Transition Adjustment CECL</b>	<b>Provision for (Reversal of) Credit Losses</b>	<b>Loans Charged Off</b>	<b>Recoveries on Charged Off Loans</b>	<b>Balance, End of Period</b>
Commercial real estate	\$ 109,629	\$ —	\$ (32,044)	\$ (186)	\$ 234	\$ 77,633
Commercial and industrial	27,703	—	450	(1,421)	1,134	27,866
Construction and land development	6,677	—	(1,492)	—	—	5,185
1-4 family residential	3,946	—	(588)	(161)	462	3,659
Consumer	876	—	(276)	(153)	145	592
Broker-dealer	213	—	121	—	—	334
<b>Total</b>	<b>\$ 149,044</b>	<b>\$ —</b>	<b>\$ (33,829)</b>	<b>\$ (1,921)</b>	<b>\$ 1,975</b>	<b>\$ 115,269</b>

<b>Three Months Ended June 30, 2020</b>	<b>Balance, Beginning of Period</b>	<b>Transition Adjustment CECL</b>	<b>Provision for (Reversal of) Credit Losses</b>	<b>Loans Charged Off</b>	<b>Recoveries on Charged Off Loans</b>	<b>Balance, End of Period</b>
Commercial real estate	\$ 53,939	\$ —	\$ 56,875	\$ (4,274)	\$ 11	\$ 106,551
Commercial and industrial	38,550	—	5,176	(12,544)	681	31,863
Construction and land development	6,360	—	2,031	—	2	8,393
1-4 family residential	6,365	—	1,199	(170)	5	7,399
Consumer	1,203	—	319	(197)	104	1,429
Broker-dealer	322	—	426	—	—	748
<b>Total</b>	<b>\$ 106,739</b>	<b>\$ —</b>	<b>\$ 66,026</b>	<b>\$ (17,185)</b>	<b>\$ 803</b>	<b>\$ 156,383</b>

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<b>Six Months Ended June 30, 2020</b>	<b>Balance, Beginning of Period</b>	<b>Transition Adjustment CECL</b>	<b>Provision for (Reversal of) Credit Losses</b>	<b>Loans Charged Off</b>	<b>Recoveries on Charged Off Loans</b>	<b>Balance, End of Period</b>
Commercial real estate	\$ 31,595	\$ 8,073	\$ 71,350	\$ (4,488)	\$ 21	\$ 106,551
Commercial and industrial	17,964	3,193	23,622	(13,984)	1,068	31,863
Construction and land development	4,878	577	2,938	(2)	2	8,393
1-4 family residential	6,386	(29)	1,400	(373)	15	7,399
Consumer	265	748	565	(373)	224	1,429
Broker-dealer	48	—	700	—	—	748
Total	<u>\$ 61,136</u>	<u>\$ 12,562</u>	<u>\$ 100,575</u>	<u>\$ (19,220)</u>	<u>\$ 1,330</u>	<u>\$ 156,383</u>

*Unfunded Loan Commitments*

The Bank uses a process similar to that used in estimating the allowance for credit losses on the funded portion to estimate the allowance for credit loss on unfunded loan commitments. The allowance is based on the estimated exposure at default, multiplied by the lifetime Probability of Default grade and Loss Given Default grade for that particular loan segment. The Bank estimates expected losses by calculating a commitment usage factor based on industry usage factors. The commitment usage factor is applied over the relevant contractual period. Loss factors from the underlying loans to which commitments are related are applied to the results of the usage calculation to estimate any liability for credit losses related for each loan type. The expected losses on unfunded commitments align with statistically calculated parameters used to calculate the allowance for credit losses on the funded portion. There is no reserve calculated for letters of credit as they are issued primarily as credit enhancements and the likelihood of funding is low.

Changes in the allowance for credit losses for loans with off-balance sheet credit exposures are shown below (in thousands).

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2021</b>	<b>2020</b>	<b>2021</b>	<b>2020</b>
Balance, beginning of period	\$ 8,807	\$ 7,209	\$ 8,388	\$ 2,075
Transition adjustment CECL accounting standard	—	—	—	3,837
Other noninterest expense	(826)	1,822	(407)	3,119
Balance, end of period	<u>\$ 7,981</u>	<u>\$ 9,031</u>	<u>\$ 7,981</u>	<u>\$ 9,031</u>

As previously discussed, the Company adopted the new CECL standard and recorded a transition adjustment entry that resulted in an allowance for credit losses of \$5.9 million as of January 1, 2020. During the three and six months ended June 30, 2020, the increase in the reserve for unfunded commitments was primarily due to the macroeconomic uncertainties associated with the impact of the market disruption caused by COVID-19 conditions. During the three and six months ended June 30, 2021, the decreases in the reserve for unfunded commitments were primarily due to improvements in loan expected loss rates.

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### 8. Mortgage Servicing Rights

The following tables present the changes in fair value of the Company's MSR asset and other information related to the serviced portfolio (dollars in thousands).

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Balance, beginning of period	\$ 142,125	\$ 30,299	\$ 143,742	\$ 55,504
Additions	15,815	59,440	50,115	63,915
Sales	(31,850)	—	(84,633)	(18,650)
Changes in fair value:				
Due to changes in model inputs or assumptions <sup>(1)</sup>	4,536	(6,284)	28,674	(15,878)
Due to customer payoffs	(6,129)	(2,191)	(13,401)	(3,627)
Balance, end of period	<u>\$ 124,497</u>	<u>\$ 81,264</u>	<u>\$ 124,497</u>	<u>\$ 81,264</u>
			<u>June 30,</u>	<u>December 31,</u>
			<u>2021</u>	<u>2020</u>
Mortgage loans serviced for others <sup>(2)</sup>			\$ 10,229,835	\$ 14,643,623
MSR asset as a percentage of serviced mortgage loans			1.22 %	0.98 %

- (1) Primarily represents normal customer payments, changes in discount rates and prepayment speed assumptions, which are primarily affected by changes in interest rates and the refinement of other MSR model assumptions. Included in the three and six months ended June 30, 2021 periods are MSR asset fair value adjustments totaling \$9.2 million and \$18.9 million, respectively, which reflect the difference between the MSR asset carrying values and the sale prices reflected in the letters of intent to sell the applicable MSR assets.
- (2) Represents unpaid principal balance of mortgage loans serviced for others.

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

	<u>June 30,</u>	<u>December 31,</u>
	<u>2021</u>	<u>2020</u>
Weighted average constant prepayment rate	12.60 %	12.15 %
Weighted average discount rate	13.77 %	14.60 %
Weighted average life (in years)	6.2	6.3

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

	<u>June 30,</u>	<u>December 31,</u>
	<u>2021</u>	<u>2020</u>
Constant prepayment rate:		
Impact of 10% adverse change	\$ (3,072)	\$ (5,639)
Impact of 20% adverse change	(6,087)	(11,164)
Discount rate:		
Impact of 10% adverse change	(3,641)	(6,435)
Impact of 20% adverse change	(6,952)	(12,287)

This sensitivity analysis presents the effect of hypothetical changes in key assumptions on the fair value of the MSR asset. The effect of such hypothetical change in assumptions generally cannot be extrapolated because the relationship of the change in one key assumption to the change in the fair value of the MSR asset is not linear. In addition, in the analysis, the impact of an adverse change in one key assumption is calculated independent of any impact on other assumptions. In reality, changes in one assumption may change another assumption.

Contractually specified servicing fees, late fees and ancillary fees earned of \$16.2 million and \$5.1 million during the three months ended June 30, 2021 and 2020, respectively, and \$32.3 million and \$11.0 million during the six months ended June 30, 2021 and 2020, respectively, were included in net gains from sale of loans and other mortgage production income within the consolidated statements of operations.

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## 9. Deposits

Deposits are summarized as follows (in thousands).

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
Noninterest-bearing demand	\$ 4,231,082	\$ 3,612,384
Interest-bearing:		
Demand accounts	2,607,332	2,399,341
Brokered - demand	4,950	282,426
Money market	3,118,975	2,716,878
Brokered - money market	208,032	124,243
Savings	293,886	276,327
Time	1,214,051	1,506,435
Brokered - time	55,477	324,285
	<u>\$ 11,733,785</u>	<u>\$ 11,242,319</u>

## 10. Short-term Borrowings

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

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
Federal funds purchased	\$ 179,100	\$ 180,325
Securities sold under agreements to repurchase	178,072	237,856
Federal Home Loan Bank	—	—
Short-term bank loans	189,500	—
Commercial paper	369,247	277,617
	<u>\$ 915,919</u>	<u>\$ 695,798</u>

### *Federal Funds Purchased and Securities Sold under Agreements to Repurchase*

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

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

	<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>
Average balance during the period	\$ 339,545	\$ 605,396
Average interest rate during the period	0.36 %	1.29 %
	<u>June 30, 2021</u>	<u>December 31, 2020</u>
Average interest rate at end of period	0.31 %	0.25 %
Securities underlying the agreements at end of period:		
Carrying value	\$ 178,034	\$ 237,913
Estimated fair value	\$ 191,759	\$ 262,554

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*Federal Home Loan Bank (“FHLB”)*

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

	Six Months Ended June 30,	
	2021	2020
Average balance during the period	\$ —	\$ 77,692
Average interest rate during the period	— %	1.62 %

*Short-Term Bank Loans*

The Hilltop Broker-Dealers use short-term bank loans periodically to finance securities owned, margin loans to customers and correspondents and underwriting activities. Interest on the borrowings varies with the federal funds rate. The weighted average interest rate on the borrowings at June 30, 2021 was 1.25%.

*Commercial Paper*

Hilltop Securities uses the net proceeds (after deducting related issuance expenses) from the sale of two commercial paper programs for general corporate purposes, including working capital and the funding of a portion of its securities inventories. The commercial paper notes (“CP Notes”) may be issued with maturities of 14 days to 270 days from the date of issuance. The CP Notes are issued under two separate programs, Series 2019-1 CP Notes and Series 2019-2 CP Notes, in maximum aggregate amounts of \$300 million and \$200 million, respectively. The CP Notes are not redeemable prior to maturity or subject to voluntary prepayment and do not bear interest, but are sold at a discount to par. The CP Notes are secured by a pledge of collateral owned by Hilltop Securities. As of June 30, 2021, the weighted average maturity of the CP Notes was 157 days at a rate of 1.13%, with a weighted average remaining life of 78 days. At June 30, 2021, the aggregate amount outstanding under these secured arrangements was \$369.2 million, which was collateralized by securities held for firm accounts valued at \$401.8 million.

**11. Notes Payable**

Notes payable consisted of the following (in thousands).

	June 30, 2021	December 31, 2020
Senior Notes due April 2025, net of discount of \$976 and \$1,063, respectively	\$ 149,024	\$ 148,937
Subordinated Notes due May 2030, net of discount of \$749 and \$793, respectively	49,251	49,207
Subordinated Notes due May 2035, net of discount of \$2,307 and \$2,392, respectively	147,693	147,608
Ventures Management lines of credit	50,685	36,235
	\$ 396,653	\$ 381,987

**12. Leases**

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

	June 30, 2021	December 31, 2020
Finance leases:		
Premises and equipment	\$ 7,780	\$ 7,780
Accumulated depreciation	(5,063)	(4,768)
Premises and equipment, net	\$ 2,717	\$ 3,012

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The components of lease costs, including short-term lease costs, are as follows (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Operating lease cost	\$ 9,746	\$ 10,621	\$ 19,403	\$ 21,251
Less operating lease and sublease income	(342)	(354)	(681)	(972)
Net operating lease cost	<u>\$ 9,404</u>	<u>\$ 10,267</u>	<u>\$ 18,722</u>	<u>\$ 20,279</u>
Finance lease cost:				
Amortization of ROU assets	\$ 147	\$ 147	\$ 295	\$ 295
Interest on lease liabilities	132	141	266	285
Total finance lease cost	<u>\$ 279</u>	<u>\$ 288</u>	<u>\$ 561</u>	<u>\$ 580</u>

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

	Six Months Ended June 30,	
	2021	2020
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ 19,162	\$ 19,075
Operating cash flows from finance leases	266	285
Financing cash flows from finance leases	336	312
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	\$ 28,935	\$ 8,476
Finance leases	—	—

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

Lease Classification	June 30, 2021		December 31, 2020	
	Weighted Average Remaining Lease Term (Years)	Weighted Average Discount Rate	Weighted Average Remaining Lease Term (Years)	Weighted Average Discount Rate
Operating	6.1	4.22 %	5.5	4.67 %
Finance	5.2	4.83 %	5.6	4.81 %

Future minimum lease payments under lease agreements as of June 30, 2021, are presented below (in thousands).

	Operating Leases	Finance Leases
2021	\$ 9,032	\$ 610
2022	32,434	1,241
2023	27,330	1,280
2024	19,480	1,163
2025	14,828	886
Thereafter	49,165	1,411
Total minimum lease payments	<u>152,269</u>	<u>6,591</u>
Less amount representing interest	(18,250)	(2,067)
Lease liabilities	<u>\$ 134,019</u>	<u>\$ 4,524</u>

As of June 30, 2021, the Company had additional operating leases that have not yet commenced with aggregate future minimum lease payments of approximately \$2.6 million. These operating leases are expected to commence in July 2021 with lease terms ranging from three to six years.

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### 13. Income Taxes

The Company applies an estimated annual effective rate to interim period pre-tax income to calculate the income tax provision for the quarter in accordance with the principal method prescribed by the accounting guidance established for computing income taxes in interim periods. The Company's effective tax rates from continuing operations were 23.5% and 23.3% for the three months ended June 30, 2021 and 2020, respectively, and 23.4% and 23.2% for the six months ended June 30, 2021 and 2020, respectively, and approximated the applicable statutory rates for such periods.

### 14. Commitments and Contingencies

#### *Legal Matters*

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

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

The Company is involved in information-gathering requests and investigations (both formal and informal), as well as reviews, examinations and proceedings (collectively, "Inquiries") by various governmental regulatory agencies, law enforcement authorities and self-regulatory bodies regarding certain of its businesses, business practices and policies, as well as the conduct of persons with whom it does business. Additional Inquiries will arise from time to time. In connection with those Inquiries, the Company receives document requests, subpoenas and other requests for information. The Inquiries 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.

PrimeLending received an investigative inquiry from the United States Attorney for the Western District of Virginia regarding PrimeLending's float down option. At this time, the United States Attorney has requested certain materials with respect to this matter, and PrimeLending is fully cooperating with such requests.

While the final outcome of litigation and claims exposures or of any Inquiries is inherently unpredictable, management is currently of the opinion that the outcome of pending and threatened litigation and inquiries will not, except related to specific matters disclosed above, have a material effect on the Company's business, consolidated financial position, results of operations or cash flows as a whole. However, in the event of unexpected future developments, it is reasonably

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possible that an adverse outcome in any matter, including the matters discussed above, could be material to the Company's business, consolidated financial position, results of operations or cash flows for any particular reporting period of occurrence.

*Indemnification Liability Reserve*

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

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

An additional reserve has been established for probable agency, investor or other party losses that may have been incurred, but not yet reported to the mortgage origination segment based upon a reasonable estimate of such losses. Factors considered in the calculation of this reserve include, but are not limited to, the total volume of loans sold exclusive of specific claimant requests, actual claim settlements and the severity of estimated losses resulting from future claims, and the mortgage origination segment's history of successfully curing defects identified in claim requests. In addition, the mortgage origination segment has considered that GNMA, FNMA and FHLMC have imposed certain restrictions on loans the agencies will accept under a forbearance agreement resulting from the COVID-19 pandemic, which could increase the magnitude of indemnification losses on these loans.

While the mortgage origination segment's sales contracts typically include borrower early payment default repurchase provisions, these provisions have not been a primary driver of claims to date, and therefore, are not a primary factor considered in the calculation of this reserve.

At June 30, 2021 and December 31, 2020, the mortgage origination segment's indemnification liability reserve totaled \$26.4 million and \$21.5 million, respectively. The provision for indemnification losses was \$2.5 million and \$3.9 million during the three months ended June 30, 2021 and 2020, respectively, and \$5.5 million and \$4.6 million during the six months ended June 30, 2021 and 2020, respectively.

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

	<b>Representation and Warranty Specific Claims</b>			
	<b>Activity - Origination Loan Balance</b>			
	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2021</b>	<b>2020</b>	<b>2021</b>	<b>2020</b>
Balance, beginning of period	\$ 30,137	\$ 34,779	\$ 30,085	\$ 32,144
Claims made	8,575	6,141	13,687	12,212
Claims resolved with no payment	(1,956)	(673)	(4,870)	(1,657)
Repurchases	(3,446)	(5,053)	(5,257)	(7,383)
Indemnification payments	(547)	—	(882)	(122)
Balance, end of period	<u>\$ 32,763</u>	<u>\$ 35,194</u>	<u>\$ 32,763</u>	<u>\$ 35,194</u>



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	<b>Indemnification Liability Reserve Activity</b>			
	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2021</b>	<b>2020</b>	<b>2021</b>	<b>2020</b>
Balance, beginning of period	\$ 24,261	\$ 12,148	\$ 21,531	\$ 11,776
Additions for new sales	2,858	2,897	5,865	3,622
Repurchases	(274)	(210)	(398)	(480)
Early payment defaults	(25)	(359)	(36)	(402)
Indemnification payments	(122)	—	(264)	(40)
Change in reserves for loans sold in prior years	(326)	987	(326)	987
Balance, end of period	<u>\$ 26,372</u>	<u>\$ 15,463</u>	<u>\$ 26,372</u>	<u>\$ 15,463</u>
	<b>June 30,</b>	<b>December 31,</b>		
	<b>2021</b>	<b>2020</b>		
Reserve for Indemnification Liability:				
Specific claims	\$ 502	\$ 961		
Incurred but not reported claims	25,870	20,570		
Total	<u>\$ 26,372</u>	<u>\$ 21,531</u>		

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.

## 15. Financial Instruments with Off-Balance Sheet Risk

### *Banking*

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

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

In the aggregate, the Bank had outstanding unused commitments to extend credit of \$2.1 billion at June 30, 2021 and outstanding financial and performance standby letters of credit of \$89.3 million at June 30, 2021.

The Bank uses the same credit policies in making commitments and standby letters of credit as it does for loans held for investment. 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.

Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

*Broker-Dealer*

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

**16. Stock-Based Compensation**

Since 2012, the Company has issued stock-based incentive awards pursuant to the Hilltop Holdings Inc. 2012 Equity Incentive Plan (the “2012 Plan”). In July 2020, pursuant to stockholders’ approval, the Company adopted the Hilltop Holdings Inc. 2020 Equity Incentive Plan (the “2020 Plan”). The 2020 Plan serves as successor to the 2012 Plan. The 2012 Plan and the 2020 Plan are referred to collectively as “the Equity Plans.”

During the six months ended June 30, 2021 and 2020, Hilltop granted 8,285 and 18,397 shares of common stock, respectively, pursuant to the Equity Plans to certain non-employee members of the Company’s board of directors for services rendered to the Company.

*Restricted Stock Units*

The following table summarizes information about nonvested restricted stock unit (“RSU”) activity for the six months ended June 30, 2021 (shares in thousands).

	RSUs	
Outstanding		Weighted Average Grant Date Fair Value
Balance, December 31, 2020	1,833	\$ 21.48
Granted	532	\$ 32.93
Vested/Released	(416)	\$ 28.59
Forfeited	(13)	\$ 22.72
Balance, June 30, 2021	1,936	\$ 23.09

Vested/Released RSUs include an aggregate of 65,558 shares withheld to satisfy employee statutory tax obligations during the six months ended June 30, 2021.

During the six months ended June 30, 2021, the Compensation Committee of the board of directors of the Company awarded certain executives and key employees an aggregate of 471,505 RSUs pursuant to the Equity Plans. Of the RSUs granted during the six months ended June 30, 2021, 318,997 that were outstanding at June 30, 2021, are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date. Of the RSUs granted during the six months ended June 30, 2021, 150,668 that were outstanding at June 30, 2021, provide for cliff vesting based upon the achievement of certain performance goals over a three-year period.

At June 30, 2021, in the aggregate, 1,572,502 of the outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 364,149 outstanding RSUs cliff vest based upon the achievement of certain performance goals over a three-year period. At June 30, 2021, unrecognized compensation expense related to outstanding RSUs of \$28.6 million is expected to be recognized over a weighted average period of 1.61 years.

Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

## 17. Regulatory Matters

### *Banking and Hilltop*

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

In order to avoid limitations on capital distributions, including dividend payments, stock repurchases and certain discretionary bonus payments to executive officers, Basel III requires banking organizations to maintain a capital conservation buffer above minimum risk-based capital requirements measured relative to risk-weighted assets.

The following table shows PlainsCapital’s and Hilltop’s actual capital amounts and ratios in accordance with Basel III compared to the regulatory minimum capital requirements including conservation buffer ratio in effect at the end of the period (dollars in thousands). Based on actual capital amounts and ratios shown in the following table, PlainsCapital’s ratios place it in the “well capitalized” (as defined) capital category under regulatory requirements. Actual capital amounts and ratios as of June 30, 2021 reflect PlainsCapital’s and Hilltop’s decision to elect the transition option as issued by the federal banking regulatory agencies in March 2020 that permits banking institutions to mitigate the estimated cumulative regulatory capital effects from CECL over a five-year transitional period.

	June 30, 2021		December 31, 2020		Minimum Capital Requirements Including Conservation Buffer	To Be Well Capitalized
	Amount	Ratio	Amount	Ratio	Ratio	Ratio
Tier 1 capital (to average assets):						
PlainsCapital	\$ 1,422,952	10.22 %	\$ 1,385,842	10.44 %	4.0 %	5.0 %
Hilltop	2,259,977	12.87 %	2,111,580	12.64 %	4.0 %	N/A
Common equity Tier 1 capital (to risk-weighted assets):						
PlainsCapital	1,422,952	15.00 %	1,385,842	14.40 %	7.0 %	6.5 %
Hilltop	2,194,977	20.22 %	2,046,580	18.97 %	7.0 %	N/A
Tier 1 capital (to risk-weighted assets):						
PlainsCapital	1,422,952	15.00 %	1,385,842	14.40 %	8.5 %	8.0 %
Hilltop	2,259,977	20.82 %	2,111,580	19.57 %	8.5 %	N/A
Total capital (to risk-weighted assets):						
PlainsCapital	1,512,646	15.95 %	1,470,364	15.27 %	10.5 %	10.0 %
Hilltop	2,549,038	23.48 %	2,409,684	22.34 %	10.5 %	N/A

Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

*Broker-Dealer*

Pursuant to the net capital requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), Hilltop Securities has elected to determine its net capital requirements using the alternative method. Accordingly, Hilltop Securities is required to maintain minimum net capital, as defined in Rule 15c3-1 promulgated under the Exchange Act, equal to the greater of \$250,000 and \$1,000,000, respectively, or 2% of aggregate debit balances, as defined in Rule 15c3-3 promulgated under the Exchange Act. Additionally, the net capital rule of the NYSE provides that equity capital may not be withdrawn or cash dividends paid if resulting net capital would be less than 5% of the aggregate debit items. Momentum Independent Network follows the primary (aggregate indebtedness) method, as defined in Rule 15c3-1 promulgated under the Exchange Act, which requires the maintenance of the larger of \$250,000 or 6-2/3% of aggregate indebtedness.

At June 30, 2021, the net capital position of each of the Hilltop Broker-Dealers was as follows (in thousands).

	<b>Hilltop Securities</b>	<b>Momentum Independent Network</b>
Net capital	\$ 300,316	\$ 4,457
Less: required net capital	10,244	250
Excess net capital	<u>\$ 290,072</u>	<u>\$ 4,207</u>
Net capital as a percentage of aggregate debit items	58.6 %	
Net capital in excess of 5% aggregate debit items	<u>\$ 274,705</u>	

Under certain conditions, Hilltop Securities may be required to segregate cash and securities in a special reserve account for the benefit of customers under Rule 15c3-3 promulgated under the Exchange Act. Assets segregated for regulatory purposes under the provisions of the Exchange Act are restricted and not available for general corporate purposes. At June 30, 2021 and December 31, 2020, the Hilltop Broker-Dealers held cash of \$207.3 million and \$290.4 million, respectively, segregated in special reserve bank accounts for the benefit of customers. The Hilltop Broker-Dealers were not required to segregate cash and securities in special reserve accounts for the benefit of proprietary accounts of introducing broker-dealers at June 30, 2021 or December 31, 2020.

*Mortgage Origination*

As a mortgage originator, PrimeLending and its subsidiaries are subject to minimum net worth and liquidity requirements established by HUD and GNMA, as applicable. On an annual basis, PrimeLending and its subsidiaries submit audited financial statements to HUD and GNMA, as applicable, documenting their respective compliance with minimum net worth and liquidity requirements. As of June 30, 2021, PrimeLending and its subsidiaries’ net worth and liquidity exceeded the amounts required by both HUD and GNMA, as applicable.

**18. Stockholders’ Equity**

*Dividends*

During the six months ended June 30, 2021 and 2020, the Company declared and paid cash dividends of \$0.24 and \$0.18 per common share, or an aggregate of \$19.8 million and \$16.3 million, respectively.

On July 22, 2021, Hilltop’s board of directors declared a quarterly cash dividend of \$0.12 per common share, payable on August 31, 2021, to all common stockholders of record as of the close of business on August 13, 2021.

Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

*Stock Repurchases*

In January 2021, the Hilltop board of directors authorized a new stock repurchase program through January 2022, pursuant to which the Company was originally authorized to repurchase, in the aggregate, up to \$75.0 million of its outstanding common stock. In July 2021, the Hilltop board of directors authorized, subject to regulatory review, an increase to the aggregate amount of common stock the Company may repurchase under this program to \$150.0 million, which is inclusive of repurchases to offset dilution related to grants of stock-based compensation.

During the six months ended June 30, 2021, the Company paid \$49.5 million to repurchase an aggregate of 1,390,721 shares of common stock at an average price of \$35.55 per share. The Company's stock repurchase program, prior year repurchases and related accounting policy are discussed in detail in Note 1 and Note 25 to the consolidated financial statements included in the Company's 2020 Form 10-K.

**19. Derivative Financial Instruments**

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

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

As discussed in Note 4 to the consolidated financial statements, the Company has elected to measure substantially all mortgage loans held for sale at fair value under the provisions of the Fair Value Option. The election provides the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without applying hedge accounting provisions. The fair values of PrimeLending's IRLCs and forward commitments are recorded in other assets or other liabilities, as appropriate, and changes in the fair values of these derivative instruments are recorded as a component of net gains from sale of loans and other mortgage production income. These changes in fair value are attributable to changes in the volume of IRLCs, mortgage loans held for sale, commitments to purchase and sell MBSs and MSR assets, and changes in market interest rates. Changes in market interest rates also conversely affect the value of PrimeLending's mortgage loans held for sale and its MSR asset, which are measured at fair value under the Fair Value Option. The effect of the change in market interest rates on PrimeLending's loans held for sale and MSR asset is discussed in Note 8 to the consolidated financial statements. The fair values of the Hilltop Broker-Dealers' and the Bank's derivative instruments are recorded in other assets or other liabilities, as appropriate. Changes in the fair value of derivatives are presented in the following table (in thousands).

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2021</b>	<b>2020</b>	<b>2021</b>	<b>2020</b>
Increase (decrease) in fair value of derivatives during period:				
PrimeLending	\$ 4,033	\$ 47,267	\$ (225)	\$ 67,143
Hilltop Broker-Dealers	6,923	20,149	(15,272)	12,008
Bank	8	(0)	19	(135)

Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)  
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*Hedging Derivative Instruments*

The Company has entered into interest rate swap contracts to manage the exposure to changes in fair value associated with certain available for sale fixed rate collateralized mortgage backed securities and fixed rate loans held for investment attributable to changes in the designated benchmark interest rate. Certain of these fair value hedges have been designated as a last-of-layer hedge, which provides the Company the ability to execute a fair value hedge of the interest rate risk associated with a portfolio of similar prepayable assets whereby the last dollar amount estimated to remain in the portfolio of assets is identified as the hedged item. Additionally, the Company has outstanding interest rate swap contracts designated as cash flow hedges and utilized to manage the variability of cash flows associated with its variable rate borrowings.

Under each of its interest rate swap contracts designated as hedges, the Company receives a floating rate and pays a fixed rate on the outstanding notional amount. The Company assesses the hedge effectiveness both at the onset of the hedge and at regular intervals throughout the life of the derivative. To the extent that the derivative instruments are highly effective in offsetting the variability of the hedged cash flows or fair value, changes in the fair value of the derivative are included as a component of other comprehensive loss on our consolidated balance sheets. Although the Company has determined at the onset of the hedges that the derivative instruments will be highly effective hedges throughout the term of the contract, any portion of derivative instruments subsequently determined to be ineffective will be recognized in earnings.

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

	<b>June 30, 2021</b>		<b>December 31, 2020</b>	
	<b>Notional Amount</b>	<b>Estimated Fair Value</b>	<b>Notional Amount</b>	<b>Estimated Fair Value</b>
Derivative instruments (not designated as hedges):				
IRLCs	\$ 2,181,773	\$ 52,234	\$ 2,470,013	\$ 76,048
Commitments to purchase MBSs	1,829,929	1,077	2,478,041	22,311
Commitments to sell MBSs	5,455,909	(6,422)	6,141,079	(40,621)
Interest rate swaps	36,975	(1,524)	43,786	(2,196)
U.S. Treasury bond futures and options <sup>(1)</sup>	196,700	—	225,400	—
Eurodollar and other futures <sup>(1)</sup>	1,086,743	—	—	—
Derivative instruments (designated as hedges):				
Interest rate swaps designated as cash flow hedges	\$ 135,000	\$ (1,192)	\$ 105,000	\$ (3,112)
Interest rate swaps designated as fair value hedges <sup>(2)</sup>	128,289	2,025	60,618	(130)

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

(2) The Company designated \$128.3 million and \$60.6 million as the hedged amount (from a closed portfolio of prepayable available for sale securities and loans held for investment with a carrying value of \$126.3 million and \$60.7 million as of June 30, 2021 and December 31, 2020, respectively), of which, a subset of these hedges are in last-of-layer hedging relationships. The cumulative basis adjustment included in the carrying value of the hedged items totaled \$2.0 million and \$0.1 million as of June 30, 2021 and December 31, 2020, respectively.

The decrease in the estimated fair value of the IRLCs at June 30, 2021, compared to December 31, 2020, was driven by a decrease in the total volume of IRLCs in addition to a decrease in the average value of individual IRLCs. The decrease in the average value of individual IRLCs was due to an increase in mortgage interest rates throughout the six months ended June 30, 2021.

PrimeLending held cash collateral advances totaling \$4.2 million to offset net asset derivative positions on its commitments to sell MBSs at June 30, 2021. This amount is included in other liabilities within the consolidated balance sheets. PrimeLending had advanced cash collateral totaling \$26.1 million to offset net liability positions on its commitments to sell MBSs at December 31, 2020. In addition, PrimeLending and the Hilltop Broker-Dealers had advanced cash collateral totaling \$3.5 million and \$2.7 million on various derivative instruments at June 30, 2021 and December 31, 2020, respectively. The advanced cash collateral amounts are included in other assets within the consolidated balance sheets.

Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)  
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**20. Balance Sheet Offsetting**

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

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral Pledged	
<b>June 30, 2021</b>						
Securities borrowed:						
Institutional counterparties	\$ 1,336,847	\$ —	\$ 1,336,847	\$ (1,280,150)	\$ —	\$ 56,697
Reverse repurchase agreements:						
Institutional counterparties	202,638	—	202,638	(202,124)	—	514
Forward MBS derivatives:						
Institutional counterparties	1,801	—	1,801	(1,801)	—	—
	<u>\$ 1,541,286</u>	<u>\$ —</u>	<u>\$ 1,541,286</u>	<u>\$ (1,484,075)</u>	<u>\$ —</u>	<u>\$ 57,211</u>
<b>December 31, 2020</b>						
Securities borrowed:						
Institutional counterparties	\$ 1,338,855	\$ —	\$ 1,338,855	\$ (1,273,955)	\$ —	\$ 64,900
Reverse repurchase agreements:						
Institutional counterparties	80,319	—	80,319	(79,925)	—	394
Forward MBS derivatives:						
Institutional counterparties	22,311	—	22,311	(22,311)	—	—
	<u>\$ 1,441,485</u>	<u>\$ —</u>	<u>\$ 1,441,485</u>	<u>\$ (1,376,191)</u>	<u>\$ —</u>	<u>\$ 65,294</u>
	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		Net Amount
				Financial Instruments	Cash Collateral Pledged	
<b>June 30, 2021</b>						
Securities loaned:						
Institutional counterparties	\$ 1,260,158	\$ —	\$ 1,260,158	\$ (1,204,014)	\$ —	\$ 56,144
Interest rate swaps:						
Institutional counterparties	1,524	—	1,524	(1,471)	—	53
Repurchase agreements:						
Institutional counterparties	178,034	—	178,034	(178,034)	—	—
Forward MBS derivatives:						
Institutional counterparties	9,293	(2,147)	7,146	(2,783)	—	4,363
	<u>\$ 1,449,009</u>	<u>\$ (2,147)</u>	<u>\$ 1,446,862</u>	<u>\$ (1,386,302)</u>	<u>\$ —</u>	<u>\$ 60,560</u>
<b>December 31, 2020</b>						
Securities loaned:						
Institutional counterparties	\$ 1,245,066	\$ —	\$ 1,245,066	\$ (1,179,090)	\$ —	\$ 65,976
Interest rate swaps:						
Institutional counterparties	2,196	—	2,196	(2,123)	—	73
Repurchase agreements:						
Institutional counterparties	237,856	—	237,856	(237,856)	—	—
Forward MBS derivatives:						
Institutional counterparties	40,741	(120)	40,621	(12,670)	—	27,951
	<u>\$ 1,525,859</u>	<u>\$ (120)</u>	<u>\$ 1,525,739</u>	<u>\$ (1,431,739)</u>	<u>\$ —</u>	<u>\$ 94,000</u>

Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)  
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*Secured Borrowing Arrangements*

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

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

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

The following tables present the remaining contractual maturities of repurchase agreement and securities lending transactions accounted for as secured borrowings (in thousands). The Company had no repurchase-to-maturity transactions outstanding at both June 30, 2021 and December 31, 2020.

	Remaining Contractual Maturities				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
<b>June 30, 2021</b>					
Repurchase agreement transactions:					
Asset-backed securities	\$ 73,365	\$ —	\$ 104,669	\$ —	\$ 178,034
Securities lending transactions:					
Corporate securities	113	—	—	—	113
Equity securities	1,260,045	—	—	—	1,260,045
Total	<u>\$ 1,333,523</u>	<u>\$ —</u>	<u>\$ 104,669</u>	<u>\$ —</u>	<u>\$ 1,438,192</u>
Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above					\$ 1,438,192
Amount related to agreements not included in offsetting disclosure above					<u>\$ —</u>

	Remaining Contractual Maturities				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
<b>December 31, 2020</b>					
Repurchase agreement transactions:					
Asset-backed securities	\$ 110,831	\$ —	\$ 127,025	\$ —	\$ 237,856
Securities lending transactions:					
Corporate securities	113	—	—	—	113
Equity securities	1,244,953	—	—	—	1,244,953
Total	<u>\$ 1,355,897</u>	<u>\$ —</u>	<u>\$ 127,025</u>	<u>\$ —</u>	<u>\$ 1,482,922</u>
Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above					\$ 1,482,922
Amount related to agreements not included in offsetting disclosure above					<u>\$ —</u>



Hilltop Holdings Inc. and Subsidiaries  
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## 21. Broker-Dealer and Clearing Organization Receivables and Payables

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

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
Receivables:		
Securities borrowed	\$ 1,336,847	\$ 1,338,855
Securities failed to deliver	58,909	58,244
Other	7,691	7,628
	<u>\$ 1,403,447</u>	<u>\$ 1,404,727</u>
Payables:		
Securities loaned	\$ 1,260,158	\$ 1,245,066
Correspondents	33,475	33,547
Securities failed to receive	93,996	61,589
Trades in process of settlement	44,685	21,765
Other	7,306	6,406
	<u>\$ 1,439,620</u>	<u>\$ 1,368,373</u>

## 22. Segment and Related Information

Following the sale of NLC on June 30, 2020, we have two primary business units within continuing operations, PCC (banking and mortgage origination) and Securities Holdings (broker-dealer). Under GAAP, our continuing operations business units are comprised of three reportable business segments organized primarily by the core products offered to the segments' respective customers: banking, broker-dealer and mortgage origination. These segments reflect the manner in which operations are managed and the criteria used by the chief operating decision maker, the Company's President and Chief Executive Officer, to evaluate segment performance, develop strategy and allocate resources.

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

As discussed in Note 3 to the consolidated financial statements, during the first quarter of 2020, management had determined that the insurance segment met the criteria to be presented as discontinued operations. On June 30, 2020, Hilltop completed the sale of NLC, which comprised the operations of the former insurance segment. As a result, insurance segment results for the three and six months ended June 30, 2020 have been presented as discontinued operations in the consolidated financial statements. Loss from discontinued operations before taxes was \$1.9 million during the three months ended June 30, 2020, while income from discontinued operations before taxes during the six months ended June 30, 2020 was \$2.1 million.

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

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

<u>Three Months Ended June 30, 2021</u>	<u>Banking</u>	<u>Broker-Dealer</u>	<u>Mortgage Origination</u>	<u>Corporate</u>	<u>All Other and Eliminations</u>	<u>Continuing Operations</u>
Net interest income (expense)	\$ 105,468	\$ 10,682	\$ (5,953)	\$ (4,687)	\$ 2,406	\$ 107,916
Provision for (reversal of) credit losses	(28,775)	55	—	—	—	(28,720)
Noninterest income	10,242	83,463	241,965	6,877	(2,648)	339,899
Noninterest expense	57,514	87,234	186,963	12,072	(415)	343,368
Income (loss) from continuing operations before taxes	<u>\$ 86,971</u>	<u>\$ 6,856</u>	<u>\$ 49,049</u>	<u>\$ (9,882)</u>	<u>\$ 173</u>	<u>\$ 133,167</u>

Hilltop Holdings Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

<b>Six Months Ended June 30, 2021</b>	<b>Banking</b>	<b>Broker-Dealer</b>	<b>Mortgage Origination</b>	<b>Corporate</b>	<b>All Other and Eliminations</b>	<b>Continuing Operations</b>
Net interest income (expense)	\$ 209,352	\$ 21,196	\$ (13,051)	\$ (9,379)	\$ 5,480	\$ 213,598
Provision for (reversal of) credit losses	(33,950)	121	—	—	—	(33,829)
Noninterest income	21,566	182,086	552,409	7,383	(5,960)	757,484
Noninterest expense	113,302	178,638	397,297	21,660	(867)	710,030
Income (loss) from continuing operations before taxes	<u>\$ 151,566</u>	<u>\$ 24,523</u>	<u>\$ 142,061</u>	<u>\$ (23,656)</u>	<u>\$ 387</u>	<u>\$ 294,881</u>
<b>Three Months Ended June 30, 2020</b>						
Net interest income (expense)	\$ 94,102	\$ 9,663	\$ (1,667)	\$ (3,232)	\$ 5,692	\$ 104,558
Provision for credit losses	65,600	426	—	—	—	66,026
Noninterest income	10,656	122,961	340,487	550	(6,529)	468,125
Noninterest expense	56,622	104,411	200,493	8,888	(205)	370,209
Income (loss) from continuing operations before taxes	<u>\$ (17,464)</u>	<u>\$ 27,787</u>	<u>\$ 138,327</u>	<u>\$ (11,570)</u>	<u>\$ (632)</u>	<u>\$ 136,448</u>
<b>Six Months Ended June 30, 2020</b>						
Net interest income (expense)	\$ 188,025	\$ 22,836	\$ (1,299)	\$ (4,888)	\$ 10,220	\$ 214,894
Provision for credit losses	99,875	700	—	—	—	100,575
Noninterest income	19,427	209,170	519,455	2,838	(11,052)	739,838
Noninterest expense	113,589	185,350	340,045	13,741	(615)	652,110
Income (loss) from continuing operations before taxes	<u>\$ (6,012)</u>	<u>\$ 45,956</u>	<u>\$ 178,111</u>	<u>\$ (15,791)</u>	<u>\$ (217)</u>	<u>\$ 202,047</u>
<b>June 30, 2021</b>						
Goodwill	<u>\$ 247,368</u>	<u>\$ 7,008</u>	<u>\$ 13,071</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 267,447</u>
Total assets	<u>\$ 13,886,095</u>	<u>\$ 3,447,065</u>	<u>\$ 3,250,216</u>	<u>\$ 2,974,676</u>	<u>\$ (5,893,518)</u>	<u>\$ 17,664,534</u>
<b>December 31, 2020</b>						
Goodwill	<u>\$ 247,368</u>	<u>\$ 7,008</u>	<u>\$ 13,071</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 267,447</u>
Total assets	<u>\$ 13,338,930</u>	<u>\$ 3,196,346</u>	<u>\$ 3,285,005</u>	<u>\$ 2,823,374</u>	<u>\$ (5,699,391)</u>	<u>\$ 16,944,264</u>

### 23. Earnings per Common Share

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2021</b>	<b>2020</b>	<b>2021</b>	<b>2020</b>
Basic earnings per share:				
Income from continuing operations	\$ 99,060	\$ 97,701	\$ 219,404	\$ 144,186
Income from discontinued operations	—	30,775	—	33,926
Income attributable to Hilltop	<u>\$ 99,060</u>	<u>\$ 128,476</u>	<u>\$ 219,404</u>	<u>\$ 178,112</u>
Weighted average shares outstanding - basic	81,663	90,164	81,914	90,337
Basic earnings per common share:				
Income from continuing operations	\$ 1.21	\$ 1.08	\$ 2.68	\$ 1.60
Income from discontinued operations	—	0.34	—	0.37
	<u>\$ 1.21</u>	<u>\$ 1.42</u>	<u>\$ 2.68</u>	<u>\$ 1.97</u>
Diluted earnings per share:				
Income from continuing operations	\$ 99,060	\$ 97,701	\$ 219,404	\$ 144,186
Income from discontinued operations	—	30,775	—	33,926
Income attributable to Hilltop	<u>\$ 99,060</u>	<u>\$ 128,476</u>	<u>\$ 219,404</u>	<u>\$ 178,112</u>
Weighted average shares outstanding - basic	81,663	90,164	81,914	90,337
Effect of potentially dilutive securities	536	—	493	—
Weighted average shares outstanding - diluted	<u>82,199</u>	<u>90,164</u>	<u>82,407</u>	<u>90,337</u>
Diluted earnings per common share:				
Income from continuing operations	\$ 1.21	\$ 1.08	\$ 2.66	\$ 1.60
Income from discontinued operations	—	0.34	—	0.37
	<u>\$ 1.21</u>	<u>\$ 1.42</u>	<u>\$ 2.66</u>	<u>\$ 1.97</u>

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

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

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

### FORWARD-LOOKING STATEMENTS

This Quarterly Report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”), as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included in this Quarterly Report that address results or developments that we expect or anticipate will or may occur in the future, and statements that are preceded by, followed by or include, words such as “anticipates,” “believes,” “could,” “estimates,” “expects,” “forecasts,” “goal,” “intends,” “may,” “might,” “plan,” “probable,” “projects,” “seeks,” “should,” “target,” “view” or “would” or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our financial condition, our revenue, our liquidity and sources of funding, market trends, operations and business, taxes, the impact of natural disasters or public health emergencies, such as the current global outbreak of a novel strain of coronavirus (“COVID-19”), information technology expenses, capital levels, mortgage servicing rights (“MSR”) assets, stock repurchases, dividend payments, expectations concerning mortgage loan origination volume, servicer advances and interest rate compression, expected levels of refinancing as a percentage of total loan origination volume, projected losses on mortgage loans originated, total expenses, the effects of government regulation applicable to our operations, the appropriateness of, and changes in, our allowance for credit losses and provision for (reversal of) credit losses, expected future benchmark rates, anticipated investment yields, our expectations regarding accretion of discount on loans in future periods, the collectability of loans, cybersecurity incidents, the redemption of junior subordinated debentures and the outcome of litigation are forward-looking statements.

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

- the COVID-19 pandemic and the response of governmental authorities to the pandemic, which have had, and may continue to have an adverse impact on the global economy and our business operations and performance;
- the credit risks of lending activities, including our ability to estimate credit losses and the allowance for credit losses, as well as the effects of changes in the level of, and trends in, loan delinquencies and write-offs;
- effectiveness of our data security controls in the face of cyber attacks;
- changes in general economic, market and business conditions in areas or markets where we compete, including changes in the price of crude oil;

- risks associated with concentration in real estate related loans;
- changes in the interest rate environment and transitions away from London Interbank Offered Rate (“LIBOR”);
- the effects of our indebtedness on our ability to manage our business successfully, including the restrictions imposed by the indenture governing our indebtedness;
- 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”);
- cost and availability of capital;
- changes in key management;
- competition in our banking, broker-dealer and mortgage origination segments from other banks and financial institutions as well as investment banking and financial advisory firms, mortgage bankers, asset-based non-bank lenders and government agencies;
- legal and regulatory proceedings;
- risks associated with merger and acquisition integration; and
- our ability to use excess capital in an effective manner.

For a more detailed discussion of these and other factors that may affect our business and that could cause the actual results to differ materially from those anticipated in these forward-looking statements, see “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2020 (“2020 Form 10-K”), which was filed with the Securities and Exchange Commission (the “SEC”) on February 16, 2021, this Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and other filings we have made with the SEC. We caution that the foregoing list of factors is not exhaustive, and new factors may emerge, or changes to the foregoing factors may occur, that could impact our business. All subsequent written and oral forward-looking statements concerning our business attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements above. We do not undertake any obligation to update any forward-looking statement, whether written or oral, relating to the matters discussed in this Quarterly Report except to the extent required by federal securities laws.

## OVERVIEW

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

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

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

During the first quarter of 2020, management determined that the then-pending sale of NLC met the criteria to be presented as discontinued operations. As a result, NLC's results for the three and six months ended June 30, 2020 have been presented as discontinued operations in the consolidated financial statements. On June 30, 2020, we completed the sale of all of the outstanding capital stock of NLC, which comprised the operations of our former insurance segment, for cash proceeds of \$154.1 million. During 2020, Hilltop recognized an aggregate gain associated with this transaction of \$36.8 million, net of \$5.1 million in transaction costs and was subject to post-closing adjustments. The resulting book gain from this sale transaction was not recognized for tax purposes due to the excess tax basis over book basis being greater than the recorded book gain. Any tax loss related to this transaction is deemed disallowed pursuant to the rules under the Internal Revenue Code. We also entered into an agreement at closing to refrain for a specified period from certain activities that compete with the business of NLC. Unless otherwise noted, for purposes of this Management's Discussion and Analysis of Financial Condition and Results of Operations, "consolidated" refers to our consolidated financial position and consolidated results of operations, including discontinued operations and assets and liabilities of the discontinued operations.

During the three and six months ended June 30, 2021, income applicable to common stockholders was \$99.1 million, or \$1.21 per diluted share, and \$219.4 million, or \$2.66 per diluted share, respectively. We declared total common dividends of \$0.12 and \$0.24 per share during the three and six months ended June 30, 2021, respectively, resulting in a dividend payout ratio of 9.92% and 8.99%, respectively. Dividend payout ratio is defined as cash dividends declared per common share divided by basic earnings per common share, including discontinued operations. We also paid an aggregate of \$49.5 million to repurchase shares of our common stock during the six months ended June 30, 2021.

We reported \$133.2 million and \$294.9 million of income from continuing operations before income taxes during the three and six months ended June 30, 2021, including the following contributions from our reportable business segments.

- The banking segment contributed \$87.0 million and \$151.6 million of income before income taxes during the three and six months ended June 30, 2021;
- The broker-dealer segment contributed \$6.9 million and \$24.5 million of income before income taxes during the three and six months ended June 30, 2021; and
- The mortgage origination segment contributed \$49.0 million and \$142.1 million of income before income taxes during the three and six months ended June 30, 2021.

At June 30, 2021, on a consolidated basis, we had total assets of \$17.7 billion, total deposits of \$11.7 billion, total loans, including loans held for sale, of \$10.4 billion and stockholders' equity of \$2.5 billion.

## *Recent Developments*

### **COVID-19**

The COVID-19 pandemic and related governmental control measures severely disrupted financial markets and overall economic conditions throughout 2020. While the impact of the pandemic and the uncertainties have remained into 2021, significant progress associated with COVID-19 vaccination levels in the United States has resulted in easing of restrictive measures in the United States. Further, the U.S. federal government has continued to enact policies to provide fiscal stimulus to the economy and relief to those affected by the pandemic, with the most recent stimulus expected to bolster household finances as well as those of small businesses, states and municipalities. Throughout the pandemic, we have taken a number of precautionary steps to safeguard our business and our employees from COVID-19, including, but not limited to, banking by appointment, implementing employee travel restrictions and telecommuting arrangements, while maintaining business continuity so that we can continue to deliver service to and meet the demands of our clients. Since the start of the pandemic, most of our employees have been working remotely, with only certain operationally critical employees working on site at our principal business headquarters and business segment locations. We began the process of returning a majority of our employees to their respective office locations beginning in the second quarter of 2021 based initially on a rotational team schedule to better ensure that appropriate social distancing measures are followed, and are generally targeting a return to pre-pandemic work arrangements with available hybrid options for designated roles. We will continue to monitor and assess the impact of the COVID-19 pandemic on a regular basis to ensure that we adhere to guidelines and orders issued by federal, state and local governments.

As discussed in more detail within “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our 2020 Form 10-K, in light of the extreme volatility and disruptions in the capital and credit markets beginning in March 2020 resulting from the COVID-19 crisis and its negative impact on the economy, we took a number of precautionary actions beginning in March 2020 to enhance our financial flexibility, protect capital, minimize losses and ensure target liquidity levels.

As a result of the short-term rate adjustments by the Federal Open Markets Committee (“FOMC”) and the stressed economic outlook during March 2020, mortgage rates fell to historically low levels. Given our exposure to the mortgage market, this precipitous decline in rates resulted in significant growth in mortgage originations at both PrimeLending and Hilltop Securities through its partnerships with certain housing finance authorities. To improve our already strong liquidity position, we raised brokered and other wholesale funding to support the enhanced mortgage activity. To meet increased liquidity demands, we raised brokered deposits during 2020 that have a remaining balance of approximately \$268 million at June 30, 2021, down from approximately \$731 million at December 31, 2020. Further, beginning in March 2020, additional deposits were swept from Hilltop Securities into the Bank. Since June 30, 2020, given the continued strong cash and liquidity levels at the Bank, the total funds swept from Hilltop Securities into the Bank was reduced, and was approximately \$700 million as of June 30, 2021.

#### *Asset Valuation*

At each reporting date between annual impairment tests, we consider potential indicators of impairment. Given the current economic uncertainties surrounding COVID-19, we considered whether the events and circumstances resulted in it being more likely than not that the fair value of any reporting unit and other intangible assets were less than their respective carrying value. Impairment indicators considered comprised the condition of the economy and financial services industry; government intervention and regulatory updates; the impact of recent events to financial performance and cost factors of the reporting unit; performance of our stock and other relevant events.

Given the potential impacts as a result of economic uncertainties associated with the pandemic, actual results may differ materially from our current estimates as the scope of such impacts evolves or if the duration of business disruptions is longer than currently anticipated. While certain valuation assumptions and judgments will change to account for pandemic-related circumstances, we do not anticipate significant changes in methodology used to determine the fair value of our goodwill, intangible assets and other long-lived assets. We will continue to monitor developments regarding the COVID-19 pandemic and measures implemented in response to the pandemic, market capitalization, overall economic conditions and any other triggering events or circumstances that may indicate an impairment in the future.

To the extent a sustained decline in our stock price or the occurrence of what management would deem to be a triggering event that could, under certain circumstances, cause us to perform impairment tests on our goodwill and other intangible assets, and result in an impairment charge being recorded for that period. In the event that we conclude that all or a portion of our goodwill and other intangible assets are impaired, a non-cash charge for the respective amount of such impairment would be recorded to earnings. Such a charge would have no impact on tangible capital or regulatory capital.

### *Loan Portfolio*

In response to the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) and the Paycheck Protection Program and Health Care Enhancement Act (the “PPP/HCE Act”) were passed in March 2020, which were intended to provide emergency relief to several groups and individuals impacted by the COVID-19 pandemic. Among the numerous provisions contained in the CARES Act was the creation of a \$349 billion Paycheck Protection Program (“PPP”) that provides federal government loan forgiveness for Small Business Administration (“SBA”) Section 7(a) loans for small businesses, which may include our customers, to pay up to eight weeks of employee compensation and other basic expenses such as electric and telephone bills. Further, the CARES Act allows the Bank to suspend the troubled debt restructuring (“TDR”) requirements for certain loan modifications to be categorized as a TDR.

Starting in March 2020, the Bank implemented several actions to better support our impacted banking clients and allow for loan modifications such as principal and/or interest payment deferrals, participation in the PPP as an SBA preferred lender and personal banking assistance including waived fees, increased daily spending limits and suspension of residential foreclosure activities. The COVID-19 payment deferral programs allow for a deferral of principal and/or interest payments with such deferred principal payments due and payable on the maturity date of the existing loan. The Bank’s actions during 2020 included approval of approximately \$1.0 billion in COVID-19 related loan modifications as of December 31, 2020.

During 2021, the Bank has continued to support its impacted banking clients through the approval of COVID-19 related loan modifications, which resulted in an additional \$14 million of new COVID-19 related loan modifications during the six months ended June 30, 2021. The portfolio of active deferrals that have not reached the end of their deferral period was approximately \$76 million as of June 30, 2021. While the majority of the portfolio of COVID-19 related loan modifications no longer require deferral, such loans represent elevated risk, and therefore management continues to monitor these loans. The extent to which these measures will impact the Bank remains uncertain, and any progression of loans, whether receiving COVID-19 payment deferrals or not, into non-performing assets, during future periods is uncertain and will depend on future developments that cannot be predicted.

While all industries have experienced varying levels of adverse impacts due to the COVID-19 pandemic, certain of our loan portfolio industry sectors and subsectors, including real estate collateralized by office buildings, continue to have an increased level of risk. The following table provides information on those loans held for investment balances, by portfolio industry sector, including collectively evaluated allowance for credit losses, that include active COVID-19 payment deferrals (dollars in thousands).

	Active 90 Day Principal Deferrals	Active 90 Day Interest and Principal Deferrals	Total Active Modifications		Classified and Criticized Loans	Allowance for Credit Losses	Allowance for Credit Losses as a % of Total Active Modifications	Allowance for Credit Losses as a % of Classified and Criticized Loans
			(\$)	(#)				
<b>June 30, 2021</b>								
Hotel	\$ 57,355	\$ —	\$ 57,355	6	\$ 37,148	\$ 11,732	20.5 %	31.6 %
Restaurants	—	—	—	—	—	—	— %	— %
Transportation & Warehousing	7,681	—	7,681	11	7,681	843	11.0 %	11.0 %
1-4 Family Residential	—	8,731	8,731	91	7,589	143	1.6 %	1.9 %
Retail	—	—	—	—	—	—	— %	— %
Real Estate & Rental & Leasing	888	—	888	1	888	61	6.9 %	6.9 %
Healthcare and Social Assistance	—	1,605	1,605	1	—	11	0.7 %	— %
All Other	—	—	—	—	—	—	— %	— %
	<u>\$ 65,924</u>	<u>\$ 10,336</u>	<u>\$ 76,260</u>	<u>110</u>	<u>\$ 53,306</u>	<u>\$ 12,790</u>	16.8 %	24.0 %

In addition, the Bank’s loan portfolio includes collateralized loans extended to businesses that depend on the energy industry, including those within the exploration and production, field services, pipeline construction and transportation sectors. Crude oil prices have increased since historical lows observed in 2020, but uncertainty remains as economies continue to recover from the COVID-19 pandemic, vaccination programs evolve, and future supply and demand for oil are influenced by a return to business travel, new energy policies and government regulation, and the pace of transition

towards renewable energy resources. At June 30, 2021, the Bank's energy loan exposure was approximately \$78 million of loans held for investment with unfunded commitment balances of approximately \$42 million. The allowance for credit losses on the Bank's energy portfolio was \$2.0 million, or 2.5% of loans held for investment at June 30, 2021.

As noted above, the Bank's actions during the second quarter of 2020 also included supporting our impacted banking clients through the initial PPP effort. These efforts included approval and funding of over 2,800 PPP loans, with approximately \$54 million remaining outstanding at June 30, 2021. The PPP loans made by the Bank are guaranteed by the SBA and, if used by the borrower for authorized purposes, may be fully forgiven. On October 2, 2020, the SBA began approving the Bank's PPP forgiveness applications and remitting forgiveness payments to PPP lenders for PPP borrowers. Through July 16, 2021, the SBA had approved approximately 2,600 initial round PPP forgiveness applications totaling approximately \$643 million, with PPP loans of approximately \$9 million pending SBA review and approval.

Given the updates from the SBA regarding the second round of the PPP effort, the Bank accepted new applications from impacted banking clients beginning in January 2021 through May 2021. While the majority of these applications are second draw loans, the Bank has received some first draw loan requests. These efforts have included approval and funding of over 1,300 second round PPP loans, with approximately \$207 million outstanding at June 30, 2021. In addition, the Bank recently began submissions of PPP forgiveness applications associated with the second round PPP effort.

Refer to the discussion in the "Financial Condition – Allowance for Credit Losses on Loans" section that follows for more details regarding the significant assumptions and estimates involved in estimating credit losses given the economic uncertainties associated with COVID-19.

#### *Outlook for 2021*

The COVID-19 pandemic has adversely impacted financial markets and overall economic conditions, and is expected to continue to have implications on our business and operations. The extent of the impact of the pandemic on our operational and financial performance for the remainder of 2021 is currently uncertain and will depend on certain developments outside of our control, including, among others, the ongoing distribution and effectiveness of vaccines, government stimulus, the ultimate impact of the pandemic on our customers and clients, and additional, or extended, federal, state and local government orders and regulations that might be imposed in response to the pandemic.

See "Item 1A. Risk Factors" of our 2020 Form 10-K for additional discussion of the potential adverse impact of COVID-19 on our business, results of operations and financial condition.

#### ***Factors Affecting Results of Operations***

As a financial institution providing products and services through our banking, broker-dealer and mortgage origination segments, we are directly affected by general economic and market conditions, many of which are beyond our control and unpredictable. A key factor impacting our results of operations includes changes in the level of interest rates in addition to twists in the shape of the yield curve with the magnitude and direction of the impact varying across the different lines of business. Other factors impacting our results of operations include, but are not limited to, fluctuations in volume and price levels of securities, inflation, political events, investor confidence, investor participation levels, legal, regulatory, and compliance requirements and competition. All of these factors have the potential to impact our financial position, operating results and liquidity. In addition, the recent economic and political environment has led to legislative and regulatory initiatives, both enacted and proposed, that could substantially change the regulation of the financial services industry and may significantly impact us.

#### ***Factors Affecting Comparability of Results of Operations***

##### **NLC Sale**

As previously discussed, on June 30, 2020, we completed the sale of all of the outstanding capital stock of NLC, which comprised the operations of our insurance segment. Accordingly, NLC's results for the three and six months ended June 30, 2020 have been presented as discontinued operations in the consolidated financial statements.



## **Tender Offer**

On September 23, 2020, we announced the commencement of a modified “Dutch auction” tender offer to purchase shares of our common stock for an aggregate cash purchase price of up to \$350 million. On November 17, 2020, we completed our tender offer, repurchasing 8,058,947 shares of outstanding common stock at a price of \$24.00 per share for a total of \$193.4 million excluding fees and expenses. We funded the tender offer with cash on hand.

## **Subordinated Notes due 2030 and 2035**

On May 7, 2020, we completed a public offering of \$50 million aggregate principal amount of 5.75% fixed-to-floating rate subordinated notes due May 15, 2030 (the “2030 Subordinated Notes”) and \$150 million aggregate principal amount of 6.125% fixed-to-floating rate subordinated notes due May 15, 2035 (the “2035 Subordinated Notes”). We collectively refer to the 2030 Subordinated Notes and the 2035 Subordinated Notes as the “Subordinated Notes”. The price for the Subordinated Notes was 100% of the principal amount of the Subordinated Notes. The net proceeds from the offering, after deducting underwriting discounts and fees and expenses of \$3.4 million, were \$196.6 million. We intend to use the net proceeds of the offerings for general corporate purposes.

## **Technology Enhancements and Corporate Initiatives**

In furtherance of our goal of building a premier, diversified financial services company, we regularly evaluate strategic opportunities to invest in our business and technology platforms. Such investments are intended to support long-term technological competitiveness and improve operational efficiencies throughout our organization. During 2018, we began the significant investment in new technological solutions, substantial core system upgrades and other technology enhancements. Such significant investments specifically include single enterprise-wide general ledger and procurement solutions, a mortgage loan origination system and a core system replacement within our broker-dealer segment (collectively referred to as “Core System Improvements”). In combination with these technology enhancements, we are continuing our efforts to consolidate common back office functions. Costs incurred related to these Core System Improvements and the consolidation of common back office functions represented a significant portion of our noninterest expenses throughout 2020. We believe that such non-recurring costs will decline by the end of 2021. We have made such investments with the expectation that they will result in cost savings over the long term. Beginning in the second quarter of 2019, the mortgage origination segment began the implementation of a new mortgage loan origination system. The transition from the previous mortgage loan origination system was completed during the fourth quarter of 2020. During the second quarter of 2020, we implemented the core system replacement within our broker-dealer segment. This was a highly complex endeavor and the broker-dealer segment continues to work with the technology vendors, clients and internal stakeholders. Additionally, through the third quarter of 2020, we made significant progress in our transition to a single, enterprise-wide general ledger solution by replacing legacy ledgers at our banking and mortgage origination segments, as well as corporate, and, in April 2021, we replaced our only remaining legacy ledger and transitioned our broker-dealer segment to the enterprise-wide general ledger solution.

## ***LIBOR***

In July 2017, the Financial Conduct Authority (“FCA”) announced that it intends to cease compelling banks to submit rates for the calculation of LIBOR after 2021. Most recently in March 2021, the FCA and the Intercontinental Exchange (“ICE”) Benchmark Administration concurrently confirmed their original intention to stop requesting banks to submit the rates required to calculate LIBOR after the 2021 calendar year and additionally announced firm target dates for the phase out of various LIBOR tenors. Pursuant to the announcement, one week and two-month LIBOR will cease to be published or lose representativeness immediately after December 31, 2021, and all remaining USD LIBOR tenors will cease to be published or lose representativeness immediately after June 30, 2023.

Working groups comprised of various regulators and other industry groups have been formed in the United States and other countries in order to provide guidance on this topic. In particular, the Alternative Reference Rates Committee (“ARRC”) has proposed that the Secured Overnight Financing Rate (“SOFR”) is the rate that represents best practice as the alternative to LIBOR for use in derivatives and other financial contracts that are currently indexed to LIBOR. The ARRC has also published recommended fall-back language for LIBOR-linked financial instruments, among numerous other areas of guidance.

The Financial Accounting Standards Board (“FASB”) issued guidance in March 2020 intended to provide temporary optional expedients and exceptions to the accounting principles generally accepted in the United States (“GAAP”) guidance on contract modifications and hedge accounting to ease the financial reporting burdens related to the expected market transition from LIBOR and other interbank offered rates to alternative reference rates. Additionally, the FASB issued specific accounting guidance that permits the use of the Overnight Index Swap rate based on the SOFR to be designated as a benchmark interest rate for hedge accounting purposes.

Certain loans we originated bear interest at a floating rate based on LIBOR. We also pay interest on certain borrowings, are counterparty to derivative agreements, and have existing contracts with payment calculations that use LIBOR as the reference rate. The cessation of publication of LIBOR will create various risks surrounding the financial, operational, compliance and legal aspects associated with changing certain elements of existing contracts.

ARRC has proposed a paced market transition plan to SOFR from LIBOR, and organizations are currently working on industry-wide and company-specific transition plans as it relates to derivatives and cash markets exposed to LIBOR. However, at this time, no consensus exists as to what rate or rates may become acceptable alternatives to LIBOR and it is impossible to predict the effect of any such alternatives on the value of LIBOR-based securities and variable rate loans, debentures, or other securities or financial arrangements, given LIBOR’s role in determining market interest rates globally.

We have completed our targeted assessment of exposures across the organization associated with the migration away from LIBOR and have transitioned to the impact assessment and implementation stages. In light of the above described recent changes to the LIBOR phase out dates being pushed out to 2023, we have begun taking necessary actions, including negotiating certain of our agreements based on alternative benchmark rates that have been established. Since the third quarter of 2020, PrimeLending has been originating conventional adjustable-rate mortgage, or ARM, loan products utilizing a SOFR rate with terms consistent with government-sponsored enterprise, or GSE, guidelines. In addition, the Bank’s management team continues to work with its commercial relationships that have LIBOR-based contracts maturing after 2021 to amend terms and establish an alternative benchmark rate. We also continue to evaluate the impacts of the LIBOR phase-out and transition requirements as it pertains to contracts, models and systems. To date, an immaterial amount of expenses have been incurred as a result of our efforts; however, in the future we may incur additional expenses as we finalize the transition of our systems and processes away from LIBOR.

### ***Brokered Deposits***

In December 2020, the Federal Deposit Insurance Corporation (“FDIC”) finalized revisions to its rules and prior guidance regarding brokered deposits (the “Revisions”). The Revisions are intended to modernize the FDIC’s framework for regulating brokered deposits and ensure that the classification of a deposit as brokered appropriately reflects changes in the banking landscape. In addition, the Revisions are intended to modify the interest rate restrictions applicable to certain depository institutions and clarify the application of the brokered deposit requirements to non-maturity deposits. The Revisions became effective on April 1, 2021, but full compliance is not required during a transitional period ending January 1, 2022. We have evaluated the Revisions, and are currently working with the FDIC to finalize core deposit treatment of our current brokered deposit and funds sweep relationships between our banking and broker-dealer segments.

## ***Segment Information***

As previously discussed, on June 30, 2020, we completed the sale of all of the outstanding capital stock of NLC, which comprised the operations of the insurance segment. Accordingly, insurance segment results for the three and six months ended June 30, 2020 have been presented as discontinued operations in the consolidated financial statements and we no longer have an insurance segment. Additional details are presented in Note 3, Discontinued Operations, in the notes to our consolidated financial statements.

Following the above-noted sale of NLC, we have two primary business units within continuing operations, PCC (banking and mortgage origination) and Securities Holdings (broker-dealer). Under GAAP, our business units are comprised of three reportable business segments organized primarily by the core products offered to the segments' respective customers: banking, broker-dealer and mortgage origination. Consistent with our historical segment operating results, we anticipate that future revenues will be driven primarily from the banking segment, with the remainder being generated by our broker-dealer and mortgage origination segments. Operating results for the mortgage origination segment have historically been more volatile than operating results for the banking and broker-dealer segments.

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

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

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

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

The eliminations of intercompany transactions are included in "All Other and Eliminations." Additional information concerning our reportable segments is presented in Note 22, Segment and Related Information, in the notes to our consolidated financial statements.

The following table presents certain information about the continuing operating results of our reportable segments (in thousands). This table serves as a basis for the discussion and analysis in the segment operating results sections that follow.

	<u>Three Months Ended June 30,</u>		<u>Variance 2021 vs 2020</u>		<u>Six Months Ended June 30,</u>		<u>Variance 2021 vs 2020</u>	
	<u>2021</u>	<u>2020</u>	<u>Amount</u>	<u>Percent</u>	<u>2021</u>	<u>2020</u>	<u>Amount</u>	<u>Percent</u>
Net interest income (expense):								
Banking	\$ 105,468	\$ 94,102	\$ 11,366	12	\$ 209,352	\$ 188,025	\$ 21,327	11
Broker-Dealer	10,682	9,663	1,019	11	21,196	22,836	(1,640)	(7)
Mortgage Origination	(5,953)	(1,667)	(4,286)	(257)	(13,051)	(1,299)	(11,752)	NM
Corporate	(4,687)	(3,232)	(1,455)	(45)	(9,379)	(4,888)	(4,491)	(92)
All Other and Eliminations	2,406	5,692	(3,286)	(58)	5,480	10,220	(4,740)	(46)
Hilltop Continuing Operations	\$ 107,916	\$ 104,558	\$ 3,358	3	\$ 213,598	\$ 214,894	\$ (1,296)	(1)
Provision for (reversal of) credit losses:								
Banking	\$ (28,775)	\$ 65,600	\$ (94,375)	(144)	\$ (33,950)	\$ 99,875	\$ (133,825)	(134)
Broker-Dealer	55	426	(371)	(87)	121	700	(579)	(83)
Mortgage Origination	—	—	—	—	—	—	—	—
Corporate	—	—	—	—	—	—	—	—
All Other and Eliminations	—	—	—	—	—	—	—	—
Hilltop Continuing Operations	\$ (28,720)	\$ 66,026	\$ (94,746)	(143)	\$ (33,829)	\$ 100,575	\$ (134,404)	(134)
Noninterest income:								
Banking	\$ 10,242	\$ 10,656	\$ (414)	(4)	\$ 21,566	\$ 19,427	\$ 2,139	11
Broker-Dealer	83,463	122,961	(39,498)	(32)	182,086	209,170	(27,084)	(13)
Mortgage Origination	241,965	340,487	(98,522)	(29)	552,409	519,455	32,954	6
Corporate	6,877	550	6,327	NM	7,383	2,838	4,545	160
All Other and Eliminations	(2,648)	(6,529)	3,881	59	(5,960)	(11,052)	5,092	46
Hilltop Continuing Operations	\$ 339,899	\$ 468,125	\$ (128,226)	(27)	\$ 757,484	\$ 739,838	\$ 17,646	2
Noninterest expense:								
Banking	\$ 57,514	\$ 56,622	\$ 892	2	\$ 113,302	\$ 113,589	\$ (287)	(0)
Broker-Dealer	87,234	104,411	(17,177)	(16)	178,638	185,350	(6,712)	(4)
Mortgage Origination	186,963	200,493	(13,530)	(7)	397,297	340,045	57,252	17
Corporate	12,072	8,888	3,184	36	21,660	13,741	7,919	58
All Other and Eliminations	(415)	(205)	(210)	(102)	(867)	(615)	(252)	(41)
Hilltop Continuing Operations	\$ 343,368	\$ 370,209	\$ (26,841)	(7)	\$ 710,030	\$ 652,110	\$ 57,920	9
Income (loss) from continuing operations before taxes:								
Banking	\$ 86,971	\$ (17,464)	\$ 104,435	NM	\$ 151,566	\$ (6,012)	\$ 157,578	NM
Broker-Dealer	6,856	27,787	(20,931)	(75)	24,523	45,956	(21,433)	(47)
Mortgage Origination	49,049	138,327	(89,278)	(65)	142,061	178,111	(36,050)	(20)
Corporate	(9,882)	(11,570)	1,688	15	(23,656)	(15,791)	(7,865)	(50)
All Other and Eliminations	173	(632)	805	127	387	(217)	604	278
Hilltop Continuing Operations	\$ 133,167	\$ 136,448	\$ (3,281)	(2)	\$ 294,881	\$ 202,047	\$ 92,834	46

NM Not meaningful.

### Key Performance Indicators

We utilize several key indicators of financial condition and operating performance to evaluate the various aspects of our business. In addition to traditional financial metrics, such as revenue and growth trends, we monitor several other financial measures and non-financial operating metrics to help us evaluate growth trends, measure the adequacy of our capital based on regulatory reporting requirements, measure the effectiveness of our operations and assess operational efficiencies. These indicators change from time to time as the opportunities and challenges in our businesses change.

Specifically, performance ratios and asset quality ratios are typically used for measuring the performance of banking and financial institutions. We consider return on average stockholders' equity, return on average assets and net interest margin to be important supplemental measures of operating performance that are commonly used by securities analysts, investors and other parties interested in the banking and financial industry. The net charge-offs to average loans outstanding ratio is also considered a key measure for our banking segment as it indicates the performance of our loan portfolio.

In addition, we consider regulatory capital ratios to be key measures that are used by us, as well as banking regulators, investors and analysts, to assess our regulatory capital position and to compare our regulatory capital to that of other financial services companies. We monitor our capital strength in terms of both leverage ratio and risk-based capital ratios based on capital requirements administered by the federal banking agencies. The risk-based capital ratios are minimum supervisory ratios generally applicable to banking organizations, but banking organizations are widely

expected to operate with capital positions well above the minimum ratios. Failure to meet minimum capital requirements can initiate certain mandatory actions by regulators that, if undertaken, could have a material effect on our financial condition or results of operations.

### ***How We Generate Revenue***

We generate revenue from net interest income and from noninterest income. Net interest income represents the difference between the income earned on our assets, including our loans and investment securities, and our cost of funds, including the interest paid on the deposits and borrowings that are used to support our assets. Net interest income is a significant contributor to our operating results and is primarily earned by our banking segment. Fluctuations in interest rates, as well as the amounts and types of interest-earning assets and interest-bearing liabilities we hold, affect net interest income. Net interest income from continuing operations decreased during the six months ended June 30, 2021, compared with the same period in 2020, primarily due to decreases within our mortgage origination segment and corporate, partially offset by an increase within our banking segment.

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

- (i) *Income from broker-dealer operations.* Through Securities Holdings, we provide investment banking and other related financial services. We generated \$136.6 million and \$126.6 million in securities commissions and fees and investment and securities advisory fees and commissions, and \$39.7 million and \$74.6 million in gains from derivative and trading portfolio activities (included within other noninterest income), during the six months ended June 30, 2021 and 2020, respectively.
- (ii) *Income from mortgage operations.* Through PrimeLending, we generate noninterest income by originating and selling mortgage loans. During the six months ended June 30, 2021 and 2020, we generated \$552.0 million and \$519.7 million, respectively, in net gains from sale of loans, other mortgage production income (including income associated with retained mortgage servicing rights), and mortgage loan origination fees.

In the aggregate, we experienced an increase in noninterest income from continuing operations during the six months ended June 30, 2021, compared to the same period in 2020, noted in the segment results table previously presented, primarily due to an increase of \$32.3 million in net gains from sale of loans, other mortgage production income and mortgage loan origination fees within our mortgage origination segment, partially offset by a decrease in our broker-dealer 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.

### ***Consolidated Operating Results***

Income from continuing operations applicable to common stockholders during the three months ended June 30, 2021 was \$99.1 million, or \$1.21 per diluted share, compared with \$97.7 million, or \$1.08 per diluted share, during the three months ended June 30, 2020. Income from continuing operations applicable to common stockholders during the six months ended June 30, 2021 was \$219.4 million, or \$2.66 per diluted share, compared with \$144.2 million, or \$1.60 per diluted share, during the six months ended June 30, 2020. Hilltop's financial results from continuing operations for the three months ended June 30, 2021, compared with the same period in 2020, reflect the significant improvement in the macroeconomic outlook and resulting impact on loan expected loss rates within the banking segment, as well as a decrease in year-over-year mortgage origination segment net gains from sales of loans and other mortgage production income. The improvement in results from continuing operations for the six months ended June 30, 2021, compared with the same period in 2020, was primary due to the positive changes in macroeconomic and loan expected loss rates within the banking segment noted above, as well as an increase in mortgage origination segment net gains from sales of loans and other mortgage production income.

Including income from discontinued operations, net of income taxes, income applicable to common stockholders was \$128.5 million, or \$1.42 per diluted share, and \$178.1 million, or \$1.97 per diluted share, during the three and six months ended June 30, 2020, respectively.

Certain items included in net income for the three and six months ended June 30, 2021 and 2020 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 FDIC-assisted transaction whereby the Bank acquired certain assets and assumed certain

liabilities of FNB, the acquisition of SWS Group, Inc. in a stock and cash transaction, and the acquisition of The Bank of River Oaks in an all-cash transaction (collectively, the “Bank Transactions”). Income before income taxes during the three months ended June 30, 2021 and 2020 included net accretion on earning assets and liabilities of \$6.2 million and \$3.2 million, respectively, and amortization of identifiable intangibles of \$1.3 million and \$1.5 million, respectively, related to the Bank Transactions. During the six months ended June 30, 2021 and 2020, income before income taxes included net accretion on earning assets and liabilities of \$11.0 million and \$9.9 million, respectively, and amortization of identifiable intangibles of \$2.7 million and \$3.3 million, respectively, related to the Bank Transactions.

The information shown in the table below includes certain key performance indicators on a consolidated basis.

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Return on average stockholders' equity <sup>(1)</sup>	16.42 %	23.32 %	18.47 %	16.52 %
Return on average assets <sup>(2)</sup>	2.29 %	3.30 %	2.59 %	2.44 %
Net interest margin <sup>(3) (4)</sup>	2.62 %	2.80 %	2.66 %	3.08 %
Leverage ratio <sup>(5)</sup> (end of period)			12.87 %	12.60 %
Common equity Tier 1 risk-based capital ratio <sup>(6)</sup> (end of period)			20.22 %	18.46 %

- (1) Return on average stockholders' equity is defined as consolidated income attributable to Hilltop divided by average total Hilltop stockholders' equity.
- (2) Return on average assets is defined as consolidated net income divided by average assets.
- (3) Net interest margin is defined as net interest income divided by average interest-earning assets. We consider net interest margin as a key indicator of profitability, as it represents interest earned on our interest-earning assets compared to interest incurred.
- (4) The securities financing operations within our broker-dealer segment had the effect of lowering both the net interest margin and taxable equivalent net interest margin by 17 basis points and 22 basis points during the three months ended June 30, 2021 and 2020, respectively, and 18 basis points and 30 basis points during the six months ended June 30, 2021 and 2020, respectively.
- (5) The leverage ratio is a regulatory capital ratio and is defined as Tier 1 risk-based capital divided by average consolidated assets.
- (6) The common equity Tier 1 risk-based capital ratio is a regulatory capital ratio and is defined as common equity Tier 1 risk-based capital divided by risk weighted assets. Common equity includes common equity Tier 1 capital (common stockholders' equity and certain minority interests in the equity capital accounts of consolidated subsidiaries, but excluding goodwill and various intangible assets) and additional Tier 1 capital (certain qualifying minority interests not included in common equity Tier 1 capital, certain preferred stock and related surplus, and certain subordinated debt).

We present net interest margin and net interest income below, on a taxable-equivalent basis. Net interest margin (taxable equivalent), a non-GAAP measure, is defined as taxable equivalent net interest income divided by average interest-earning assets. Taxable equivalent adjustments are based on the applicable corporate federal income tax rate of 21% for all periods presented. The interest income earned on certain earning assets is completely or partially exempt from federal income tax. As such, these tax-exempt instruments typically yield lower returns than taxable investments. To provide more meaningful comparisons of net interest margins for all earning assets, we use net interest income on a taxable-equivalent basis in calculating net interest margin by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments.

During the three months ended June 30, 2021 and 2020, purchase accounting contributed 16 and 10 basis points, respectively, to our consolidated taxable equivalent net interest margin of 2.63% and 2.81%, respectively. During the six months ended June 30, 2021 and 2020, purchase accounting contributed 15 and 16 basis points, respectively, to our consolidated taxable equivalent net interest margin of 2.66% and 3.09%, respectively. The purchase accounting activity was primarily related to the accretion of discount of loans which totaled \$6.0 million and \$3.2 million during the three months ended June 30, 2021 and 2020, respectively, associated with the Bank Transactions. The purchase accounting activity was primarily related to the accretion of discount of loans which totaled \$10.9 million and \$9.9 million during the six months ended June 30, 2021 and 2020, respectively, associated with the Bank Transactions.

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

	Three Months Ended June 30,					
	2021			2020		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
<b>Assets</b>						
Interest-earning assets						
Loans held for sale	\$ 2,450,897	\$ 17,128	2.80 %	\$ 2,308,368	\$ 20,036	3.47 %
Loans held for investment, gross <sup>(1)</sup>	7,725,906	87,034	4.48 %	7,744,395	87,823	4.50 %
Investment securities - taxable	2,443,486	11,106	1.82 %	1,681,336	12,489	2.97 %
Investment securities - non-taxable <sup>(2)</sup>	320,685	2,731	3.41 %	215,645	1,822	3.38 %
Federal funds sold and securities purchased under agreements to resell	159,400	—	0.00 %	61,956	(7)	(0.04)%
Interest-bearing deposits in other financial institutions	1,861,861	628	0.14 %	1,569,277	541	0.14 %
Securities borrowed	1,490,097	15,586	4.14 %	1,375,849	12,883	3.70 %
Other	49,579	994	8.04 %	59,917	439	2.95 %
Interest-earning assets, gross <sup>(2)</sup>	16,501,911	135,207	3.26 %	15,016,743	136,026	3.60 %
Allowance for credit losses	(144,105)			(102,216)		
Interest-earning assets, net	16,357,806			14,914,527		
Noninterest-earning assets	1,475,422			1,603,791		
<b>Total assets</b>	<b>\$ 17,833,228</b>			<b>\$ 16,518,318</b>		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 7,740,066	\$ 6,176	0.32 %	\$ 7,925,031	\$ 11,946	0.61 %
Securities loaned	1,411,961	12,345	3.51 %	1,280,958	10,797	3.39 %
Notes payable and other borrowings	1,271,609	8,381	2.64 %	1,110,516	7,998	2.88 %
Total interest-bearing liabilities	10,423,636	26,902	1.03 %	10,316,505	30,741	1.20 %
Noninterest-bearing liabilities						
Noninterest-bearing deposits	4,090,425			3,303,165		
Other liabilities	872,916			658,416		
Total liabilities	15,386,977			14,278,086		
Stockholders' equity	2,420,436			2,215,538		
Noncontrolling interest	25,815			24,694		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 17,833,228</b>			<b>\$ 16,518,318</b>		
<b>Net interest income</b> <sup>(2)</sup>		<b>\$ 108,305</b>			<b>\$ 105,285</b>	
<b>Net interest spread</b> <sup>(2)</sup>			2.23 %			2.40 %
<b>Net interest margin</b> <sup>(2)</sup>			2.63 %			2.81 %
<b>Six Months Ended June 30,</b>						
	2021			2020		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
<b>Assets</b>						
Interest-earning assets						
Loans held for sale	\$ 2,511,653	\$ 33,361	2.66 %	\$ 1,962,872	\$ 35,667	3.63 %
Loans held for investment, gross <sup>(1)</sup>	7,686,116	175,078	4.55 %	7,504,472	183,361	4.85 %
Investment securities - taxable	2,356,083	21,338	1.81 %	1,740,116	29,095	3.34 %
Investment securities - non-taxable <sup>(2)</sup>	302,444	4,998	3.31 %	212,254	3,724	3.51 %
Federal funds sold and securities purchased under agreements to resell	126,644	—	— %	61,449	128	0.42 %
Interest-bearing deposits in other financial institutions	1,714,688	1,210	0.14 %	1,015,526	2,053	0.41 %
Securities borrowed	1,471,504	44,558	6.02 %	1,472,293	26,210	3.52 %
Other	49,746	1,756	7.11 %	69,257	1,951	5.66 %
Interest-earning assets, gross <sup>(2)</sup>	16,218,878	282,299	3.47 %	14,038,239	282,189	4.00 %
Allowance for credit losses	(146,737)			(88,323)		
Interest-earning assets, net	16,072,141			13,949,916		
Noninterest-earning assets	1,517,000			1,618,589		
<b>Total assets</b>	<b>\$ 17,589,141</b>			<b>\$ 15,568,505</b>		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 7,683,634	\$ 13,917	0.37 %	\$ 7,094,929	\$ 27,071	0.77 %
Securities loaned	1,384,108	37,831	5.51 %	1,377,973	22,073	3.22 %
Notes payable and other borrowings	1,201,230	16,394	2.73 %	1,239,277	16,542	2.67 %
Total interest-bearing liabilities	10,268,972	68,142	1.34 %	9,712,179	65,686	1.36 %
Noninterest-bearing liabilities						
Noninterest-bearing deposits	3,911,205			3,017,070		
Other liabilities	986,810			646,069		
Total liabilities	15,166,987			13,375,318		
Stockholders' equity	2,395,994			2,168,707		
Noncontrolling interest	26,160			24,480		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 17,589,141</b>			<b>\$ 15,568,505</b>		
<b>Net interest income</b> <sup>(2)</sup>		<b>\$ 214,157</b>			<b>\$ 216,503</b>	
<b>Net interest spread</b> <sup>(2)</sup>			2.13 %			2.64 %
<b>Net interest margin</b> <sup>(2)</sup>			2.66 %			3.09 %

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- (1) Average balance includes non-accrual loans.
  - (2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on the applicable corporate federal income tax rate of 21% for the periods presented. The adjustment to interest income was \$0.4 million and \$0.3 million for the three months ended June 30, 2021 and 2020, respectively, and \$0.6 million and \$0.6 million for the six months ended June 30, 2021 and 2020, respectively.

The banking segment's net interest margin exceeds our consolidated net interest margin shown above. Our consolidated net interest margin includes certain items that are not reflected in the calculation of our net interest margin within our banking segment and reduce our consolidated net interest margin, such as the borrowing costs of Hilltop and the yields and costs associated with certain items within interest-earning assets and interest-bearing liabilities in the broker-dealer segment, including items related to securities financing operations that particularly decrease net interest margin. In addition, yields and costs on certain interest-earning assets, such as warehouse lines of credit extended to subsidiaries (operating segments) by the banking segment, are eliminated from the consolidated financial statements. Our consolidated net interest margins for the three and six months ended June 30, 2021 and 2020 were also negatively impacted by certain actions taken by management during 2020 to strengthen our available liquidity position. Such actions, including increasing overall cash balances by raising brokered money market and brokered time deposits and raising capital through the issuance of subordinated debt, were taken out of an abundance of caution in light of the extreme volatility and disruptions in the capital and credit markets beginning in March 2020 resulting from the COVID-19 crisis and its negative impact on the economy.

On a consolidated basis, the changes in net interest income during the three and six months ended June 30, 2021, compared with the same periods in 2020, were primarily due to the effects of decreased net yields on mortgage loans held for sale, interest incurred beginning in May 2020 related to the Subordinated Notes at corporate, and the decrease in market interest rates on deposits within the banking segment. Refer to the discussion in the "Banking Segment" section that follows for more details on the changes in net interest income, including the component changes in the volume of average interest-earning assets and interest-bearing liabilities and changes in the rates earned or paid on those items.

The provision for (reversal of) credit losses is determined by management as the amount necessary to maintain the allowance for credit losses at the amount of expected credit losses inherent within the loans held for investment portfolio. The amount of expense and the corresponding level of allowance for credit losses for loans are based on our evaluation of the collectability of the loan portfolio based on historical loss experience, reasonable and supportable forecasts, and other significant qualitative and quantitative factors. Substantially all of our consolidated provision for (reversal of) credit losses is related to the banking segment. During the three and six months ended June 30, 2021, the reversal of credit losses was primarily impacted by the banking segment's reduction in reserves associated with collectively evaluated loans within the portfolio attributable to improvements in macroeconomic forecast assumptions and positive risk rating grade migration, including a high concentration of credits within the restaurant and commercial real estate industry sectors. Refer to the discussion in the "Financial Condition – Allowance for Credit Losses on Loans" section that follows for more details regarding the significant assumptions and estimates involved in estimating credit losses.

Noninterest income from continuing operations decreased during the three months ended June 30, 2021, compared with the same period in 2020, primarily due to decreases in total mortgage loan sales volume and changes in net fair value and related derivative activity within our mortgage origination segment, as well as decreases in structured finance net revenues within our broker-dealer segment. Noninterest income from continuing operations increased slightly during the six months ended June 30, 2021, compared with the same period in 2020, primarily due to increases in total mortgage loan sales volume offset by changes in net fair value and related derivative activity.

Noninterest expense from continuing operations decreased during the three months ended June 30, 2021, compared with the same period in 2020, primarily due to decreases in variable compensation within our mortgage origination and broker-dealer segments. Noninterest expense from continuing operations increased during the six months ended June 30, 2021, compared with the same period in 2020, primarily due to increases in both variable and non-variable compensation within our mortgage origination segment associated with the increased mortgage loan originations.

Effective income tax rates from continuing operations during the three months ended June 30, 2021 and 2020 were 23.5% and 23.3%, respectively, and for the six months ended June 30, 2021 and 2020, were 23.4% and 23.2%, respectively, and approximated the applicable statutory rates for such periods.



## Segment Results from Continuing Operations

### Banking Segment

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

	Three Months Ended June 30,		Variance 2021 vs 2020	Six Months Ended June 30,		Variance 2021 vs 2020
	2021	2020		2021	2020	
Net interest income	\$ 105,468	\$ 94,102	\$ 11,366	\$ 209,352	\$ 188,025	\$ 21,327
Provision for (reversal of) credit losses	(28,775)	65,600	(94,375)	(33,950)	99,875	(133,825)
Noninterest income	10,242	10,656	(414)	21,566	19,427	2,139
Noninterest expense	57,514	56,622	892	113,302	113,589	(287)
Income (loss) before income taxes	\$ 86,971	\$ (17,464)	\$ 104,435	\$ 151,566	\$ (6,012)	\$ 157,578

The increases in income before income taxes during the three and six months ended June 30, 2021, compared with the same periods in 2020, were primarily due to the combined impact of reversals of credit losses during the first and second quarters of 2021, which reflected improvement in both realized economic results and the macroeconomic outlook, as opposed to significant increases in the provision for credit losses during the first and second quarters of 2020 associated with the adoption of the “current expected credit losses” (CECL) model and the significant market disruption caused by COVID-19. Changes to net interest income related to the component changes in the volume of average interest-earning assets and interest-bearing liabilities and changes in the rates earned or paid on those items are discussed in more detail below.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Efficiency ratio <sup>(1)</sup>	49.71 %	54.05 %	49.07 %	54.75 %
Return on average assets <sup>(2)</sup>	1.91 %	(0.42)%	1.70 %	(0.08)%
Net interest margin <sup>(3)</sup>	3.19 %	3.11 %	3.25 %	3.42 %
Net charge-offs to average loans outstanding <sup>(4)</sup>	0.03 %	0.90 %	0.00 %	0.51 %

(1) Efficiency ratio is defined as noninterest expenses divided by the sum of total noninterest income and net interest income for the period. We consider the efficiency ratio to be a measure of the banking segment’s profitability.

(2) Return on average assets is defined as net income divided by average assets.

(3) Net interest margin is defined as net interest income divided by average interest-earning assets. We consider net interest margin as a key indicator of profitability, as it represents interest earned on interest-earning assets compared to interest incurred.

(4) Net charge-offs to average loans outstanding is defined as the greater of charge-offs during the reported period minus recoveries divided by average loans outstanding. We use the ratio to measure the credit performance of our loan portfolio.

The banking segment presents net interest margin and net interest income in the following discussion and tables below on a taxable equivalent basis. Net interest margin (taxable equivalent), a non-GAAP measure, is defined as taxable equivalent net interest income divided by average interest-earning assets. Taxable equivalent adjustments are based on the applicable corporate federal income tax rate of 21% for all periods presented. The interest income earned on certain earning assets is completely or partially exempt from federal income tax. As such, these tax-exempt instruments typically yield lower returns than taxable investments. To provide more meaningful comparisons of net interest margins for all earning assets, we use net interest income on a taxable equivalent basis in calculating net interest margin by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments.

During the three months ended June 30, 2021 and 2020, purchase accounting contributed 20 and 12 basis points, respectively, to the banking segment’s taxable equivalent net interest margin of 3.20% and 3.12%, respectively. During the six months ended June 30, 2021 and 2020, purchase accounting contributed 18 and 20 basis points, respectively, to the banking segment’s taxable equivalent net interest margin of 3.25% and 3.43%, respectively. These purchase accounting items are primarily related to accretion of discount of loans associated with the Bank Transactions presented in the Consolidated Operating Results section.

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

	Three Months Ended June 30,					
	2021			2020		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
<b>Assets</b>						
Interest-earning assets						
Loans held for investment, gross <sup>(1)</sup>	\$ 7,158,625	\$ 82,987	4.61 %	\$ 7,295,513	\$ 83,408	4.54 %
Subsidiary warehouse lines of credit	2,349,513	22,292	3.75 %	2,109,947	19,898	3.73 %
Investment securities - taxable	1,961,289	7,244	1.48 %	1,243,917	6,677	2.15 %
Investment securities - non-taxable <sup>(2)</sup>	116,391	1,001	3.44 %	114,272	977	3.42 %
Federal funds sold and securities purchased under agreements to resell	413	—	0.14 %	401	—	0.03 %
Interest-bearing deposits in other financial institutions	1,617,437	406	0.10 %	1,335,238	339	0.10 %
Other	36,912	155	1.68 %	40,559	(300)	(2.96)%
Interest-earning assets, gross <sup>(2)</sup>	13,240,580	114,085	3.42 %	12,139,847	110,999	3.63 %
Allowance for credit losses	(143,857)			(101,821)		
Interest-earning assets, net	13,096,723			12,038,026		
Noninterest-earning assets	968,430			992,270		
<b>Total assets</b>	<b>\$ 14,065,153</b>			<b>\$ 13,030,296</b>		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 7,589,397	\$ 8,014	0.42 %	\$ 7,801,882	\$ 16,142	0.83 %
Notes payable and other borrowings	130,157	397	1.22 %	173,888	558	1.28 %
Total interest-bearing liabilities	7,719,554	8,411	0.44 %	7,975,770	16,700	0.84 %
Noninterest-bearing liabilities						
Noninterest-bearing deposits	4,525,940			3,330,573		
Other liabilities	138,282			124,761		
Total liabilities	12,383,776			11,431,104		
Stockholders' equity	1,681,377			1,599,192		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 14,065,153</b>			<b>\$ 13,030,296</b>		
<b>Net interest income</b> <sup>(2)</sup>		<b>\$ 105,674</b>			<b>\$ 94,299</b>	
<b>Net interest spread</b> <sup>(2)</sup>			2.98 %			2.79 %
<b>Net interest margin</b> <sup>(2)</sup>			3.20 %			3.12 %

	Six Months Ended June 30,					
	2021			2020		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
<b>Assets</b>						
Interest-earning assets						
Loans held for investment, gross <sup>(1)</sup>	\$ 7,171,946	\$ 167,506	4.66 %	\$ 7,016,800	\$ 173,337	4.90 %
Subsidiary warehouse lines of credit	2,344,094	44,202	3.75 %	1,788,722	34,333	3.80 %
Investment securities - taxable	1,874,582	13,517	1.44 %	1,228,847	14,079	2.29 %
Investment securities - non-taxable <sup>(2)</sup>	115,734	1,986	3.43 %	110,676	1,877	3.39 %
Federal funds sold and securities purchased under agreements to resell	399	—	0.07 %	480	1	0.22 %
Interest-bearing deposits in other financial institutions	1,452,810	727	0.10 %	815,465	1,246	0.31 %
Other	36,861	229	1.24 %	49,308	251	1.02 %
Interest-earning assets, gross <sup>(2)</sup>	12,996,426	228,167	3.50 %	11,010,298	225,124	4.06 %
Allowance for credit losses	(146,455)			(88,083)		
Interest-earning assets, net	12,849,971			10,922,215		
Noninterest-earning assets	982,294			956,029		
<b>Total assets</b>	<b>\$ 13,832,265</b>			<b>\$ 11,878,244</b>		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 7,550,463	\$ 17,595	0.47 %	\$ 6,912,743	\$ 34,901	1.02 %
Notes payable and other borrowings	139,598	800	1.15 %	248,722	1,823	1.46 %
Total interest-bearing liabilities	7,690,061	18,395	0.48 %	7,161,465	36,724	1.03 %
Noninterest-bearing liabilities						
Noninterest-bearing deposits	4,302,949			3,035,303		
Other liabilities	163,294			112,025		
Total liabilities	12,156,304			10,308,793		
Stockholders' equity	1,675,961			1,569,451		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 13,832,265</b>			<b>\$ 11,878,244</b>		
<b>Net interest income</b> <sup>(2)</sup>		<b>\$ 209,772</b>			<b>\$ 188,400</b>	
<b>Net interest spread</b> <sup>(2)</sup>			3.02 %			3.03 %
<b>Net interest margin</b> <sup>(2)</sup>			3.25 %			3.43 %

(1) Average balance includes non-accrual loans.

(2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on the applicable corporate federal income tax rates of 21% for all the periods presented. The adjustment to interest income was \$0.2 million for both the three months ended June 30, 2021 and 2020, respectively, and \$0.4 million for both the six months ended June 30, 2021 and 2020, respectively.

The banking segment's net interest margin exceeds our consolidated net interest margin. Our consolidated net interest margin includes certain items that are not reflected in the calculation of our net interest margin within our banking segment and reduce our consolidated net interest margin, such as the borrowing costs of Hilltop and the yields and costs associated with certain items within interest-earning assets and interest-bearing liabilities in the broker-dealer segment, including items related to securities financing operations that particularly decrease net interest margin. In addition, the banking segment's interest-earning assets include warehouse lines of credit extended to other subsidiaries, which are eliminated from the consolidated financial statements. The banking segment's net interest margin for the three and six months ended June 30, 2021 and 2020 were negatively impacted by certain actions taken by management during 2020 to strengthen the Bank's available liquidity position. Such actions, including increasing overall cash balances by raising brokered money market and brokered time deposits, were taken out of an abundance of caution in light of the extreme volatility and disruptions in the capital and credit markets beginning in March 2020 resulting from the COVID-19 crisis and its negative impact on the economy.

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).

	<u>Three Months Ended June 30,</u>			<u>Six Months Ended June 30,</u>		
	<u>2021 vs. 2020</u>			<u>2021 vs. 2020</u>		
	<u>Change Due To <sup>(1)</sup></u>			<u>Change Due To <sup>(1)</sup></u>		
	<u>Volume</u>	<u>Yield/Rate</u>	<u>Change</u>	<u>Volume</u>	<u>Yield/Rate</u>	<u>Change</u>
<b>Interest income</b>						
Loans held for investment, gross	\$ (1,549)	\$ 1,128	\$ (421)	\$ 3,770	\$ (9,601)	\$ (5,831)
Subsidiary warehouse lines of credit	2,228	166	2,394	10,465	(596)	9,869
Investment securities - taxable	3,845	(3,278)	567	7,333	(7,895)	(562)
Investment securities - non-taxable <sup>(2)</sup>	18	6	24	85	24	109
Federal funds sold and securities purchased under agreements to resell	—	—	—	—	(1)	(1)
Interest-bearing deposits in other financial institutions	70	(3)	67	980	(1,499)	(519)
Other	27	428	455	(63)	41	(22)
<b>Total interest income <sup>(2)</sup></b>	<b>4,639</b>	<b>(1,553)</b>	<b>3,086</b>	<b>22,570</b>	<b>(19,527)</b>	<b>3,043</b>
<b>Interest expense</b>						
Deposits	\$ (440)	\$ (7,688)	\$ (8,128)	\$ 3,226	\$ (20,532)	\$ (17,306)
Notes payable and other borrowings	(140)	(21)	(161)	(790)	(233)	(1,023)
<b>Total interest expense</b>	<b>(580)</b>	<b>(7,709)</b>	<b>(8,289)</b>	<b>2,436</b>	<b>(20,765)</b>	<b>(18,329)</b>
<b>Net interest income <sup>(2)</sup></b>	<b>\$ 5,219</b>	<b>\$ 6,156</b>	<b>\$ 11,375</b>	<b>\$ 20,134</b>	<b>\$ 1,238</b>	<b>\$ 21,372</b>

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

(2) Annualized taxable equivalent.

Changes in the yields earned on interest-earning assets decreased taxable equivalent net interest income during the three and six months ended June 30, 2021, compared to the same periods in 2020, primarily as a result of lower loan yields due to decreased market rates and lower reinvestment yields on the securities portfolio, partially offset by increases in PPP loan-related fee income of \$4.6 million and \$12.1 million and accretion of discount on loans of \$2.8 million and \$1.0 million, respectively. While accretion of discount on loans increased between periods, it is expected to decrease in future periods as loans acquired in the Bank Transactions are repaid, refinanced or renewed. Changes in the volume of interest-earning assets, primarily due to the increases in mortgage warehouse lending volume and investment securities portfolio, increased taxable equivalent net interest income during the three and six months ended June 30, 2021, compared with the same periods in 2020. Changes in rates paid on interest-bearing liabilities increased taxable equivalent net interest income during the three and six months ended June 30, 2021, compared with the same periods in 2020, due to decreases in market interest rates. Our portfolio includes loans that periodically reprice or mature prior to the end of an amortized term. Some of our variable-rate loans remain at applicable rate floors, which may delay and/or limit changes in net interest income during a period of changing rates. If interest rates were to fall further, the impact on our net interest income for certain variable-rate loans would be limited by these rate floors. In addition, declining interest rates may reduce our cost of funds on deposits. The extent of this impact will ultimately be driven by the timing,

magnitude and frequency of interest rate and yield curve movements, as well as changes in market conditions and timing of management strategies. If interest rates were to rise, yields on the portion of our loan portfolio that remain at applicable rate floors would rise more slowly than increases in market interest rates. Any changes in interest rates across the term structure will continue to impact net interest income and net interest margin. The impact of rate movements will change with the shape of the yield curve, including any changes in steepness or flatness and inversions at any points on the yield curve.

In response to the COVID-19 pandemic, the Bank implemented several actions to better support our impacted banking clients. Such programs include loan modifications such as principal and/or interest payment deferrals, participation in the PPP as an SBA preferred lender and personal banking assistance including waived fees, increased daily spending limits and suspension of residential foreclosure activities. The adverse economic conditions caused by the COVID-19 pandemic negatively impacted the banking segment's business and results of operations, including significantly reduced demand for loan products and services from customers, recognition of credit losses and increases in allowance for credit losses. In the event future operating performance is below our projections, there are negative changes to the projected provision for credit losses on loans, or long-term loan and deposit growth rates or discount rates increase, the estimated fair value of the banking reporting unit may decline below carrying value, and we may be required to record a goodwill impairment charge. Additionally, with respect to its core deposit intangible assets, in the event that the deposit retention levels and derived cost savings from available core deposits at the Bank relative to an alternative cost of funds falls to a level that cannot support the remaining carrying value, we may be required to record an impairment charge. We will continue to monitor developments regarding the COVID-19 pandemic and measures implemented in response to the pandemic, market capitalization, overall economic conditions, effectiveness of vaccinations, government stimulus, payment deferral programs and any other triggering events or circumstances that may indicate an impairment in the future. See further detail in the "Recent Developments" section above.

The banking segment retained approximately \$181.1 million and \$12.0 million during the three months ended June 30, 2021 and 2020, respectively, and \$339.8 million and \$142.6 million during the six months ended June 30, 2021 and 2020, respectively, in mortgage loans originated by the mortgage origination segment. These loans are purchased by the banking segment at par. For origination services provided, the banking segment reimburses the mortgage origination segment for direct origination costs associated with these mortgage loans, in addition to payment of a correspondent fee. The correspondent fees are eliminated in consolidation. In March 2020, the Bank made a decision to sell the previously purchased mortgage loans to the mortgage origination segment, instead of holding them for investment. In October 2020, the Bank restarted purchasing and retaining mortgage loans originated by the mortgage origination segment. During 2021, we expect loans originated by the mortgage origination segment on behalf of and retained by the banking segment to increase based on approved authority for up to 5% of the mortgage origination segment's total origination volume. The determination of mortgage loan retention levels by the banking segment will be impacted by, among other things, an ongoing review of the prevailing mortgage rates, balance sheet positioning at Hilltop and the banking segment's outlook for commercial loan growth.

The banking segment's provision for (reversal of) credit losses has been subject to significant year-over-year and quarterly changes primarily attributable to the effects of the deteriorating economic outlook associated with the impact of the market disruption caused by the COVID-19 pandemic beginning in March 2020, and then the reduction in reserves associated with improvements in macroeconomic forecast assumptions. Specifically, the banking segment's provision for credit losses and associated significant increase in the allowance for credit losses during the three and six months ended June 30, 2020 included provision for credit losses on individually evaluated loans of \$6.2 million and \$23.8 million, respectively, while the provision for credit losses on expected losses of collectively evaluated loans accounted for \$59.9 million and \$76.6 million, respectively, primarily due to the increase in the expected lifetime credit losses under CECL attributable to the deteriorating economic outlook associated with the impact of the market disruption caused by the COVID-19 pandemic. The changes in the allowance for credit losses during the noted periods were also attributable to other factors including, but not limited to, loan growth, loan mix and changes in risk rating grades. The change in the allowance during the three and six months ended June 30, 2020 was also impacted by net charge-offs of \$16.4 million and \$17.9 million, respectively, primarily associated with loans specifically reserved for during the first quarter of 2020.

During the three and six months ended June 30, 2021, the banking segment had net reversals of credit losses on expected losses of collectively evaluated loans of \$27.7 million and \$34.2 million, respectively, primarily due to improvements in the macroeconomic forecast assumptions and positive risk rating grade migration, including a high concentration of credits within the restaurant and commercial real estate industry sectors. The net impact to the allowance of changes

associated with individually evaluated loans during the three months ended June 30, 2021 was a reversal of credit losses of \$1.1 million, while the six months ended June 30, 2021 included a provision of credit losses of \$0.3 million. The changes in the allowance for credit losses during the noted periods also reflected other factors including, but not limited to, loan mix, and changes in loan balances and qualitative factors from the prior quarter. The changes in the allowance for credit losses during the three months ended June 30, 2021 were also impacted by net charge-offs of \$0.5 million, while the six months ended June 30, 2021 included net recoveries of \$0.1 million. Refer to the discussion in the “Financial Condition – Allowance for Credit Losses on Loans” section that follows for more details regarding the significant assumptions and estimates involved in estimating credit losses.

The banking segment’s noninterest income increased during the six months ended June 30, 2021, compared to the same period in 2020, primarily due to increased other real estate owned (“OREO”) income as well as changes in our intercompany financing charges.

The banking segment’s noninterest expense increased during the three months ended June 30, 2021, compared to the same period in 2020, primarily due to increases in FDIC assessment and OREO expenses partially offset by a decrease in the reserve for unfunded commitments attributable to year-over-year improvements in loan expected loss rates as well as reductions in salary and employee benefits, legal, and business development expenses.

## Broker-Dealer Segment

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

	<u>Three Months Ended June 30,</u>		<u>Variance</u>	<u>Six Months Ended June 30,</u>		<u>Variance</u>
	<u>2021</u>	<u>2020</u>	<u>2021 vs 2020</u>	<u>2021</u>	<u>2020</u>	<u>2021 vs 2020</u>
<b>Net interest income:</b>						
Wealth management:						
Securities lending	\$ 3,241	\$ 2,087	\$ 1,154	\$ 6,727	\$ 4,137	\$ 2,590
Clearing services	1,784	1,992	(208)	3,233	4,570	(1,337)
Structured finance <sup>(5)</sup>	477	1,650	(1,173)	873	4,573	(3,700)
Fixed income services	4,185	3,159	1,026	8,313	5,683	2,630
Other <sup>(5)</sup>	995	775	220	2,050	3,873	(1,823)
Total net interest income	10,682	9,663	1,019	21,196	22,836	(1,640)
<b>Noninterest income:</b>						
Securities commissions and fees by business line <sup>(1)</sup> :						
Fixed income services	15,239	12,617	2,622	28,913	25,773	3,140
Wealth management:						
Retail <sup>(5)</sup>	18,035	16,046	1,989	36,789	36,398	391
Clearing services	5,580	7,959	(2,379)	11,822	16,965	(5,143)
Structured finance <sup>(5)</sup>	337	752	(415)	671	1,164	(493)
Other <sup>(5)</sup>	843	994	(151)	1,887	2,054	(167)
Total noninterest income	40,034	38,368	1,666	80,082	82,354	(2,272)
Investment and securities advisory fees and commissions by business line:						
Public finance services <sup>(5)</sup>	23,187	21,054	2,133	40,650	37,561	3,089
Fixed income services <sup>(5)</sup>	212	1,622	(1,410)	2,116	1,408	708
Wealth management:						
Retail	7,781	5,063	2,718	15,031	11,044	3,987
Clearing services	563	329	234	1,008	709	299
Structured finance <sup>(5)</sup>	446	968	(522)	1,002	1,409	(407)
Other	79	84	(5)	156	169	(13)
Total noninterest income	32,268	29,120	3,148	59,963	52,300	7,663
Other:						
Structured finance	10,248	43,091	(32,843)	34,799	52,448	(17,649)
Fixed income services	(1,089)	11,438	(12,527)	4,946	22,182	(17,236)
Other	2,002	944	1,058	2,296	(114)	2,410
Total noninterest income	11,161	55,473	(44,312)	42,041	74,516	(32,475)
Total noninterest income	83,463	122,961	(39,498)	182,086	209,170	(27,084)
Net revenue <sup>(2)</sup>	94,145	132,624	(38,479)	203,282	232,006	(28,724)
<b>Noninterest expense:</b>						
Variable compensation <sup>(3)</sup>	34,409	52,372	(17,963)	71,820	84,396	(12,576)
Non-variable compensation and benefits <sup>(5)</sup>	27,880	27,475	405	56,626	52,167	4,459
Segment operating costs <sup>(4)(5)</sup>	25,000	24,990	10	50,313	49,487	826
Total noninterest expense	87,289	104,837	(17,548)	178,759	186,050	(7,291)
<b>Income before income taxes</b>	<b>\$ 6,856</b>	<b>\$ 27,787</b>	<b>\$ (20,931)</b>	<b>\$ 24,523</b>	<b>\$ 45,956</b>	<b>\$ (21,433)</b>

- (1) Securities commissions and fees includes income of \$1.7 million and \$4.1 million during the three months ended June 30, 2021 and 2020, respectively, and \$3.5 million and \$8.1 million during the six months ended June 30, 2021 and 2020, respectively, that is eliminated in consolidation.
- (2) Net revenue is defined as the sum of total net interest income and total noninterest income. We consider net revenue to be a key performance measure in the evaluation of the broker-dealer segment's financial position and operating performance as we believe it is the primary revenue performance measure used by investors and analysts. Net revenue provides for some level of comparability of trends across the financial services industry as it reflects both noninterest income, including investment and securities advisory fees and commissions, as well as net interest income. Internally, we assess the broker-dealer segment's performance on a revenue basis for comparability with our banking segment.
- (3) Variable compensation represents performance-based commissions and incentives.
- (4) Segment operating costs include provision for credit losses associated with the broker-dealer segment within other noninterest expenses.
- (5) Noted balances during all prior periods include certain reclassifications to conform to current period presentation.

During the second quarter of 2021, the broker-dealer segment's structured finance business and fixed income services lines experienced a combined \$45.2 million decrease in net revenues. Structured finance business line net revenues declined \$34.9 million compared to the second quarter of 2020 due to lower production volumes and rate volatility. Fixed income services business line net revenues decreased \$10.3 million, compared with the same period in 2020, which included a decrease of \$12.5 million in net gains from trading activities. Partially offsetting these declines in net revenues were the broker-dealer segment's public finance services and wealth management business lines which experienced a combined \$5.8 million increase in net revenues. The improvement in the public finance business line's net revenue reflects favorable issuance trends both nationally and in Texas. The wealth management business line's net revenues were slightly higher in the three months ended June 30, 2021, compared to the same period in 2020, as improved production and fee income offset declines in rate sensitive administrative fees.

The decreases in the broker-dealer segment's income before income taxes during the three and six months ended June 30, 2021, compared with the same periods in 2020, were primarily as a result of the following:

- a \$34.9 million and \$22.2 million decrease, respectively, in the broker-dealer segment's structured finance net revenues. For the three and six months ended June 30, 2021, structured finance net revenues declined in line with decreased volumes and a volatile interest rate environment resulting in a \$32.8 million and \$17.6 million respective decreases in the business line's other noninterest income compared to the same periods in 2020.
- a \$10.3 million and \$10.8 million decrease, respectively, in the broker-dealer segment's fixed income services net revenues. The decline in fixed income services net revenues primarily resulted from the \$12.5 million and \$17.2 million, respective declines in the business line's other noninterest income compared to the same periods in 2020. During the three and six months ended June 30, 2020, the fixed income business line performed well across all asset classes as a result of robust customer demand and active position management. For the three months ended June 30, 2021, the broker-dealer segment experienced net revenue declines in each trading division. For the six months ended June 30, 2021, the broker-dealer segment experienced net revenue declines in the mortgage and taxable divisions, partially offset by improvement in the municipal division. These declines were a result of less robust customer demand and a less favorable trading environment. Additionally, for the six month comparable period, the decline also included a \$1.6 million decrease in net revenues due to the wind-down of the equity capital market division.
- a \$17.6 million and \$8.1 million decrease, respectively, in compensation expense, of which \$18.0 million and \$12.6 million was due to the decrease in variable compensation primarily resulting from decreases in our structured finance and fixed income business line revenues.

The broker-dealer segment is subject to interest rate risk as a consequence of maintaining inventory positions, trading in interest rate sensitive financial instruments and maintaining a matched stock loan book. Changes in interest rates are likely to have a meaningful impact on our overall financial performance. Our broker-dealer segment has historically earned a significant portion of its revenues from advisory fees upon the successful completion of client transactions, which could be adversely impacted by interest rate volatility. Rapid or significant changes in interest rates could adversely affect the broker-dealer segment's bond trading, sales, underwriting activities and other interest spread-sensitive activities described below. The broker-dealer segment also receives administrative fees for providing money market and FDIC investment alternatives to clients, which tend to be sensitive to short term interest rates. In addition, the profitability of the broker-dealer segment depends, to an extent, on the spread between revenues earned on customer loans and excess customer cash balances, and the interest expense paid on customer cash balances, as well as the interest revenue earned on trading securities, net of financing costs.

In the broker-dealer segment, interest is earned from securities lending activities, interest charged on customer margin loan balances and interest earned on investment securities used to support sales, underwriting and other customer activities. The increase in net interest income during the three months ended June 30, 2021, compared with the same period in 2020, was primarily due to the income in net interest income from our structured finance business and the net interest earned from our securities lending division of our wealth management business line with a 35 basis point increase in the net interest spread. The decrease in net interest income during the six months ended June 30, 2021, compared with the same period in 2020, was primarily due to decreases in net interest income from our structured finance business and the interest earned from customer activities. With the 59 basis point decrease in the six-month weighted average Federal Funds interest rate from June 30, 2020 to June 30, 2021, the amount of interest earned on customer investment activities decreased as well. This decrease was partially offset by an increase in net interest earned from the broker-dealer's taxable securities and our stock lending business. The net interest spread in our stock lending business increased 28 basis points from June 30, 2020 to June 30, 2021.

Noninterest income decreased during the three and six months ended June 30, 2021, compared to the same periods in 2020, primarily due to decreases in other noninterest income, partially offset by the increases in securities commissions and fees and investment banking and advisory fees and commissions for the three months ended June 30, 2021 and partially offset by the increase in investment and securities advisory fees and commissions for the six months ended June 30, 2021.

Securities commissions and fees increased during the three months ended June 30, 2021, compared with the same period in 2020, primarily due to increases in commissions earned in mutual fund and insurance product sales transactions.

These increases were partially offset by a decrease in commissions earned in our wealth management line of business given declines in our money market and FDIC sweep revenues of \$3.3 million. Securities commissions and fees decreased during the six months ended June 30, 2021, compared with the same period in 2020, primarily due to a decrease in commissions earned in our wealth management line of business given declines in our money market and FDIC sweep revenues of \$7.9 million. These decreases were partially offset by an increase in commissions earned on sales transactions within our fixed income business line, primarily from the sale of municipal bonds and mortgage backed securities offset by decreases in commissions earned from sales of OTC corporate bond securities and our wind-down of the equity capital markets division.

Investment and securities advisory fees and commissions increased during the three and six months ended June 30, 2021, compared with the same periods in 2020, primarily due to increases in fees earned from our public finance business line with increases in fees received for municipal transactions and from our wealth management business line with increases in management fees from advisory services.

Other noninterest income decreased during the three and six months ended June 30, 2021, compared with the same periods in 2020, primarily due to decreases in trading gains earned from our structured finance business line's derivative activities due to decreased volumes and interest rate volatility. These year-over-year decreases in other noninterest income were heightened by decreases within our fixed income services business line within our taxable and municipal securities trading portfolios.

Noninterest expenses decreased during the three and six months ended June 30, 2021, compared to the same periods in 2020, primarily due to decreases in variable compensation as previously noted, partially offset by increased expenses in 2021 associated with the deployment of the new back-office system.

Selected information concerning the broker-dealer segment, including key performance indicators, follows (dollars in thousands).

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Total compensation as a % of net revenue <sup>(1)</sup>	66.2 %	60.2 %	63.2 %	58.9 %
Pre-tax margin <sup>(2)</sup>	7.3 %	21.0 %	12.1 %	19.8 %
FDIC insured program balances at the Bank (end of period)			\$ 721,472	\$ 1,300,155
Other FDIC insured program balances (end of period)			\$ 1,627,673	\$ 1,014,400
Customer funds on deposit, including short credits (end of period)			\$ 454,165	\$ 430,388
Public finance services:				
Number of issues	388	379	625	596
Aggregate amount of offerings	\$ 14,712,647	\$ 14,784,486	\$ 30,618,795	\$ 26,177,625
Structured finance:				
Lock production/TBA volume	\$ 1,784,094	\$ 2,070,420	\$ 3,717,308	\$ 4,024,902
Fixed income services:				
Total volumes	\$ 67,695,308	\$ 27,853,061	\$ 131,025,503	\$ 53,444,078
Net inventory (end of period)			\$ 549,385	\$ 590,368
Wealth management (Retail and Clearing services groups):				
Retail employee representatives (end of period)			107	119
Independent registered representatives (end of period)			187	191
Correspondents (end of period)			124	137
Correspondent receivables (end of period)			\$ 295,908	\$ 162,495
Customer margin balances (end of period)			\$ 332,414	\$ 259,972
Wealth management (Securities lending group):				
Interest-earning assets - stock borrowed (end of period)			\$ 1,336,847	\$ 1,112,826
Interest-bearing liabilities - stock loaned (end of period)			\$ 1,260,158	\$ 982,070

(1) Total compensation includes the sum of non-variable compensation and benefits and variable compensation. We consider total compensation as a percentage of net revenue to be a key performance measure and indicator of segment profitability.

(2) Pre-tax margin is defined as income before income taxes divided by net revenue. We consider pre-tax margin to be a key performance measure given its use as a profitability metric representing the percentage of net revenue earned that results in a profit.



## Mortgage Origination Segment

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

	Three Months Ended June 30,		Variance	Six Months Ended June 30,		Variance
	2021	2020	2021 vs 2020	2021	2020	2021 vs 2020
Net interest income (expense)	\$ (5,953)	\$ (1,667)	\$ (4,286)	\$ (13,051)	\$ (1,299)	\$ (11,752)
Noninterest income	241,965	340,487	(98,522)	552,409	519,455	32,954
Noninterest expense	186,963	200,493	(13,530)	397,297	340,045	57,252
Income before income taxes	\$ 49,049	\$ 138,327	\$ (89,278)	\$ 142,061	\$ 178,111	\$ (36,050)

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

Recent trends, as well as typical historical patterns in loan origination volume from purchases of homes or from refinancings as a result of movements in mortgage interest rates, may not be indicative of future loan origination volumes given continued economic uncertainties stemming from the COVID-19 pandemic. The mortgage origination segment's business is dependent upon the willingness and ability of its employees and customers to conduct mortgage transactions. Current home inventory levels, affordability challenges, and supply chain problems related to new home construction have impacted customers' abilities to purchase homes. Home inventory shortages and affordability challenges present prior to 2020 were amplified by the economic impact of COVID-19, while supply chain problems can be more directly tied to COVID-19. The continuing impact of the COVID-19 pandemic on customers could have a material adverse effect on the operations of the mortgage origination segment. In addition, a further increase in mortgage interest rates and/or continuing home inventory shortages and supply chain issues related to new home construction could adversely affect loan origination volume and/or alter the percentage mix of refinancing and purchase volumes relative to total loan origination volume compared to 2020.

Since March 2020, economic uncertainties resulting from the spread of COVID-19 have had disruptive effects on the financial markets in which the mortgage origination segment operates as well as the global economy. In response to the COVID-19 pandemic, the U.S. 10 Year Treasury Rate declined significantly during the first quarter of 2020, which was followed by a steady decrease in mortgage interest rates during the remainder of 2020. Since December 2020, mortgage rates have increased, but remained lower during 2021 compared to the same period in 2020. As discussed in the "Recent Developments" section above, while the impact of the pandemic and the uncertainties have remained into 2021, significant progress associated with COVID-19 vaccination levels for Americans has resulted in easing of restrictive measures in the United States. Further, the U.S. federal government has continued to enact policies to provide fiscal stimulus to the economy and relief to those affected by the pandemic.

Income before income taxes decreased \$89.3 million, or 64.5%, during the three months ended June 30, 2021, compared with the same period in 2020. This decrease was primarily the result of a decrease in interest rate lock commitments ("IRLCs") related to a decrease in mortgage loan applications, and to a greater extent a decrease in the average value of individual IRLCs. During the six months ended June 30, 2021, income before income taxes decreased \$36.1 million, or 20.2%. This decrease was primarily the result of a decrease in IRLCs related to decrease in mortgage loan applications, a decrease in the average value of individual IRLCs, and an increase in variable compensation primarily driven by an increase in loan origination volume.

The CARES Act provides borrowers the ability to request forbearance of residential mortgage loan payments, placing a significant strain on mortgage servicers as they may be required to fund missed or deferred payments related to loans in forbearance. A significant increase in nationwide forbearance requests that began in March 2020 resulted in the reduction of third-party mortgage servicers willing to purchase mortgage servicing rights. As a result of this market dynamic, beginning in the second quarter of 2020, we increased the amount of retained servicing on mortgage loans sold, as discussed in more detail below. Beginning in the fourth quarter of 2020 and continuing into the second quarter of 2021, PrimeLending has reduced the amount of retained servicing. However, amounts retained during the second

quarter of 2021 continued to exceed amounts retained prior to the second quarter of 2020. PrimeLending utilizes a third-party to manage its servicing portfolio, and we therefore do not expect significant fluctuations in infrastructure costs to manage changes in PrimeLending's servicing portfolio. PrimeLending's liquidity has not been, and we do not expect that it will be significantly impacted by forbearance requests resulting from the CARES Act. GNMA, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation may impose restrictions on loans the agencies will accept, including loans under a forbearance agreement, which could result in PrimeLending seeking non-agency investors or choosing to retain these loans.

Although average mortgage interest rates declined between both the three and six month ended June 30, 2021, as compared to the same periods of 2020, refinancing volume as a percentage of total origination volume decreased during both periods. Refinancing volume during the three months ended June 30, 2021, decreased to 31.9% from 47.5% during the same period in 2020, while refinancing volume during the six months ended June 30, 2021, decreased slightly to 42.7% from 42.9% during the same period in 2020. While a decrease in mortgage interest rates typically leads to an increase in refinancing volume, significant refinancing activity during 2020 resulted in a decrease in the total market population of loans eligible for a rate/term refinance, which contributed to altering this trend during both periods. In addition, the mortgage origination segment's history of selling substantially all mortgage loans it originates to various investors in the secondary market servicing released, results in a relatively small servicing portfolio available to be refinanced compared to larger servicing aggregators. If current mortgage interest rates remain relatively unchanged through December 31, 2021, we anticipate a lower percentage of refinancing volume relative to total loan origination volume during the last two quarters of 2021 as compared to the last two quarters of 2020. However, a higher refinance percentage could be driven by a slowing of purchase volume due to the negative impact on new and existing home sales resulting from existing home inventory shortages, affordability challenges, and supply chain problems related to new home construction.

The mortgage origination segment primarily originates its mortgage loans through a retail channel, with limited lending through its affiliated business arrangements ("ABAs"). For the six months ended June 30, 2021, funded volume through ABAs was approximately 5% of the mortgage origination segment's total loan volume. As of June 30, 2021, PrimeLending owned a greater than 50% membership interest in three ABAs. We expect total production within the ABA channel to increase slightly to 7% of loan volume of the mortgage origination segment during the remainder of 2021.

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

	Three Months Ended June 30,				Variance 2021 vs 2020	Six Months Ended June 30,				Variance 2021 vs 2020
	2021		2020			2021		2020		
	Amount	% of Total	Amount	% of Total		Amount	% of Total	Amount	% of Total	
Mortgage Loan Originations - units	19,991		22,391		(2,400)	41,732		36,129		5,603
Mortgage Loan Originations - volume	\$ 5,900,043		\$ 6,099,059		\$ (199,016)	\$ 12,084,149		\$ 9,721,647		\$ 2,362,502
Mortgage Loan Originations:										
Conventional	\$ 4,055,964	68.75 %	\$ 4,266,105	69.95 %	\$ (210,141)	\$ 8,538,727	70.66 %	\$ 6,582,091	67.71 %	\$ 1,956,636
Government	873,453	14.80 %	1,432,122	23.48 %	(558,669)	1,676,625	13.88 %	2,322,298	23.89 %	(645,673)
Jumbo	731,798	12.40 %	217,016	3.56 %	514,782	1,439,341	11.91 %	461,475	4.75 %	977,866
Other	238,828	4.05 %	183,816	3.01 %	55,012	429,456	3.55 %	355,783	3.65 %	73,673
	<u>\$ 5,900,043</u>	<u>100.00 %</u>	<u>\$ 6,099,059</u>	<u>100.00 %</u>	<u>\$ (199,016)</u>	<u>\$ 12,084,149</u>	<u>100.00 %</u>	<u>\$ 9,721,647</u>	<u>100.00 %</u>	<u>\$ 2,362,502</u>
Home purchases	\$ 4,018,922	68.12 %	\$ 3,204,573	52.54 %	\$ 814,349	\$ 6,921,632	57.28 %	\$ 5,546,421	57.05 %	\$ 1,375,211
Refinancings	1,881,121	31.88 %	2,894,486	47.46 %	(1,013,365)	5,162,517	42.72 %	4,175,226	42.95 %	987,291
	<u>\$ 5,900,043</u>	<u>100.00 %</u>	<u>\$ 6,099,059</u>	<u>100.00 %</u>	<u>\$ (199,016)</u>	<u>\$ 12,084,149</u>	<u>100.00 %</u>	<u>\$ 9,721,647</u>	<u>100.00 %</u>	<u>\$ 2,362,502</u>
Texas	\$ 1,094,085	18.54 %	\$ 1,149,799	18.85 %	\$ (55,714)	\$ 2,170,977	17.97 %	\$ 1,855,156	19.08 %	\$ 315,821
California	730,421	12.38 %	636,294	10.43 %	94,127	1,525,481	12.62 %	1,016,357	10.45 %	509,124
Arizona	266,816	4.52 %	277,131	4.54 %	(10,315)	557,251	4.61 %	451,855	4.65 %	105,396
Florida	271,973	4.61 %	432,339	7.09 %	(160,366)	552,880	4.57 %	703,523	7.24 %	(150,643)
South Carolina	264,222	4.48 %	245,464	4.02 %	18,758	525,440	4.35 %	397,309	4.09 %	128,131
Ohio	227,592	3.86 %	235,788	3.87 %	(8,196)	450,231	3.73 %	361,982	3.72 %	88,249
North Carolina	192,436	3.26 %	192,994	3.16 %	(558)	418,902	3.47 %	306,639	3.15 %	112,263
Washington	176,333	2.99 %	183,315	3.01 %	(6,982)	391,793	3.24 %	306,357	3.15 %	85,436
Maryland	194,877	3.30 %	217,412	3.56 %	(22,535)	389,990	3.23 %	350,782	3.61 %	39,208
Missouri	179,969	3.05 %	209,861	3.44 %	(29,892)	368,981	3.05 %	325,520	3.35 %	43,461
All other states	2,301,319	39.01 %	2,318,662	38.03 %	(17,343)	4,732,223	39.16 %	3,646,167	37.51 %	1,086,056
	<u>\$ 5,900,043</u>	<u>100.00 %</u>	<u>\$ 6,099,059</u>	<u>100.00 %</u>	<u>\$ (199,016)</u>	<u>\$ 12,084,149</u>	<u>100.00 %</u>	<u>\$ 9,721,647</u>	<u>100.00 %</u>	<u>\$ 2,362,502</u>
Mortgage Loan Sales - volume:										
Third parties	\$ 5,343,169	96.72 %	\$ 5,922,884	99.80 %	\$ (579,715)	\$ 11,535,242	97.14 %	\$ 9,278,573	98.49 %	\$ 2,256,669
Banking segment	181,057	3.28 %	12,030	0.20 %	169,027	339,821	2.86 %	142,590	1.51 %	197,231
	<u>\$ 5,524,226</u>	<u>100.00 %</u>	<u>\$ 5,934,914</u>	<u>100.00 %</u>	<u>\$ (410,688)</u>	<u>\$ 11,875,063</u>	<u>100.00 %</u>	<u>\$ 9,421,163</u>	<u>100.00 %</u>	<u>\$ 2,453,900</u>

We consider the mortgage origination segment's total loan origination volume to be a key performance measure. Loan origination volume is central to the segment's ability to generate income by originating and selling mortgage loans, resulting in net gains from the sale of loans, mortgage loan origination fees, and other mortgage production income. Total loan origination volume is a measure utilized by management, our investors and analysts in assessing market share and growth of the mortgage origination segment.

The mortgage origination segment's total loan origination volume during the three and six months ended June 30, 2021, decreased 3.3% and increased 24.3% compared to the same periods in 2020, respectively, while income before income taxes decreased 64.5% and 20.2%, respectively, during the same periods. The decrease in income before income taxes during the three and six months ended June 30, 2021, was primarily the result of a decrease of IRLCs related to a decrease in mortgage loan applications, and a decrease in the average value of individual IRLCs. Also contributing to the decrease during the six months ended June 30, 2021, was an increase in variable compensation primarily driven by an increase in loan origination volume.

Net interest expense during the three and six months ended June 30, 2021 and 2020 was comprised of interest income earned on loans held for sale offset by interest incurred on warehouse lines of credit primarily held with the Bank, and related intercompany financing costs. The decrease in net interest expense during the three and six months ended June 30, 2021 and 2020 included the effects of decreased net yields on mortgage loans held for sale between the two periods.

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

	<b>Three Months Ended June 30,</b>		<b>Variance</b>	<b>Six Months Ended June 30,</b>		<b>Variance</b>
	<b>2021</b>	<b>2020</b>	<b>2021 vs 2020</b>	<b>2021</b>	<b>2020</b>	<b>2021 vs 2020</b>
Net gains from sale of loans	\$ 200,882	\$ 218,274	\$ (17,392)	\$ 447,470	\$ 331,590	\$ 115,880
Mortgage loan origination fees and other related income	42,146	45,361	(3,215)	85,301	74,138	11,163
Other mortgage production income:						
Change in net fair value and related derivative activity:						
IRLCs and loans held for sale	(19,766)	79,916	(99,682)	(24,372)	113,943	(138,315)
Mortgage servicing rights asset	2,553	(8,182)	10,735	11,685	(11,209)	22,894
Servicing fees	16,150	5,118	11,032	32,325	10,993	21,332
Total noninterest income	<u>\$ 241,965</u>	<u>\$ 340,487</u>	<u>\$ (98,522)</u>	<u>\$ 552,409</u>	<u>\$ 519,455</u>	<u>\$ 32,954</u>

The decrease in net gains from sale of loans during the three months ended June 30, 2021, compared with the same period in 2020, was primarily a result of a decrease in total loan sales volume, in addition to a decrease in average loan sales margin. The increase in net gains from sale of loans during the six months ended June 30, 2021, compared with the same period in 2020, was primarily a result of an increase in total loan sales volume, in addition to an increase in average loan sales margin. Since PrimeLending sells substantially all mortgage loans it originates to various investors in the secondary market, the increase in loan sales volume during the six months ended June 30, 2021, is consistent with the increase in loan origination volume during the period. The increase in average loans sales margin during the six months ended June 30, 2021, was primarily driven by PrimeLending managing increased loan origination volumes to a level that could be supported by its loan fulfillment operations and addressing anticipated enhanced credit and liquidity risks triggered by the economic impact of the COVID-19 pandemic beginning in the second quarter of 2020. While average loan sales margins increased between the second and fourth quarters of 2020, margins have steadily declined during the six months ended June 30, 2021, approaching margins recognized at the beginning of the COVID-19 pandemic. The increase in mortgage loan origination fees during the six months ended June 30, 2021, compared with the same period in 2020, was primarily the result of an increase in loan origination volume, partially offset by a decrease in average mortgage loan origination fees.

We consider the mortgage origination segment's net gains from sale of loans margin, in basis points, to be a key performance measure. Net gains from sale of loans margin is defined as net gains from sale of loans divided by loan sales volume. The net gains from sale of loans is central to the segment's generation of income. The mortgage origination segment's net gains from sale of loans margin, including loans sold to and retained by the banking segment, during the three months ended June 30, 2021 and 2020, was 364 bps and 368 bps, respectively. The mortgage origination segment's net gains from sale of loans margin, including loans sold to and retained by the banking segment, during the six months ended June 30, 2021 and 2020, was 377 bps and 352 bps, respectively. During the three months ended June 30, 2021 and 2020, the mortgage origination segment originated approximately \$181.1 million and \$12.0 million, respectively, in loans on behalf of the banking segment, representing 3.3% and 0.2%, respectively, of PrimeLending's total loan origination volume during each respective period. During the six months ended June 30, 2021 and 2020, the mortgage origination segment originated approximately \$339.8 million and \$142.6 million, respectively, in loans on behalf of the banking segment, representing 2.9% and 1.5%, respectively, of PrimeLending's total loan origination volume during each respective period. These loans were sold to the banking segment at par. For origination services provided, the mortgage origination segment was reimbursed direct origination costs associated with these loans, in addition to payment of a correspondent fee. The reimbursed origination costs and correspondent fee are included in the mortgage origination segment operating results, and the correspondent fees are eliminated in consolidation. The impact of loans sold to and retained by the banking segment at par was a decrease to the net gains from sale of loans margin of 12 basis points and 1 basis point during the three months ended June 30, 2021 and 2020, respectively, and a decrease of 11 basis points and 3 basis points during the six months ended June 30, 2021 and 2020, respectively. Loan volumes to be originated on behalf of and retained by the banking segment are evaluated each quarter. While we anticipate an increase in loans sold to and retained by the banking segment during the remainder of 2021, we do not expect these sales to exceed 5% of total origination volume during this time. In March 2020, the mortgage origination segment executed a letter of intent with the banking segment to purchase mortgage loans previously sold to and retained by the banking segment with an unpaid principal balance of approximately \$210 million. Such original sales of approximately \$121 million are reflected in the previous mortgage loan details table within the mortgage loan sales volume to the banking segment during the six months ended June 30, 2020. The remaining \$91 million of such original sales were sold to the banking segment during 2019. When these loans were sold at par by the mortgage origination segment, the banking segment's intent was to hold these loans for investment. The mortgage origination segment completed the repurchase of these loans from the banking segment and in turn sold the loans to investors in the secondary market during the second quarter of 2020.

Noninterest income included changes in the net fair value of the mortgage origination segment's IRLCs and loans held for sale and the related activity associated with forward commitments used by the mortgage origination segment to mitigate interest rate risk associated with its IRLCs and mortgage loans held for sale. The decrease during the three and six months ended June 30, 2021 was the result of decreases in the total volume of individual IRLCs and loans held for sale and the average value of individual IRLCs and loans held for sale.

The mortgage origination segment sells substantially all mortgage loans it originates to various investors in the secondary market, historically with the majority servicing released. In addition, the mortgage origination segment originates loans on behalf of the Bank. The mortgage origination segment's determination of whether to retain or release servicing on mortgage loans it sells is impacted by, among other things, changes in mortgage interest rates, and refinancing and market activity. During the three and six months ended June 30, 2021, PrimeLending retained servicing on 25% and 39% of loans sold, respectively. Beginning in the second quarter of 2020, we increased the amount of retained servicing on mortgage loan sales. During both the second and third quarters of 2020, PrimeLending retained servicing on 89% of total mortgage loans sold. The increase in rates of retained servicing during this time was due to the reduction in third-party servicing outlets during the second quarter of 2020 resulting from the impact of the CARES Act. The CARES Act permits borrowers of federally-backed mortgage loans to forbear payments, which could negatively impact servicers' liquidity and their ability to purchase servicing. As forbearance requests leveled off during the latter part of 2020, the third-party market for mortgage servicing rights improved, increasing demand, which allowed PrimeLending to reduce retained servicing to 57% of total mortgage loans sold during the fourth quarter of 2020, then to 50% and 25% of total mortgage loans sold during the first and second quarters of 2021, respectively. If the third-party market for mortgage servicing rights continues to improve, we expect that PrimeLending will continue to reduce retained servicing on mortgage loans sold during the remainder of 2021. The related MSR asset was valued at \$124.8 million on \$10.3 billion of serviced loan volume at June 30, 2021, compared with a value of \$144.2 million on \$14.7 billion of serviced loan volume at December 31, 2020. The mortgage origination segment may, from time to time, manage its MSR asset through different strategies, including varying the percentage of mortgage loans sold servicing released and opportunistically selling MSR assets. The mortgage origination segment has also retained servicing on certain loans sold to and retained by the banking segment. Gains and losses associated with such sales to the banking segment and the related MSR asset are eliminated in consolidation. The mortgage origination segment uses derivative financial instruments, including U.S. Treasury bond futures and options, as a means to mitigate interest rate risk associated with its MSR asset. Changes in the net fair value of the MSR asset and the related derivatives associated with normal customer payments, changes in discount rates, prepayment speed assumptions and customer payoffs resulted in net gains of \$2.6 million and \$11.7 million during the three and six months ended June 30, 2021, respectively, compared to net losses of \$8.2 million and \$11.2 million during the three and six months ended June 30, 2020, respectively. Included in the net gains for the three and six months ended June 30, 2021 are MSR asset fair value adjustments totaling \$9.2 million and \$18.9 million, respectively, which reflect the difference between the MSR asset carrying values and the sale prices reflected in the letters of intent to sell the applicable MSR assets. Additionally, net servicing income was \$8.9 million and \$16.8 million, respectively, during the three and six months ended June 30, 2021, compared with \$1.0 million and \$3.7 million, respectively, during the same periods in 2020. On March 31 and June 30, 2021, the mortgage origination segment sold MSR assets of \$52.8 million, which represented \$4.9 billion of its serviced loan volume at the time, and \$31.9 million, which represented \$2.6 billion of its serviced loan volume at the time, respectively. As of June 30, 2021, the mortgage origination segment had executed two letters of intent for pending sales of MSR assets with a serviced loan volume totaling \$3.4 billion. The sales of these MSR assets are expected to be completed during the third and fourth quarters of 2021, at a total price of approximately \$42 million.

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

	<u>Three Months Ended June 30,</u>		<u>Variance</u>	<u>Six Months Ended June 30,</u>		<u>Variance</u>
	<u>2021</u>	<u>2020</u>	<u>2021 vs 2020</u>	<u>2021</u>	<u>2020</u>	<u>2021 vs 2020</u>
Variable compensation	\$ 97,081	\$ 113,826	\$ (16,745)	\$ 212,567	\$ 172,105	\$ 40,462
Non-variable compensation and benefits	48,320	46,999	1,321	99,082	89,047	10,035
Segment operating costs	29,368	29,016	352	59,788	60,669	(881)
Lender paid closing costs	4,913	6,558	(1,645)	10,381	10,918	(537)
Servicing expense	7,281	4,094	3,187	15,479	7,306	8,173
Total noninterest expense	<u>\$ 186,963</u>	<u>\$ 200,493</u>	<u>\$ (13,530)</u>	<u>\$ 397,297</u>	<u>\$ 340,045</u>	<u>\$ 57,252</u>

Total employees' compensation and benefits accounted for the majority of noninterest expenses incurred during all periods presented. Specifically, variable compensation comprised 66.8% and 70.8% of total employees' compensation and benefits expenses during the three months ended June 30, 2021 and 2020, respectively, and 68.2% and 65.9% during

the six months ended June 30, 2021 and 2020, respectively. The decrease in the percentage concentration of variable compensation and benefits between the three months ended June 30, 2021 and 2020, was primarily due to a decrease in the average incentive rate paid and the impact of incentive plans driven by non-mortgage production criteria. The increase in the percentage concentration of variable compensation and benefits between the six months ended June 30, 2021 and 2020, was primarily due to an increase in loan origination volume. Variable compensation, which is primarily driven by loan origination volume, tends to fluctuate to a greater degree than loan origination volume, because mortgage loan originator and fulfillment staff incentive compensation plans are structured to pay at increasing rates as higher monthly volume tiers are achieved. However, certain other incentive compensation plans driven by non-mortgage production criteria may alter this trend.

While total loan origination volume decreased 3.3% and increased 24.3%, respectively, during the three and six months ended June 30, 2021, compared to the same periods in 2020, respectively, the aggregate non-variable compensation and benefits of the mortgage origination segment increased 2.8% and 11.3% during the same periods, respectively. The increase during the six months ended June 30, 2021, was primarily due to an increase in salaries mainly resulting from increased underwriting and loan fulfillment staff to support the increase in loan origination volume starting in the second quarter of 2020. These additional staff continued to be needed to support loan origination volumes during the remainder of 2020 and the first six months of 2021. Segment operating costs were relatively unchanged during the three and six months ended June 30, 2021, compared to the same periods in 2020.

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

Between January 1, 2012 and June 30, 2021, the mortgage origination segment sold mortgage loans totaling \$140.7 billion. These loans were sold under sales contracts that generally include provisions that hold the mortgage origination segment responsible for errors or omissions relating to its representations and warranties that loans sold meet certain requirements, including representations as to underwriting standards and the validity of certain borrower representations in connection with the loan. In addition, the sales contracts typically require the refund of purchased servicing rights plus certain investor servicing costs if a loan experiences an early payment default. While the mortgage origination segment sold loans prior to 2012, it does not anticipate experiencing significant losses in the future on loans originated prior to 2012 as a result of investor claims under these provisions of its sales contracts.

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

Following is a summary of the mortgage origination segment’s claims resolution activity relating to loans sold between January 1, 2012 and June 30, 2021 (dollars in thousands).

	Original Loan Balance		Loss Recognized	
	Amount	% of Loans Sold	Amount	% of Loans Sold
Claims resolved with no payment	\$ 200,070	0.14%	\$ —	0.00%
Claims resolved because of a loan repurchase or payment to an investor for losses incurred <sup>(1)</sup>	221,223	0.16%	8,579	0.01%
	<u>\$ 421,293</u>	<u>0.30%</u>	<u>\$ 8,579</u>	<u>0.01%</u>

(1) Losses incurred include refunded purchased servicing rights.

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

such losses. In addition to other factors, the mortgage origination segment has considered that GNMA, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation have imposed certain restrictions on loans the agencies will accept under a forbearance agreement resulting from the COVID-19 pandemic, which could increase the magnitude of indemnification losses on these loans.

At June 30, 2021 and December 31, 2020, the mortgage origination segment's total indemnification liability reserve totaled \$26.4 million and \$21.5 million, respectively. The related provision for indemnification losses was \$2.5 million and \$3.9 million during the three months ended June 30, 2021 and 2020, respectively, and \$5.5 million and \$4.6 million during the six months ended June 30, 2021 and 2020, respectively.

## Corporate

The following table presents certain financial information regarding the operating results of corporate (in thousands).

	<u>Three Months Ended June 30,</u>		<u>Variance</u>	<u>Six Months Ended June 30,</u>		<u>Variance</u>
	<u>2021</u>	<u>2020</u>	<u>2021 vs 2020</u>	<u>2021</u>	<u>2020</u>	<u>2021 vs 2020</u>
Net interest income (expense)	\$ (4,687)	\$ (3,232)	\$ (1,455)	\$ (9,379)	\$ (4,888)	\$ (4,491)
Noninterest income	6,877	550	6,327	7,383	2,838	4,545
Noninterest expense	12,072	8,888	3,184	21,660	13,741	7,919
Income (loss) from continuing operations before income taxes	<u>\$ (9,882)</u>	<u>\$ (11,570)</u>	<u>\$ 1,688</u>	<u>\$ (23,656)</u>	<u>\$ (15,791)</u>	<u>\$ (7,865)</u>

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

As a holding company, Hilltop's primary investment objectives are to support capital deployment for organic growth and to preserve capital to be deployed through acquisitions, dividend payments and potential stock repurchases. Investment and interest income earned during the three and six months ended June 30, 2021 was primarily comprised of dividend income from merchant banking investment activities, in addition to interest income earned on intercompany notes.

Interest expense during each period included recurring quarterly interest expense of \$1.9 million incurred on our \$150.0 million aggregate principal amount of 5% senior notes due 2025 ("Senior Notes"). During the three months ended June 30, 2021 and 2020, we incurred interest expense of \$3.1 million and \$1.7 million, respectively, and \$6.2 million and \$1.7 million during the six months ended June 30, 2021 and 2020, respectively, on our \$200 million aggregate principal amount of Subordinated Notes, which were issued in May 2020. Additionally, we incurred interest expense of \$0.5 million and \$0.7 million during the three months ended June 30, 2021 and 2020, respectively, and \$1.1 million and \$1.6 million during the six months ended June 30, 2021 and 2020, respectively, on junior subordinated debentures of \$67.0 million issued by PCC (the "Debentures").

Noninterest income from continuing operations during each period included activity related to our investment in a real estate development in Dallas' University Park, which also serves as headquarters for both Hilltop and the Bank, and net noninterest income associated with activity within our merchant bank subsidiary. During the three and six months ended June 30, 2021, noninterest income included an aggregate of \$6.5 million in pre-tax gains associated with observable transactions related to two merchant bank equity investments.

Noninterest expenses from continuing operations were primarily comprised of employees' compensation and benefits, occupancy expenses and professional fees, including corporate governance, legal and transaction costs. Noninterest expenses increased during the three and six months ended June 30, 2021, compared to the same periods in 2020, primarily due to prior year non-recurring activities associated with a gain on sale transaction and certain compensation-related expenses.

## ***Results from Discontinued Operations***

### **Insurance Segment**

As previously discussed, on June 30, 2020, we completed the sale of NLC. Accordingly, insurance segment results for the three and six months ended June 30, 2020 have been presented as discontinued operations in the consolidated financial statements. Additional details are presented in Note 3, Discontinued Operations, in the notes to our consolidated financial statements. All activity associated with the insurance segment was recognized in 2020, therefore, there are no results in the three and six months ended June 30, 2021. Loss from discontinued operations before income taxes was \$1.9 million during the three months ended June 30, 2020, while income from discontinued operations before income taxes was \$2.1 million during the six months ended June 30, 2020.

### **Corporate**

As a result of the previously noted sale of NLC on June 30, 2020 for cash proceeds of \$154.1 million, during 2020, Hilltop recognized an aggregate pre-tax gain on sale within discontinued operations of corporate of \$36.8 million, net of customary transaction costs of \$5.1 million. The resulting book gain from this sale transaction was not recognized for tax purposes pursuant to the rules under the Internal Revenue Code. Income from discontinued operations before income taxes associated with corporate was \$32.3 million during both the three and six months ended June 30, 2020.

### ***Financial Condition***

The following discussion contains a more detailed analysis of our financial condition at June 30, 2021, as compared with December 31, 2020.

### **Securities Portfolio**

At June 30, 2021, 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, as well as mortgage-backed, corporate debt, and equity securities. We may categorize investments as trading, available for sale, held to maturity and equity securities.

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



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

	<b>June 30, 2021</b>	<b>December 31, 2020</b>
<b>Trading securities, at fair value</b>		
U.S. Treasury securities	\$ 1,289	\$ 40,491
U.S. government agencies:		
Bonds	15,764	40
Residential mortgage-backed securities	187,488	336,081
Commercial mortgage-backed securities	—	876
Collateralized mortgage obligations	117,257	69,172
Corporate debt securities	82,379	62,481
States and political subdivisions	266,707	171,573
Private-label securitized product	6,624	8,571
Other	4,975	4,970
	<u>682,483</u>	<u>694,255</u>
<b>Securities available for sale, at fair value</b>		
U.S. Treasury securities	4,974	—
U.S. government agencies:		
Bonds	49,899	82,806
Residential mortgage-backed securities	924,487	641,611
Commercial mortgage-backed securities	148,835	124,538
Collateralized mortgage obligations	641,458	565,908
States and political subdivisions	48,154	47,342
	<u>1,817,807</u>	<u>1,462,205</u>
<b>Securities held to maturity, at amortized cost</b>		
U.S. government agencies:		
Residential mortgage-backed securities	11,637	13,547
Commercial mortgage-backed securities	151,812	152,820
Collateralized mortgage obligations	56,737	74,932
States and political subdivisions	68,590	70,645
	<u>288,776</u>	<u>311,944</u>
<b>Equity securities, at fair value</b>	<u>193</u>	<u>140</u>
<b>Total securities portfolio</b>	<u>\$ 2,789,259</u>	<u>\$ 2,468,544</u>

We had net unrealized gains of \$7.8 million and \$26.3 million at June 30, 2021 and December 31, 2020, respectively, related to the available for sale investment portfolio, and net unrealized gains of \$12.4 million and \$14.7 million associated with the securities held to maturity portfolio at June 30, 2021 and December 31, 2020, respectively. Equity securities included net unrealized gains of \$0.1 million at both June 30, 2021 and December 31, 2020.

#### *Banking Segment*

The banking segment's securities portfolio plays a role in the management of our interest rate sensitivity and generates additional interest income. In addition, the securities portfolio is used to meet collateral requirements for public and trust deposits, securities sold under agreements to repurchase and other purposes. The available for sale and equity securities portfolios serve as a source of liquidity. Historically, the Bank's policy has been to invest primarily in securities of the U.S. government and its agencies, obligations of municipalities in the State of Texas and other high grade fixed income securities to minimize credit risk. At June 30, 2021, the banking segment's securities portfolio of \$2.1 billion was comprised of trading securities of \$0.1 million, available for sale securities of \$1.8 billion, equity securities of \$0.2 million and held to maturity securities of \$288.8 million, in addition to \$14.3 million of other investments included in other assets within the consolidated balance sheets.

#### *Broker-Dealer Segment*

The broker-dealer segment holds securities to support sales, underwriting and other customer activities. The interest rate risk inherent in holding these securities is managed by setting and monitoring limits on the size and duration of positions and on the length of time the securities can be held. The Hilltop Broker-Dealers are required to carry their securities at fair value and record changes in the fair value of the portfolio in operations. Accordingly, the securities portfolio of the Hilltop Broker-Dealers included trading securities of \$682.3 million at June 30, 2021. In addition, the Hilltop Broker-

Dealers enter into transactions that represent commitments to purchase and deliver securities at prevailing future market prices to facilitate customer transactions and satisfy such commitments. Accordingly, the Hilltop Broker-Dealers' ultimate obligation may exceed the amount recognized in the financial statements. These securities, which are carried at fair value and reported as securities sold, not yet purchased in the consolidated balance sheets, had a value of \$133.0 million at June 30, 2021.

### *Corporate*

At June 30, 2021, the corporate portfolio included other investments, including those associated with merchant banking, of \$39.9 million in other assets within the consolidated balance sheets.

### *Allowance for Credit Losses for Available for Sale Securities and Held to Maturity Securities*

We have evaluated available for sale debt securities that are in an unrealized loss position and have determined that any declines in value are unrelated to credit loss and related to changes in market interest rates since purchase. None of the available for sale debt securities held were past due at June 30, 2021. In addition, as of June 30, 2021, we had evaluated our held to maturity debt securities, considering the current credit ratings and recognized losses, and determined the potential credit loss to be minimal. With respect to these securities, we considered the risk of credit loss to be negligible, and therefore, no allowance was recognized on the debt securities portfolio at June 30, 2021.

### **Loan Portfolio**

Consolidated loans held for investment are detailed in the tables below, classified by portfolio segment.

	<b>June 30, 2021</b>	<b>December 31, 2020</b>
Commercial real estate	\$ 3,090,480	\$ 3,133,903
Commercial and industrial	2,232,035	2,627,774
Construction and land development	770,779	828,852
1-4 family residential	893,243	629,938
Consumer	30,018	35,667
Broker-dealer	<u>628,672</u>	<u>437,007</u>
Loans held for investment, gross	7,645,227	7,693,141
Allowance for credit losses	<u>(115,269)</u>	<u>(149,044)</u>
Loans held for investment, net of allowance	<u>\$ 7,529,958</u>	<u>\$ 7,544,097</u>

### *Banking Segment*

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

The banking segment's total loans held for investment, net of the allowance for credit losses, were \$9.4 billion and \$9.6 billion at June 30, 2021 and December 31, 2020, respectively. The banking segment's loan portfolio includes warehouse lines of credit extended to PrimeLending of \$3.3 billion, of which \$2.5 billion was drawn at both June 30, 2021 and December 31, 2020. Amounts advanced against the warehouse lines of credit are eliminated from net loans held for investment on our consolidated balance sheets. The banking segment does not generally participate in syndicated loan transactions and has no foreign loans in its portfolio.

The banking segment's loan portfolio included \$261.2 million related to both initial and second round PPP loans at June 30, 2021. While these loans have terms up to 60 months, borrowers can apply for forgiveness of these loans with the SBA. Through July 16, 2021, the SBA had approved approximately 2,600 initial round PPP forgiveness applications from the Bank totaling approximately \$643 million, with PPP loans of approximately \$9 million pending SBA review and approval. The Bank recently began submissions of PPP forgiveness applications on second round PPP loans. We anticipate a significant amount of these remaining initial and second round PPP loans pending approval being forgiven over the next three quarters. The forgiveness/payoff of the PPP loans would generate an increase in interest income as we would recognize the remaining unamortized origination fee at the time of payoff or forgiveness.

At June 30, 2021, the banking segment had loan concentrations (loans to borrowers engaged in similar activities) that exceeded 10% of total loans in its real estate portfolio. The areas of concentration within our real estate portfolio were non-construction commercial real estate loans, non-construction residential real estate loans, and construction and land development loans, which represented 44.0%, 12.7% and 11.0%, respectively, of the banking segment's total loans held investment at June 30, 2021. The banking segment's loan concentrations were within regulatory guidelines at June 30, 2021.

#### *Broker-Dealer Segment*

The loan portfolio of the broker-dealer segment consists primarily of margin loans to customers and correspondents. These loans are collateralized by the securities purchased or by other securities owned by the clients and, because of collateral coverage ratios, are believed to present minimal collectability exposure. Additionally, these loans are subject to a number of regulatory requirements as well as the Hilltop Broker-Dealers' internal policies. The broker-dealer segment's total loans held for investment, net of the allowance for credit losses, were \$628.3 million and \$436.8 million at June 30, 2021 and December 31, 2020, respectively. This increase from December 31, 2020 to June 30, 2021 was primarily attributable to an increase of \$115.7 million, or 64%, in receivables from correspondents and an increase of \$75.7 million, or 30%, in customer margin accounts.

#### *Mortgage Origination Segment*

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

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
Loans held for sale:		
Unpaid principal balance	\$ 2,521,773	\$ 2,411,626
Fair value adjustment	87,261	109,778
	<u>\$ 2,609,034</u>	<u>\$ 2,521,404</u>
IRLCs:		
Unpaid principal balance	\$ 2,181,773	\$ 2,470,013
Fair value adjustment	52,234	76,048
	<u>\$ 2,234,007</u>	<u>\$ 2,546,061</u>

The mortgage origination segment uses forward commitments to mitigate interest rate risk associated with its loans held for sale and IRLCs. The notional amounts of these forward commitments at both June 30, 2021 and December 31, 2020 were \$4.0 billion, while the related estimated fair values were (\$4.4) million and (\$28.0) million, respectively.

#### **Allowance for Credit Losses on Loans**

For additional information regarding the allowance for credit losses, refer to the section captioned "Critical Accounting Policies and Estimates" set forth in Part II, Item 7 of our 2020 Form 10-K.

#### *Loans Held for Investment*

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 and 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. The Bank's loan policy provides specific underwriting guidelines by portfolio segment, including commercial and industrial, real estate, construction and land development, and consumer loans. The guidelines for each individual portfolio segment set forth permissible and

impermissible loan types. With respect to each loan type, the guidelines within the Bank's loan policy provide minimum requirements for the underwriting factors listed above. The Bank's underwriting procedures also include an analysis of any collateral and guarantor. Collateral analysis includes a complete description of the collateral, as well as determined 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 evaluation based on the significance with which the guarantors are expected to serve as secondary repayment sources.

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, the Bank's board of directors and the Risk Committee of the board of directors of the Company.

The allowance for credit losses for loans held for investment represents management's best estimate of all expected credit losses over the expected contractual life of our existing portfolio. Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Subsequent evaluations of the then-existing loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for credit losses in those future periods. Such future changes in the allowance for credit losses are expected to be volatile given dependence upon, among other things, the portfolio composition and quality, as well as the impact of significant drivers, including prepayment assumptions and macroeconomic conditions and forecasts.

The COVID-19 pandemic disrupted financial markets and overall economic conditions that have affected borrowers across our lending portfolios. Significant judgment is required to estimate the severity and duration of the current economic uncertainties, as well as its potential impact on borrower defaults and loss severity. In particular, macroeconomic conditions and forecasts are rapidly changing and remain highly uncertain as COVID-19 cases and vaccine effectiveness, as well as government stimulus and policy measures, evolve nationally and in key geographies. It is difficult to predict exactly how borrower behavior will be impacted by these economic conditions as the effectiveness of vaccinations, government stimulus and policy measures, customer relief and enhanced unemployment benefits have helped mitigate in the short term, but the extent and duration of government stimulus remains uncertain.

One of the most significant judgments involved in estimating our allowance for credit losses relates to the macroeconomic forecasts used to estimate credit losses over the reasonable and supportable forecast period. To determine the allowance for credit losses as of June 30, 2021, we utilized a single macroeconomic alternative baseline, or S7, scenario published by Moody's Analytics in June 2021.

During previous quarterly macroeconomic assessments through March 31, 2021, we also utilized a single baseline scenario published by Moody's Analytics. The economic scenario selected as of June 30, 2021 was based on our evaluation of the Moody's baseline economic forecast compared to other industry surveys over the reasonable and supportable period and our assessment of the reasonableness of impacts associated with the key monetary and government stimulus policy assumptions.

The following table summarizes the U.S. Real Gross Domestic Product (“GDP”) growth rates and unemployment rate assumptions used in our economic forecast to determine our best estimate of expected credit losses.

		As of				
		June 30, 2021	March 31, 2021	December 31, 2020	September 30, 2020	June 30, 2020
GDP growth rates:						
	Q2 2020					(33.4)%
	Q3 2020				26.6%	19.8%
	Q4 2020			4.0%	2.9%	0.1%
	Q1 2021		5.0%	1.6%	3.6%	0.2%
	Q2 2021	10.8%	6.5%	4.5%	3.1%	1.8%
	Q3 2021	6.6%	6.7%	4.7%	4.4%	8.5%
	Q4 2021	6.9%	4.8%	5.8%	6.0%	7.3%
	Q1 2022	5.4%	3.2%	4.8%	5.5%	
	Q2 2022	2.8%	2.5%	4.4%		
	Q3 2022	2.3%	2.1%			
	Q4 2022	1.8%				
Unemployment rates:						
	Q2 2020					14.0%
	Q3 2020				8.9%	9.1%
	Q4 2020			6.7%	9.1%	9.5%
	Q1 2021		6.3%	6.9%	8.9%	9.7%
	Q2 2021	5.8%	6.2%	7.1%	8.7%	9.7%
	Q3 2021	5.2%	5.8%	7.0%	8.3%	9.2%
	Q4 2021	4.5%	5.4%	6.8%	7.8%	8.7%
	Q1 2022	4.0%	5.1%	6.5%	7.3%	
	Q2 2022	3.7%	4.9%	6.2%		
	Q3 2022	3.6%	4.7%			
	Q4 2022	3.5%				

As of June 30, 2021, our economic forecast improved from March 31, 2021, as real GDP growth rates for the first quarter of 2021 were revised to 6.4% and average unemployment rates for April and May 2021 indicated an improved economic outlook in labor markets. Our new economic forecast also considers additional risks to U.S. economic recovery from recent inflation rates observed higher than Moody’s baseline scenario. Forecasts for commercial real estate prices nationally were updated based on available data and assume recovery to pre-COVID-19 levels in late 2022. We assume the Federal Reserve continues to support a target range of the federal funds rate at 0% to 0.25% through monetary policy support until the fourth quarter of 2022 when interest rates begin to increase.

As of December 31, 2020, our near-term economic forecast improved from September 30, 2020, reflecting better than expected economic data and approval of additional government stimulus earlier than expected. As such, projected real GDP growth in the first quarter of 2021 was revised upward. However, we revised our near-term 2021 real GDP forecast to reflect approximately \$900 billion of additional stimulus compared to \$1.5 trillion planned as of September 30, 2020. Unemployment rate forecasts were adjusted lower based on economic data observed in October and November 2020, as well as recent COVID-19 vaccine approvals showing progress towards the next phase of labor market recovery. Forecasts for commercial real estate prices nationally were updated lower as of December 31, 2020 to reflect declines through 2022 and recovery to pre-COVID-19 levels in late 2024. Prior quarter forecasts as of September 30, 2020 assumed declines through 2021 and recovery to pre-COVID-19 levels in mid-2023. Our interest rate expectations continued to assume monetary policy support from the Federal Reserve and a target range of the federal funds rate at 0% to 0.25% into late 2023.

Since December 31, 2019, our economic forecast changed significantly year-over-year in response to weak economic conditions caused by the COVID-19 pandemic as developments occurred rapidly in February and March 2020 associated with fiscal and monetary stimulus measures and the expected beneficial impacts of the CARES Act and certain regulatory interagency guidance. As of December 31, 2019, we assumed the U.S. economy was in the late stages of the economic cycle with unemployment rates near historical lows of 3.6% increasing to 3.8% in the fourth quarter of 2020 and reverting to historical data in the fourth quarter of 2022. Downside risks to the economy were concerns over international trade war between the U.S. and its trading partners and potential fallout from a Brexit in 2020. Interest rate expectations assumed one rate cut in 2020 with the Federal Reserve target range of the federal funds rate at 1.25% to 1.50% before reverting to historical data in 2023. In response to the COVID-19 pandemic, the Federal Reserve twice cut

federal funds rate targets in March 2020 to 0% to 0.25% with interest rate expectations as of December 31, 2020 unchanged until late 2023. Several U.S. fiscal and monetary policy changes during early 2020 were enacted to counter a severe, but short U.S. recession during the first half of 2020 and support a strong economic recovery during the second half of 2020 with U.S. budget deficits increasing to more than \$3 trillion during the year. U.S. unemployment rates reached 14.8% in April 2020 before declining to 6.7% as of December 31, 2020, which was 3.1% higher than the unemployment rate as of December 31, 2019. Annualized real GDP growth rates declined 31.4% in the second quarter of 2020 and increased 33.4% in the third quarter of 2020. The U.S. presidential election later in 2020 resulted in several changes, as Presidential Candidate Joe Biden won the electoral vote to replace President Donald Trump in 2021 and majority control of the U.S. Congress moved from Republican to Democratic parties. As economic growth slowed during the fourth quarter of 2020, additional government stimulus of approximately \$900 billion was approved.

As previously discussed, we adopted the new CECL standard and recorded transition adjustment entries that resulted in an allowance for credit losses for loans held for investment of \$73.7 million as of January 1, 2020, an increase of \$12.6 million. This increase reflected credit losses of \$18.9 million from the expansion of the loss horizon to life of loan and also takes into account forecasts of expected future macroeconomic conditions, partially offset by the elimination of the non-credit component within the historical allowance related to previously categorized PCI loans of \$6.3 million. This increase, net of tax, was largely reflected within the banking segment and included a decrease of \$5.7 million to opening retained earnings at January 1, 2020.

During the three and six months ended June 30, 2021, the decreases in the allowance for credit losses reflect improvement in both realized economic results and the macroeconomic outlook and were significantly comprised of net reversals of credit losses on expected losses of collectively evaluated loans of \$27.7 million and \$34.2 million, respectively. Such reversals were primarily due to improvements in the macroeconomic forecast assumptions and positive risk rating grade migration, including a high concentration of credits within the restaurant and commercial real estate industry sectors. The net impact to the allowance of changes associated with individually evaluated loans during the three months ended June 30, 2021 was a reversal of credit losses of \$1.0 million, while the six months ended June 30, 2021 included a provision for credit losses of \$0.4 million. The changes in the allowance for credit losses during the noted periods were primarily attributable to the Bank and also reflected other factors including, but not limited to, loan mix, and changes in loan balances and qualitative factors from the prior quarter. The changes in the allowance during the three months ended June 30, 2021 were also impacted by net charge-offs of \$0.5 million, while the six months ended June 30, 2021 included net recoveries of \$0.1 million.

As discussed under the section entitled “Loan Portfolio” earlier in this Item 2, the Bank’s actions beginning in the second and third quarters of 2020 included supporting our impacted banking clients experiencing an increased level of risk due to the COVID-19 pandemic through loan modifications. The significant build in the allowance included provision for credit losses associated with this deteriorating economic outlook and resulted in an allowance for credit losses as a percentage of our total loan portfolio, excluding margin loans in the broker-dealer segment and banking segment mortgage warehouse lending and PPP lending programs, of 1.86%.

The respective distribution of the allowance for credit losses as a percentage of our total loan portfolio and total active loan modifications, excluding margin loans in the broker-dealer segment and banking segment mortgage warehouse lending and PPP lending programs, are presented in the following table (dollars in thousands).

	Total Loans Held For Investment	Total Allowance for Credit Losses	Allowance For Credit Losses as a % of Total Loans Held For Investment	Active Loan Modifications	Allowance For Credit Losses on Active Loan Modifications	Allowance For Credit Losses as a % of Active Loan Modifications
<b>June 30, 2021</b>						
Commercial real estate	\$ 3,090,480	\$ 77,633	2.51 %	\$ 62,982	\$ 11,922	18.93 %
Commercial and industrial <sup>(1)</sup>	1,365,770	27,563	2.02 %	4,547	725	15.94 %
Construction and land development	770,779	5,185	0.67 %	—	—	— %
1-4 family residential	893,243	3,659	0.41 %	8,731	143	1.64 %
Consumer	30,018	592	1.97 %	—	—	— %
	<u>6,150,290</u>	<u>114,632</u>	1.86 %	<u>76,260</u>	<u>12,790</u>	16.77 %
Broker-dealer	628,672	334	0.05 %	—	—	— %
Mortgage warehouse lending	605,047	303	0.05 %	—	—	— %
Paycheck Protection Program	261,218	—	— %	—	—	— %
	<u>\$ 7,645,227</u>	<u>\$ 115,269</u>	1.51 %	<u>\$ 76,260</u>	<u>\$ 12,790</u>	16.77 %

(1) Commercial and industrial portfolio amounts reflect balances excluding banking segment mortgage warehouse lending and PPP loans.

### *Allowance Model Sensitivity*

Our allowance model was designed to capture the historical relationship between economic and portfolio changes. As such, evaluating shifts in individual portfolio attributes or macroeconomic variables in isolation may not be indicative of past or future performance. It is difficult to estimate how potential changes in any one factor or input might affect the overall allowance for credit losses because we consider a wide variety of factors and inputs in the allowance for credit losses estimate. Changes in the factors and inputs considered may not occur at the same rate and may not be consistent across all geographies or product types, and changes in factors and input may be directionally inconsistent, such that improvement in one factor may offset deterioration in others.

However, to consider the sensitivity of credit loss estimates to alternative macroeconomic forecasts, we compared the Company's allowance for credit loss estimates as of June 30, 2021, excluding margin loans in the broker-dealer segment, the banking segment mortgage warehouse and PPP lending programs, with modeled results using both upside ("S1") and downside ("S3") economic scenario forecasts published by Moody's Analytics.

Compared to our economic forecast, the upside scenario assumes consumer and business confidence increases as new cases, hospitalizations and deaths from COVID-19 recede faster than expected, while availability and acceptance of vaccines and consumer spending accelerate more than expected. Real GDP is expected to grow 9.3% in the third quarter of 2021, 9.7% in the fourth quarter of 2021, and 7.8% in the first quarter of 2022. Average unemployment rates decline to 4.0% by the fourth quarter of 2021 and 3.0% by the end of 2022. Monetary and fiscal policy assumptions include the Federal Reserve maintaining a near 0% target for the federal funds rate until the beginning of 2023 and additional government infrastructure and social program spending approved in the fourth quarter of 2021 of \$2.5 trillion.

Compared to our economic forecast, the downside scenario assumes consumer and business confidence declines as new cases, hospitalizations and deaths from COVID-19 diminish more slowly than expected, resulting in fewer people than expected getting vaccinated and increased worries about resistant strains. As a result, consumer confidence and spending erode causing the economy to fall back into recession. Real GDP is expected to decrease 3.1% in the third quarter of 2021, 3.1% in the fourth quarter of 2021, and 1.7% in the first quarter of 2022. Average unemployment rates increase to 8.1% by the fourth quarter of 2021 and 8.9% by the end of 2022. Average unemployment is expected to remain elevated but improve to 6.6% by the fourth quarter of 2023 and reverts to historical average rates over time. Monetary and fiscal policy assumptions include the Federal Reserve maintaining a near 0% target for the federal funds rate through late-2025, while disagreements in Congress prevent any additional stimulus from being enacted beyond the American Rescue Plan Act passed in March 2021.

The impact of applying all of the assumptions of the upside economic scenario during the reasonable and supportable forecast period would have resulted in a decrease in the allowance for credit losses of approximately \$10 million or a weighted average expected loss rate of 1.3% as a percentage of our total loan portfolio, excluding margin loans in the broker-dealer segment and the banking segment mortgage warehouse lending and PPP lending programs.

The impact of applying all of the assumptions of the downside economic scenario during the reasonable and supportable forecast period would have resulted in an increase in the allowance for credit losses of approximately \$64 million or a weighted average expected loss rate of 2.5% as a percentage of our total loan portfolio, excluding margin loans in the broker-dealer segment and the banking segment mortgage warehouse lending and PPP lending programs.

This analysis relates only to the modeled credit loss estimates and is not intended to estimate changes in the overall allowance for credit losses as they do not reflect any potential changes in the adjustment to the quantitative calculation, which would also be influenced by the judgment management applies to the modeled lifetime loss estimates to reflect the uncertainty and imprecision of these modeled lifetime loss estimates based on then-current circumstances and conditions. It also did not consider impacts from recent Bank deferral and customer accommodation efforts or government fiscal and monetary stimulus measures.

Our allowance for credit losses reflects our best estimate of current expected credit losses, which is highly dependent on the path of the virus and expectations around the production and distribution of reliable vaccines and medical treatments. We continue to monitor the impact of the COVID-19 pandemic and related policy measures on the economy and if pace and vigor of the expected recovery is worse than expected, further meaningful provisions could be required. Future allowance for credit losses may vary considerably for these reasons.

### Allowance Activity

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

Loans Held for Investment	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Balance, beginning of period	\$ 144,499	\$ 106,739	\$ 149,044	\$ 61,136
Transition adjustment for adoption of CECL accounting standard	—	—	—	12,562
Provision for (reversal of) credit losses	(28,720)	66,026	(33,829)	100,575
Recoveries of loans previously charged off:				
Commercial real estate	220	11	234	21
Commercial and industrial	701	681	1,134	1,068
Construction and land development	—	2	—	2
1-4 family residential	53	5	462	15
Consumer	69	104	145	224
Broker-dealer	—	—	—	—
Total recoveries	1,043	803	1,975	1,330
Loans charged off:				
Commercial real estate	186	4,274	186	4,488
Commercial and industrial	1,242	12,544	1,421	13,984
Construction and land development	—	—	—	2
1-4 family residential	51	170	161	373
Consumer	74	197	153	373
Broker-dealer	—	—	—	—
Total charge-offs	1,553	17,185	1,921	19,220
Net recoveries (charge-offs)	(510)	(16,382)	54	(17,890)
Balance, end of period	\$ 115,269	\$ 156,383	\$ 115,269	\$ 156,383
Allowance for credit losses as a percentage of gross loans held for investment			1.51 %	1.99 %

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

	June 30, 2021		December 31, 2020	
	Reserve	% of Gross Loans	Reserve	% of Gross Loans
Commercial real estate	\$ 77,633	40.42 %	\$ 109,629	40.74 %
Commercial and industrial	27,866	29.21 %	27,703	34.16 %
Construction and land development	5,185	10.08 %	6,677	10.77 %
1-4 family residential	3,659	11.68 %	3,946	8.19 %
Consumer	592	0.39 %	876	0.46 %
Broker-dealer	334	8.22 %	213	5.68 %
Total	\$ 115,269	100.00 %	\$ 149,044	100.00 %



The following table summarizes historical levels of the allowance for credit losses on loans held for investment, distributed by portfolio segment (in thousands).

	<u>June 30, 2021</u>	<u>March 31, 2021</u>	<u>December 31, 2020</u>	<u>September 30, 2020</u>	<u>June 30, 2020</u>
Commercial real estate	\$ 77,633	\$ 104,126	\$ 109,629	\$ 104,566	\$ 106,551
Commercial and industrial	27,866	28,513	27,703	38,178	31,863
Construction and land development	5,185	7,249	6,677	6,270	8,393
1-4 family residential	3,659	3,388	3,946	5,052	7,399
Consumer	592	944	876	1,002	1,429
Broker-dealer	334	279	213	146	748
	<u>\$ 115,269</u>	<u>\$ 144,499</u>	<u>\$ 149,044</u>	<u>\$ 155,214</u>	<u>\$ 156,383</u>

### *Unfunded Loan Commitments*

In order to estimate the allowance for credit losses on unfunded loan commitments, the Bank uses a process similar to that used in estimating the allowance for credit losses on the funded portion. The allowance is based on the estimated exposure at default, multiplied by the lifetime probability of default grade and loss given default grade for that particular loan segment. The Bank estimates expected losses by calculating a commitment usage factor based on industry usage factors. The commitment usage factor is applied over the relevant contractual period. Loss factors from the underlying loans to which commitments are related are applied to the results of the usage calculation to estimate any liability for credit losses related for each loan type. The expected losses on unfunded commitments align with statistically calculated parameters used to calculate the allowance for credit losses on the funded portion. Letters of credit are not currently reserved because they are issued primarily as credit enhancements and the likelihood of funding is low.

Changes in the allowance for credit losses for loans with off-balance sheet credit exposures are shown below (in thousands).

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2021</u>	<u>2020</u>
Balance, beginning of period	\$ 8,807	\$ 7,209	\$ 8,388	\$ 2,075
Transition adjustment CECL accounting standard	—	—	—	3,837
Other noninterest expense	(826)	1,822	(407)	3,119
Balance, end of period	<u>\$ 7,981</u>	<u>\$ 9,031</u>	<u>\$ 7,981</u>	<u>\$ 9,031</u>

As previously discussed, we adopted the new CECL standard and recorded a transition adjustment entry that resulted in an allowance for credit losses of \$5.9 million as of January 1, 2020. During the three and six months ended June 30, 2021, the decrease in the reserve for unfunded commitments was primarily due to improvements in loan expected loss rates.

### *Potential Problem Loans*

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor's potential operating or financial difficulties. Management monitors these loans and reviews their performance on a regular basis. Potential problem loans contain potential weaknesses that could improve, persist or further deteriorate. If such potential weaknesses persist without improving, the loan is subject to downgrade, typically to substandard, in three to six months. Potential problem loans are assigned a grade of special mention within our risk grading matrix. Potential problem loans do not include purchased credit deteriorated ("PCD") loans because PCD loans exhibited evidence of more than insignificant credit deterioration at acquisition that made it probable that all contractually required principal payments would not be collected. Additionally, potential problem loans do not include loans that have been modified in connection with our COVID-19 payment deferral programs which allow for a deferral of principal and/or interest payments. Within our loan portfolio, we had four credit relationships totaling \$10.8 million of potential problem loans at June 30, 2021, compared with seven credit relationships totaling \$11.3 million of potential problem loans at December 31, 2020.

### Non-Performing Assets

In response to the COVID-19 pandemic, the CARES Act was passed in March 2020, which among other things, allows the Bank to suspend the TDR requirements for certain loan modifications to be categorized as a TDR. Starting in March 2020, the Bank implemented several actions to better support our impacted banking clients and allow for loan modifications such as principal and/or interest payment deferrals, participation in the PPP as an SBA preferred lender and personal banking assistance including waived fees, increased daily spending limits and suspension of residential foreclosure activities. The COVID-19 payment deferral programs allow for a deferral of principal and/or interest payments with such deferred principal payments due and payable on the maturity date of the existing loan.

Specifically, as discussed under the section titled “Loan Portfolio” earlier in this Item 2, the Bank’s actions during 2020 included approval of \$1.0 billion of COVID-19 related loan modifications. During 2021, the Bank continued to support its impacted banking clients through the approval of COVID-19 related loan modifications with a portfolio of active deferrals that have not reached the end of their deferral period of approximately \$76 million as of June 30, 2021. While the majority of the portfolio of COVID-19 related loan modifications no longer require deferral, such loans represent elevated risk, and therefore management continues to monitor these loans. The extent to which these measures will impact the Bank, and any progression of loans, whether receiving COVID-19 payment deferrals or not, into non-performing assets, during future periods is uncertain and will depend on future developments that cannot be predicted.

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

	<u>June 30, 2021</u>	<u>December 31, 2020</u>	<u>Variance</u>
Loans accounted for on a non-accrual basis:			
Commercial real estate	\$ 7,211	\$ 11,133	\$ (3,922)
Commercial and industrial	33,033	34,049	(1,016)
Construction and land development	474	507	(33)
1-4 family residential	27,100	32,263	(5,163)
Consumer	26	28	(2)
Broker-dealer	—	—	—
	<u>\$ 67,844</u>	<u>\$ 77,980</u>	<u>\$ (10,136)</u>
Troubled debt restructurings included in accruing loans held for investment	1,139	1,954	(815)
Non-performing loans	<u>\$ 68,983</u>	<u>\$ 79,934</u>	<u>\$ (10,951)</u>
Non-performing loans as a percentage of total loans	<u>0.66 %</u>	<u>0.76 %</u>	<u>(0.10)%</u>
Other real estate owned	<u>\$ 21,078</u>	<u>\$ 21,289</u>	<u>\$ (211)</u>
Other repossessed assets	<u>\$ —</u>	<u>\$ 101</u>	<u>\$ (101)</u>
Non-performing assets	<u>\$ 90,061</u>	<u>\$ 101,324</u>	<u>\$ (11,263)</u>
Non-performing assets as a percentage of total assets	<u>0.51 %</u>	<u>0.60 %</u>	<u>(0.09)%</u>
Loans past due 90 days or more and still accruing	<u>\$ 245,828</u>	<u>\$ 243,630</u>	<u>\$ 2,198</u>

At June 30, 2021, non-accrual loans included 47 commercial and industrial relationships with loans secured by accounts receivable, life insurance, oil and gas, livestock and equipment. Non-accrual loans at June 30, 2021 also included \$6.2 million of loans secured by residential real estate which were classified as loans held for sale. At December 31, 2020, non-accrual loans included 60 commercial and industrial relationships with loans secured by accounts receivable, life insurance, oil and gas, livestock and equipment. Non-accrual loans at December 31, 2020 also included \$10.9 million of loans secured by residential real estate which were classified as loans held for sale.

At June 30, 2021, TDRs were comprised of \$1.1 million of loans that are considered to be performing and accruing, and \$13.9 million of loans considered to be non-performing reported in non-accrual loans. At December 31, 2020, TDRs were comprised of \$2.0 million of loans that are considered to be performing and accruing, and \$16.0 million of loans that were considered to be non-performing reported in non-accrual loans. In March 2020, the CARES Act was passed, which, among other things, allows the Bank to suspend the requirements for certain loan modifications to be categorized as a TDR. Therefore, the Bank is not reporting COVID-19 related modifications as TDRs in accordance with the CARES Act.

OREO decreased from December 31, 2020 to June 30, 2021, primarily due to disposals and valuation adjustments totaling \$2.0 million, partially offset by additions of \$1.8 million. At both June 30, 2021 and December 31, 2020, OREO was primarily comprised of commercial properties.

Loans past due 90 days or more and still accruing at June 30, 2021 and December 31, 2020, were primarily comprised of loans held for sale and guaranteed by U.S. government agencies, including GNMA-related loans subject to repurchase within our mortgage origination segment. As of June 30, 2021, \$149.6 million of loans subject to repurchase were under a forbearance agreement resulting from the COVID-19 pandemic. During May 2020, GNMA announced it will temporarily exclude any new GNMA lender delinquencies, occurring on or after April 2020, when calculating the delinquency ratios for the purposes of enforcing compliance with its delinquency rate thresholds. This exclusion is extended automatically to GNMA lenders that were compliant with GNMA's delinquency rate thresholds as reflected by their April 2020 investor accounting report. The mortgage origination segment qualified for this exclusion as of June 30, 2021. As of June 30, 2021, \$145.1 million of loans subject to repurchase under a forbearance agreement had delinquencies on or after April 2020.

## Deposits

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

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

	Six Months Ended June 30,			
	2021		2020	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
Noninterest-bearing demand deposits	\$ 3,911,205	0.00 %	\$ 3,017,070	0.00 %
Interest-bearing demand deposits	5,829,890	0.22 %	5,120,125	0.49 %
Savings deposits	279,481	0.07 %	206,715	0.12 %
Time deposits	1,574,263	0.97 %	1,768,089	1.63 %
	<u>\$ 11,594,839</u>	<u>0.24 %</u>	<u>\$ 10,111,999</u>	<u>0.54 %</u>

## Borrowings

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

	June 30, 2021		December 31, 2020		Variance
	Balance	Average Rate Paid	Balance	Average Rate Paid	
Short-term borrowings	\$ 915,919	1.19 %	\$ 695,798	1.46 %	\$ 220,121
Notes payable	396,653	5.24 %	381,987	4.54 %	14,666
Junior subordinated debentures	67,012	3.43 %	67,012	4.13 %	—
	<u>\$ 1,379,584</u>	<u>2.62 %</u>	<u>\$ 1,144,797</u>	<u>2.51 %</u>	<u>\$ 234,787</u>

Short-term borrowings consisted of federal funds purchased, securities sold under agreements to repurchase, borrowings at the Federal Home Loan Bank ("FHLB"), short-term bank loans and commercial paper. The increase in short-term borrowings at June 30, 2021, compared with December 31, 2020, included increases in short-term bank loans and

commercial paper used by the Hilltop Broker-Dealers to finance their activities, partially offset by a decrease in securities sold under agreements to repurchase by the Hilltop Broker-Dealers. Notes payable at June 30, 2021 was comprised of \$149.0 million related to the Senior Notes, net of loan origination fees, Subordinated Notes, net of origination fees, of \$196.9 million and mortgage origination segment borrowings of \$50.7 million.

### *Liquidity and Capital Resources*

Hilltop is a financial holding company whose assets primarily consist of the stock of its subsidiaries and invested assets. Hilltop's primary investment objectives, as a holding company, are to support capital deployment for organic growth and to preserve capital to be deployed through acquisitions, dividend payments and stock repurchases. At June 30, 2021, Hilltop had \$355.0 million in cash and cash equivalents, a decrease of \$19.8 million from \$374.8 million at December 31, 2020. This decrease in cash and cash equivalents was primarily due to \$19.8 million in cash dividends declared, \$49.5 million of stock repurchases, and other general corporate expenses, partially offset by the receipt of \$75.0 million of dividends from subsidiaries. Subject to regulatory restrictions, Hilltop has received, and may also continue to receive, dividends from its subsidiaries. If necessary or appropriate, we may also finance acquisitions with the proceeds from equity or debt issuances. We believe that Hilltop's liquidity is sufficient for the foreseeable future, with current short-term liquidity needs including operating expenses, interest on debt obligations, dividend payments to stockholders and potential stock repurchases.

### *COVID-19*

As previously discussed, in light of the extreme volatility and disruptions in the capital and credit markets beginning in March 2020 resulting from the COVID-19 crisis and its negative impact on the economy, we took a number of precautionary actions beginning in March 2020 to enhance our financial flexibility, protect capital, minimize losses and ensure target liquidity levels.

To strengthen the Bank's available liquidity position during 2020, we raised brokered deposits, as well as swept additional deposits from Hilltop Securities into the Bank. At June 30, 2021, given the continued strong cash and liquidity levels at the Bank, brokered deposits declined to approximately \$268 million and the total funds swept from Hilltop Securities into the Bank was approximately \$700 million. In addition, we continue to evaluate market conditions to determine the appropriateness of capital market inventory limits at Hilltop Securities.

To meet demand for customer loan advances and satisfy our obligations to repay any debt maturing over the next 12 months, we believe we currently have sufficient liquidity from the available on- and off-balance sheet liquidity sources and our ability to issue debt in the capital markets. We continue to review actions that we may take to further enhance our financial flexibility in the event that market conditions deteriorate for an extended period.

### *Dividend Declaration*

On July 22, 2021, our board of directors declared a quarterly cash dividend of \$0.12 per common share, payable on August 31, 2021 to all common stockholders of record as of the close of business on August 13, 2021.

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

### *Stock Repurchases*

In January 2021, our board of directors authorized a new stock repurchase program through January 2022 pursuant to which we were originally authorized to repurchase, in the aggregate, up to \$75.0 million of our outstanding common stock. In July 2021, our board of directors authorized, subject to regulatory review, an increase to the aggregate amount of common stock we may repurchase under this program to \$150.0 million, which is inclusive of repurchases to offset dilution related to grants of stock-based compensation. Under the stock repurchase program authorized, we may repurchase shares in the open market or through privately negotiated transactions as permitted under Rule 10b-18 promulgated under the Exchange Act. The extent to which we repurchase our shares and the timing of such repurchases depends upon market conditions and other corporate considerations, as determined by Hilltop's management team. Repurchased shares will be returned to our pool of authorized but unissued shares of common stock.

During the six months ended June 30, 2021, we paid \$49.5 million to repurchase an aggregate of 1,390,721 shares of common stock at an average price of \$35.55 per share. The purchases were funded from available cash balances.

#### *Senior Notes due 2025*

The Senior Notes bear interest at a rate of 5% per year, payable semi-annually in arrears in cash on April 15 and October 15 of each year, commencing on October 15, 2015. The Senior Notes will mature on April 15, 2025, unless we redeem the Senior Notes, in whole at any time or in part from time to time, on or after January 15, 2025 (three months prior to the maturity date of the Senior Notes) at our election at a redemption price equal to 100% of the principal amount of the Senior Notes to be redeemed plus accrued and unpaid interest to, but excluding, the redemption date. At June 30, 2021, \$150.0 million of our Senior Notes was outstanding.

#### *Subordinated Notes due 2030 and 2035*

On May 7, 2020, we completed a public offering of \$50 million aggregate principal amount of 2030 Subordinated Notes and \$150 million aggregate principal amount of 2035 Subordinated Notes. The price to the public for the Subordinated Notes was 100% of the principal amount of the Subordinated Notes. The net proceeds from the offering, after deducting underwriting discounts and fees and expenses of \$3.4 million, were \$196.6 million.

The 2030 Subordinated Notes and the 2035 Subordinated Notes will mature on May 15, 2030 and May 15, 2035, respectively. We may redeem the Subordinated Notes, in whole or in part, from time to time, subject to obtaining Federal Reserve approval, beginning with the interest payment date of May 15, 2025 for the 2030 Subordinated Notes and beginning with the interest payment date of May 15, 2030 for the 2035 Subordinated Notes at a redemption price equal to 100% of the principal amount of the Subordinated Notes being redeemed plus accrued and unpaid interest to but excluding, the date of redemption.

The 2030 Subordinated Notes bear interest at a rate of 5.75% per year, payable semi-annually in arrears commencing on November 15, 2020. The interest rate for the 2030 Subordinated Notes will reset quarterly beginning May 15, 2025 to an interest rate, per year, equal to the then-current benchmark rate, which is expected to be three-month term SOFR rate, plus 5.68%, payable quarterly in arrears. The 2035 Subordinated Notes bear interest at a rate of 6.125% per year, payable semi-annually in arrears commencing on November 15, 2020. The interest rate for the 2035 Subordinated Notes will reset quarterly beginning May 15, 2030 to an interest rate, per year, equal to the then-current benchmark rate, which is expected to be three-month term SOFR rate plus 5.80%, payable quarterly in arrears. At June 30, 2021, \$200.0 million of our Subordinated Notes was outstanding.

#### *Junior Subordinated Debentures*

The Debentures, which are held by four statutory trusts created for the sole purpose of issuing and selling preferred securities and common securities used to acquire the Debentures, have a stated term of 30 years with maturities ranging from July 2031 to February 2038. Interest on the Debentures is payable quarterly and the rate, which resets quarterly, is based on three-month LIBOR plus an average spread of 3.22%. The total average interest rate at June 30, 2021 was 3.37%. The Debentures are callable at PCC's discretion with a minimum of a 45- to 60- day notice. At June 30, 2021, \$67.0 million of PCC's Debentures were outstanding.

Following receipt of regulatory approval, in June 2021, PCC submitted to the trustee of one of the statutory trusts a notice to redeem in full outstanding Debentures in the principal amount of \$18,042,000 (which would result in the full redemption to the holders of the associated preferred securities and common securities) with a target payment date of July 31, 2021. Additionally, PCC currently intends to redeem all outstanding Debentures held by the remaining statutory trusts totaling \$49.0 million during the third quarter of 2021. The redemptions are expected to be funded from available cash balances held at PCC.

## *Regulatory Capital*

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

In order to avoid limitations on capital distributions, including dividend payments, stock repurchases and certain discretionary bonus payments to executive officers, Basel III requires banking organizations to maintain a capital conservation buffer above minimum risk-based capital requirements measured relative to risk-weighted assets.

Actual capital amounts and ratios as of June 30, 2021 reflect PlainsCapital's and Hilltop's decision to elect the transition option as issued by the federal banking regulatory agencies in March 2020 that permits banking institutions to mitigate the estimated cumulative regulatory capital effects from CECL over a five-year transitional period.

At June 30, 2021, Hilltop had a total capital to risk weighted assets ratio of 23.48%, Tier 1 capital to risk weighted assets ratio of 20.82%, common equity Tier 1 capital to risk weighted assets ratio of 20.22% and a Tier 1 capital to average assets, or leverage, ratio of 12.87%. Accordingly, Hilltop's actual capital amounts and ratios in accordance with Basel III exceeded the regulatory capital requirements including conservation buffer in effect at the end of the period.

At June 30, 2021, PlainsCapital had a total capital to risk weighted assets ratio of 15.95%, Tier 1 capital to risk weighted assets ratio of 15.00%, common equity Tier 1 capital to risk weighted assets ratio of 15.00% and a Tier 1 capital to average assets, or leverage, ratio of 10.22%. Accordingly, PlainsCapital's actual capital amounts and ratios in accordance with Basel III resulted in it being considered "well-capitalized" and exceeded the regulatory capital requirements including conservation buffer in effect at the end of the period.

We discuss regulatory capital requirements in more detail in Note 17 to our consolidated financial statements, as well as under the caption "Government Supervision and Regulation — Corporate — Capital Adequacy Requirements and BASEL III" set forth in Part I, Item I. of our 2020 Form 10-K.

## *Banking Segment*

Within our banking segment, our primary uses of cash are for customer withdrawals and extensions of credit as well as our borrowing costs and other operating expenses. Our corporate treasury group is responsible for continuously monitoring our liquidity position to ensure that our assets and liabilities are managed in a manner that will meet our short-term and long-term cash requirements. Our goal is to manage our liquidity position in a manner such that we can meet our customers' short-term and long-term deposit withdrawals and anticipated and unanticipated increases in loan demand without penalizing earnings. Funds invested in short-term marketable instruments, the continuous maturing of other interest-earning assets, cash flows from self-liquidating investments such as mortgage-backed securities and collateralized mortgage obligations, the possible sale of available for sale securities and the ability to securitize certain types of loans provide sources of liquidity from an asset perspective. The liability base provides sources of liquidity through deposits and the maturity structure of short-term borrowed funds. For short-term liquidity needs, we utilize federal fund lines of credit with correspondent banks, securities sold under agreements to repurchase, borrowings from the Federal Reserve and borrowings under lines of credit with other financial institutions. For intermediate liquidity needs, we utilize advances from the FHLB. To supply liquidity over the longer term, we have access to brokered time deposits, term loans at the FHLB and borrowings under lines of credit with other financial institutions.

As previously discussed, to meet increased liquidity demands and ensure availability of adequate cash to meet both expected and unexpected funding needs without adversely affecting our daily operations and to improve the Bank's already strong liquidity position, we raised brokered deposits during 2020 that have a remaining balance of approximately \$268 million at June 30, 2021, down from approximately \$731 million at December 31, 2020. Further, beginning in March 2020, additional deposits were swept from Hilltop Securities into the Bank. Since June 30, 2020, given the continued strong cash and liquidity levels at the Bank, the total funds swept from Hilltop Securities into the Bank was reduced, and is approximately \$700 million as of June 30, 2021. As a result, the Bank was able to further

fortify its borrowing capacity through access to secured funding sources as summarized in the following table (in millions).

	<u>June 30,</u> <u>2021</u>	<u>December 31,</u> <u>2020</u>
FHLB capacity	\$ 4,476	\$ 4,410
Investment portfolio (available)	1,442	982
Fed deposits (excess daily requirements)	1,345	875
	<u>\$ 7,263</u>	<u>\$ 6,267</u>

As noted in the table above, the Bank’s available liquidity position and borrowing capacity at June 30, 2021 continues to be at a heightened level given the uncertain outlook for 2021 due to the COVID-19 pandemic. While the extent to which COVID-19 will impact the Bank remains uncertain, the Bank is targeting available liquidity of between approximately \$5 billion and \$6 billion during the remainder of 2021. Available liquidity does not include borrowing capacity available through the discount window at the Federal Reserve.

Within our banking segment, deposit flows are affected by the level of market interest rates, the interest rates and products offered by competitors, the volatility of equity markets and other factors. While the Bank began to experience an increase in non-brokered customer deposits during 2020, an economic recovery and improved commercial real estate investment outlook may result in an outflow of deposits at an accelerated pace as customers utilize such available funds for expanded operations and investment opportunities. The Bank regularly evaluates its deposit products and pricing structures relative to the market to maintain competitiveness over time.

The Bank’s 15 largest depositors, excluding Hilltop and Hilltop Securities, collectively accounted for 9.77% of the Bank’s total deposits, and the Bank’s five largest depositors, excluding Hilltop and Hilltop Securities, collectively accounted for 4.54% of the Bank’s total deposits at June 30, 2021. 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.

#### *Broker-Dealer Segment*

The Hilltop Broker-Dealers rely on their equity capital, short-term bank borrowings, interest-bearing and noninterest-bearing client credit balances, correspondent deposits, securities lending arrangements, repurchase agreement financing, commercial paper issuances and other payables to finance their assets and operations, subject to their respective compliance with broker-dealer net capital and customer protection rules. At June 30, 2021, Hilltop Securities had credit arrangements with four unaffiliated banks, with maximum aggregate commitments of up to \$600.0 million. These credit arrangements are used to finance securities owned, securities held for correspondent accounts, receivables in customer margin accounts and underwriting activities. These credit arrangements are provided on an “as offered” basis and are not committed lines of credit. In addition, Hilltop Securities has committed revolving credit facilities with three unaffiliated banks, with aggregate availability of up to \$250.0 million. At June 30, 2021, Hilltop Securities had borrowed \$189.5 million under its credit arrangements and had no borrowings under its credit facilities.

Hilltop Securities uses the net proceeds (after deducting related issuance expenses) from the sale of two commercial paper programs for general corporate purposes, including working capital and the funding of a portion of its securities inventories. The commercial paper notes (“CP Notes”) may be issued with maturities of 14 days to 270 days from the date of issuance. The commercial paper notes (“CP Notes”) are issued under two separate programs, Series 2019-1 CP Notes and Series 2019-2 CP Notes, in maximum aggregate amounts of \$300 million and \$200 million, respectively. As of June 30, 2021, the weighted average maturity of the CP Notes was 157 days at a rate of 1.13% with a weighted average remaining life of 78 days. At June 30, 2021, the aggregate amount outstanding under these secured arrangements was \$369.2 million, which was collateralized by securities held for firm accounts valued at \$401.8 million.

#### *Mortgage Origination Segment*

PrimeLending funds the mortgage loans it originates through warehouse lines of credit maintained with the Bank, which have an aggregate commitment of \$3.3 billion, of which \$2.5 billion was drawn at June 30, 2021. PrimeLending sells substantially all mortgage loans it originates to various investors in the secondary market, historically with the majority with servicing released. As these mortgage loans are sold in the secondary market, PrimeLending pays down its

warehouse line of credit with the Bank. In addition, PrimeLending has an available line of credit with an unaffiliated bank of up to \$1.0 million, of which no borrowings were drawn at June 30, 2021.

PrimeLending owns a 100% membership interest in PrimeLending Ventures Management, LLC (“Ventures Management”) which holds an ownership interest in and is the managing member of certain ABAs. At June 30, 2021, these ABAs had combined available lines of credit totaling \$170.0 million, \$80.0 million of which was with a single unaffiliated bank, and the remaining \$90.0 million of which was with the Bank. At June 30, 2021, Ventures Management had outstanding borrowings of \$66.8 million, \$16.1 million of which was with the Bank.

### ***Impact of Inflation and Changing Prices***

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

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

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

#### ***Banking Segment***

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

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

In the aggregate, the Bank had outstanding unused commitments to extend credit of \$2.1 billion at June 30, 2021 and outstanding financial and performance standby letters of credit of \$89.3 million at June 30, 2021.

#### ***Broker-Dealer***

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



### ***Critical Accounting 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 credit losses, goodwill and identifiable intangible assets, mortgage loan indemnification liability, mortgage servicing rights asset and acquisition accounting. Since December 31, 2020, 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 2020 Form 10-K.

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

Our assessment of market risk as of June 30, 2021 indicates there are no material changes in the quantitative and qualitative disclosures from those previously reported in our 2020 Form 10-K, except as discussed below.

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

#### *Banking Segment*

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

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

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

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

negative GAP would tend to affect net interest income adversely, while a positive GAP would tend to result in an increase in net interest income. During a period of falling interest rates, a negative GAP would tend to result in an increase in net interest income, while a positive GAP would tend to affect net interest income adversely. However, it is our intent to remain relatively balanced so that changes in rates do not have a significant impact on earnings.

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

	June 30, 2021					Total
	3 Months or Less	> 3 Months to 1 Year	> 1 Year to 3 Years	> 3 Years to 5 Years	> 5 Years	
<b>Interest sensitive assets:</b>						
Loans	\$ 5,930,299	\$ 1,295,259	\$ 1,452,880	\$ 660,386	\$ 204,129	\$ 9,542,953
Securities	254,255	232,279	503,745	348,108	738,361	2,076,748
Federal funds sold and securities purchased under agreements to resell	387	—	—	—	—	387
Other interest sensitive assets	1,353,942	—	—	—	29,487	1,383,429
Total interest sensitive assets	7,538,883	1,527,538	1,956,625	1,008,494	971,977	13,003,517
<b>Interest sensitive liabilities:</b>						
Interest bearing checking	\$ 5,816,274	\$ —	\$ —	\$ —	\$ —	\$ 5,816,274
Savings	293,886	—	—	—	—	293,886
Time deposits	337,045	788,007	108,776	35,700	—	1,269,528
Notes payable and other borrowings	179,162	197	614	769	2,882	183,624
Total interest sensitive liabilities	6,626,367	788,204	109,390	36,469	2,882	7,563,312
Interest sensitivity gap	\$ 912,516	\$ 739,334	\$ 1,847,235	\$ 972,025	\$ 969,095	\$ 5,440,205
Cumulative interest sensitivity gap	\$ 912,516	\$ 1,651,850	\$ 3,499,085	\$ 4,471,110	\$ 5,440,205	
Percentage of cumulative gap to total interest sensitive assets	7.02 %	12.70 %	26.91 %	34.38 %	41.84 %	

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 50 to 100 basis points to determine the effect on net interest income changes for the next twelve months. The banking segment also measures the effects of changes in interest rates on economic value of equity by discounting projected cash flows of deposits and loans. Economic value changes in the investment portfolio are estimated by discounting future cash flows and using duration analysis. Investment security prepayments are estimated using current market information. We believe the simulation analysis presents a more accurate picture than the GAP analysis. Simulation analysis recognizes that deposit products may not react to changes in interest rates as quickly or with the same magnitude as earning assets contractually tied to a market rate index. The sensitivity to changes in market rates varies across deposit products. Also, unlike GAP analysis, simulation analysis takes into account the effect of embedded options in the securities and loan portfolios as well as any off-balance sheet derivatives.

The table below shows the estimated impact of a range of changes in interest rates on net interest income and on economic value of equity for the banking segment at June 30, 2021 (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	\$ 114,686	31.13 %	\$ 599,200	32.35 %
+200	\$ 74,204	20.14 %	\$ 423,566	22.87 %
+100	\$ 34,994	9.50 %	\$ 219,526	11.85 %
-50	\$ (6,306)	(1.71)%	\$ (204,000)	(11.02)%

The projected changes in net interest income and economic value of equity to changes in interest rates at June 30, 2021 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.

Our portfolio includes loans that periodically reprice or mature prior to the end of an amortized term. Some of our variable-rate loans remain at applicable rate floors, which may delay and/or limit changes in interest income during a period of changing rates. If interest rates were to fall, the impact on our interest income would be limited by these rate floors. In addition, declining interest rates may negatively affect our cost of funds on deposits. The extent of this impact will ultimately be driven by the timing, magnitude and frequency of interest rate and yield curve movements, as well as changes in market conditions and timing of management strategies. If interest rates were to rise, yields on the portion of our portfolio that remain at applicable rate floors would rise more slowly than increases in market interest rates. Any changes in interest rates across the term structure will continue to impact net interest income and net interest margin. The impact of rate movements will change with the shape of the yield curve, including any changes in steepness or flatness and inversions at any points on the yield curve.

### *Broker-Dealer Segment*

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

Our broker-dealer segment is exposed to interest rate risk as a result of maintaining inventories of interest rate sensitive financial instruments and other interest-earning assets including customer and correspondent margin loans and receivables and securities borrowing activities. Our funding sources, which include customer and correspondent cash balances, bank borrowings, repurchase agreements and securities lending activities, also expose the broker-dealer to interest rate risk. Movement in short-term interest rates could reduce the positive spread between the broker-dealer segment's interest income and interest expense.

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

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

	June 30, 2021				
	1 Year or Less	> 1 Year to 5 Years	> 5 Years to 10 Years	> 10 Years	Total
<b><u>Trading securities, at fair value</u></b>					
Municipal obligations	\$ 52	\$ 4,666	\$ 17,664	\$ 244,325	\$ 266,707
U.S. government and government agency obligations	15	8,320	(53,451)	257,194	212,078
Corporate obligations	(1,445)	917	6,057	60,096	65,625
Total debt securities	(1,378)	13,903	(29,730)	561,615	544,410
Corporate equity securities	—	—	—	—	—
Other	4,975	—	—	—	4,975
	<u>\$ 3,597</u>	<u>\$ 13,903</u>	<u>\$ (29,730)</u>	<u>\$ 561,615</u>	<u>\$ 549,385</u>
<b><u>Weighted average yield</u></b>					
Municipal obligations	0.00 %	2.02 %	1.95 %	3.12 %	3.04 %
U.S. government and government agency obligations	0.09 %	0.47 %	1.03 %	4.27 %	3.65 %
Corporate obligations	0.54 %	2.96 %	3.18 %	2.65 %	2.64 %

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

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

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

### *Mortgage Origination Segment*

Within our mortgage origination segment, our principal market exposure is to interest rate risk due to the impact on our mortgage-related assets and commitments, including mortgage loans held for sale, IRLCs and MSR. Changes in interest rates could also materially and adversely affect our volume of mortgage loan originations.

IRLCs represent an agreement to extend credit to a mortgage loan applicant, whereby the interest rate on the loan is set prior to funding. Our mortgage loans held for sale, which we hold in inventory while awaiting sale into the secondary market, and our IRLCs are subject to the effects of changes in mortgage interest rates from the date of the commitment through the sale of the loan into the secondary market. As a result, we are exposed to interest rate risk and related price risk during the period from the date of the lock commitment until (i) the lock commitment cancellation or expiration date or (ii) the date of sale into the secondary mortgage market. Loan commitments generally range from 20 to 60 days, and our average holding period of the mortgage loan from funding to sale is approximately 30 days. An integral component of our interest rate risk management strategy is our execution of forward commitments to sell MBSs to minimize the impact on earnings resulting from significant fluctuations in the fair value of mortgage loans held for sale and IRLCs caused by changes in interest rates.

We have expanded, and may continue to expand, our residential mortgage servicing operations within our mortgage origination segment. As a result of our mortgage servicing business, we have a portfolio of retained MSR. One of the principal risks associated with MSR is that in a declining interest rate environment, they will likely lose a substantial portion of their value as a result of higher than anticipated prepayments. Moreover, if prepayments are greater than expected, the cash we receive over the life of the mortgage loans would be reduced. The mortgage origination segment uses derivative financial instruments, including U.S. Treasury bond futures and options, Eurodollar futures and forward MBS commitments, as a means to mitigate market risk associated with MSR assets. No hedging strategy can protect us completely, and hedging strategies may fail because they are improperly designed, improperly executed and documented or based on inaccurate assumptions and, as a result, could actually increase our risks and losses. The increasing size of our MSR portfolio may increase our interest rate risk and, correspondingly, the volatility of our earnings, especially if we cannot adequately hedge the interest rate risk relating to our MSR.

The goal of our interest rate risk management strategy within our mortgage origination segment is not to eliminate interest rate risk, but to manage it within appropriate limits. To mitigate the risk of loss, we have established policies and procedures, which include guidelines on the amount of exposure to interest rate changes we are willing to accept.

#### **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 the period covered by this report, 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 during our second fiscal quarter covered by this quarterly 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 14 to our Consolidated Financial Statements, which is incorporated by reference herein.

### Item 1A. Risk Factors.

There have been no material changes to the risk factors disclosed under “Item 1A. Risk Factors” of our 2020 Form 10-K. For additional information concerning our risk factors, please refer to “Item 1A. Risk Factors” of our 2020 Form 10-K.

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

The following table details our repurchases of shares of common stock during the three months ended June 30, 2021.

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1)</sup></u>
April 1 - April 30, 2021	115,000	\$ 35.24	115,000	\$ 65,998,824
May 1 - May 31, 2021	1,122,103	35.91	1,122,103	25,699,683
June 1 - June 30, 2021	3,740	36.96	3,740	25,561,444
Total	1,240,843	\$ 35.85	1,240,843	

- (1) On January 22, 2021, we announced that our board of directors authorized a stock repurchase program under which we were originally authorized to repurchase, in the aggregate, up to \$75.0 million of our outstanding common stock through January 2022. In July 2021, our board of directors authorized, subject to regulatory review, an increase to the aggregate amount of common stock we may repurchase under this program to \$150.0 million, which is inclusive of repurchases to offset dilution related to grants of stock-based compensation.

## Item 6. Exhibits.

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
2.1#	Stock Purchase Agreement by and among Hilltop Holdings Inc., ARC Insurance Holdings, Inc., Align NL Holdings, LLC and, for limited purposes set forth therein, Align Financial Holdings, LLC and MGI Holdings, Inc., dated January 30, 2020 (filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed February 5, 2020 (File No. 001-31987) and incorporated herein by reference).
2.2#	First Amendment to Stock Purchase Agreement by and among Hilltop Holdings Inc., ARC Insurance Holdings, Inc., Align NL Holdings, LLC and, for limited purposes set forth therein, Align Financial Holdings, LLC and MGI Holdings, Inc., dated June 30, 2020 (filed as Exhibit 2.2 to the Registrant's Current Report on Form 8-K filed July 1, 2020 (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 – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH*	Inline XBRL Taxonomy Extension Schema
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase
104	Cover Page Interactive File (formatted as Inline XBRL and contained in Exhibit 101)

\* Filed herewith.

\*\* Furnished herewith.

# Schedules and similar attachments have been omitted from this Exhibit pursuant to Item 601(b)(2) of Regulation S-K. A copy of any omitted schedule or similar attachment will be furnished to the SEC upon request.

## 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: July 26, 2021

By: /s/ William B. Furr

William B. Furr

Chief Financial Officer

(Principal Financial Officer and duly authorized officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**

I, Jeremy B. Ford, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Hilltop Holdings Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 26, 2021

By: /s/ Jeremy B. Ford

Jeremy B. Ford  
President and Chief Executive Officer



**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER**

I, William B. Furr, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Hilltop Holdings Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 26, 2021

By: /s/ William B. Furr  
William B. Furr  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q for the period ended June 30, 2021 (the “Report”) of Hilltop Holdings Inc. (the “Company”), the undersigned hereby certify in their capacities as President and Chief Executive Officer and Chief Financial Officer, respectively, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to their knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Report.

Date: July 26, 2021

By: /s/ Jeremy B. Ford

Jeremy B. Ford  
President and Chief Executive Officer

Date: July 26, 2021

By: /s/ William B. Furr

William B. Furr  
Chief Financial Officer

*The foregoing certification is furnished as an exhibit to the Report and will not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof, regardless of any general incorporation language in such filing.*