

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended: December 31, 2020

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

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)

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

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

**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

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

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, a 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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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 has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

Aggregate market value of the voting and non-voting common equity held by non-affiliates, computed by reference to the price at which the common stock was last sold on the New York Stock Exchange on June 30, 2020, was approximately \$1.18 billion. For the purposes of this computation, all officers, directors and 10% stockholders are considered affiliates. The number of shares of the registrant's common stock outstanding at February 16, 2021 was 82,188,513.

**DOCUMENTS INCORPORATED BY REFERENCE**

The Registrant's definitive Proxy Statement pertaining to the 2021 Annual Meeting of Stockholders, filed or to be filed not later than 120 days after the end of the fiscal year pursuant to Regulation 14A, is incorporated herein by reference into Part III.

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### MARKET AND INDUSTRY DATA AND FORECASTS

Market and industry data and other statistical information and forecasts used throughout this Annual Report on Form 10-K (this “Annual Report”) are based on independent industry publications, government publications and reports by market research firms or other published independent sources. We have not sought or obtained the approval or endorsement of the use of this third party information. Some data also is based on our good faith estimates, which are derived from our review of internal surveys, as well as independent sources. Forecasts are particularly likely to be inaccurate, especially over long periods of time.

*Unless the context otherwise indicates, all references in this Annual Report 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., formerly Hilltop Securities 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 Annual 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 Annual 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, use of proceeds from offerings, 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, including as a result of the “current expected credit losses” (CECL) model, expected future benchmarks rates, anticipated investment yields, our expectations regarding accretion of discount on loans in future periods, the collectability of loans, cybersecurity incidents and the outcome of litigation are forward-looking statements.

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

- the COVID-19 pandemic and the response of governmental authorities to the pandemic, which have caused and are causing significant harm to the global economy and our business;
- the credit risks of lending activities, including our ability to estimate credit losses and increases to the allowance for credit losses as a result of the implementation of CECL, 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 our concentration in real estate related loans;
- changes in the interest rate environment and transitions away from the 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 Item 1A, “Risk Factors,” and Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” herein. 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 Annual Report except to the extent required by federal securities laws.

## PART I

### Item 1. Business.

#### General

Hilltop Holdings Inc. is a diversified, Texas-based financial holding company registered under the Bank Holding Company Act of 1956, as amended (the “Bank Holding Company Act”). 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. We endeavor to build and maintain a strong financial services company through organic growth as well as acquisitions, which we may make using available capital, excess liquidity and, if necessary or appropriate, additional equity or debt financing sources. The following includes additional details regarding the financial products and services provided by each of our two 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.

At December 31, 2020, on a consolidated basis, we had total assets of \$16.9 billion, total deposits of \$11.2 billion, total loans, including loans held for sale, of \$10.3 billion and stockholders’ equity of \$2.4 billion.

Our common stock is listed on the New York Stock Exchange (“NYSE”) under the symbol “HTH.”

Our principal office is located at 6565 Hillcrest Avenue, Dallas, Texas 75205, and our telephone number at that location is (214) 855-2177. Our internet address is [www.hilltop-holdings.com](http://www.hilltop-holdings.com). Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are available on our website at <http://ir.hilltop-holdings.com/> under the tab “Investor Relations - SEC Filings” as soon as reasonably practicable after we electronically file such reports with, or furnish them to, the Securities and Exchange Commission (the “SEC”). The references to our website in this Annual Report are inactive textual references only. The information on our website is not incorporated by reference into this Annual Report.

#### Business Segments

Under accounting principles generally accepted in the United States (“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. These segments reflect the manner in which operations are managed and the criteria used by our chief operating decision maker, our President and Chief Executive Officer, to evaluate segment performance, develop strategy and allocate resources.

The following graphic reflects our current business segment.



On June 30, 2020, we completed the sale of all of the outstanding capital stock of NLC, which comprised the operations of the former insurance segment. As a result, insurance segment results and its assets and liabilities have been presented as discontinued operations in our consolidated financial statements, and we no longer have an insurance segment. Following the sale of NLC, 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.

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.

For more financial information about each of our business segments, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," herein. See also Note 30 in the notes to our consolidated financial statements included under Item 8, "Financial Statements and Supplementary Data."

### *Banking*

The banking segment includes the operations of the Bank, which, at December 31, 2020, had \$13.3 billion in assets and total deposits of \$11.4 billion. The primary sources of our deposits are residents and businesses located in Texas. At December 31, 2020, the Bank employed approximately 1,100 people.

The table below sets forth a distribution of the banking segment's loans, classified by portfolio segment. The banking segment's loan portfolio includes \$3.3 billion in warehouse lines of credit extended to PrimeLending, of which \$2.5 billion was drawn at December 31, 2020. Amounts advanced against the warehouse line of credit are included in the table below, but are eliminated from net loans on our consolidated balance sheets.

	<b>Total Loans Held for Investment</b>	<b>% of Total Loans Held for Investment</b>
Commercial real estate:		
Non-owner occupied	\$ 1,788,311	18.3 %
Owner occupied	1,345,592	13.7 %
Commercial and industrial <sup>(1)</sup>	1,834,968	18.8 %
Mortgage warehouse lending	792,806	8.1 %
Construction and land development	828,852	8.5 %
1-4 family residential	629,938	6.4 %
Consumer	35,667	0.4 %
	7,256,134	74.2 %
PrimeLending warehouse lines of credit	2,525,422	25.8 %
Total loans held for investment	\$ 9,781,556	100.0 %

(1) Included loans totaling \$486.7 million at December 31, 2020 funded through the Paycheck Protection Program.

Our lending policies seek to establish an asset portfolio that will provide a return on stockholders' equity sufficient to maintain capital to assets ratios that meet or exceed established regulations. In support of that goal, we have designed our underwriting standards to determine:

- that our borrowers possess sound ethics and competently manage their affairs;
- that we know the source of the funds the borrower will use to repay the loan;
- that the purpose of the loan makes economic sense; and
- that we identify relevant risks of the loan and determine that the risks are acceptable.

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 were passed in March and April 2020, which are intended to provide emergency relief to several groups and individuals impacted by the COVID-19 pandemic. 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 Paycheck Protection Program ("PPP") as a Small Business Administration ("SBA") preferred lender and personal banking assistance including waived fees, increased daily spending limits and suspension of residential foreclosure activities. The COVID-19 payment deferment 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.

We implement our underwriting standards according to the facts and circumstances of each particular loan request, as discussed below.

*Business Banking.* Our business banking customers primarily consist of agribusiness, energy, healthcare, institutions of higher education, real estate (including construction and land development) and wholesale/retail trade companies. We provide these customers with extensive banking services, such as online banking, business check cards and other add-on services as determined on a customer-by-customer basis. Our treasury management services, which are designed to reduce the time, burden and expense of collecting, transferring, disbursing and reporting cash, are also available to our business customers. We offer our business banking customers term loans, lines of credit, equipment loans and leases, letters of credit, agricultural loans, commercial real estate loans and other loan products, including PPP loans.

Commercial and industrial loans are primarily made within Texas and are underwritten on the basis of the borrower's ability to service the debt from cash flow from an operating business. In general, commercial and industrial loans involve more credit risk than residential and commercial real estate loans and, therefore, usually yield a higher return. The increased risk in commercial and industrial loans results primarily from the type of collateral securing these loans, which typically includes accounts receivable, equipment and inventory. Additionally, increased risk arises from the expectation that commercial and industrial loans generally will be serviced principally from operating cash flow of the business, and such cash flows are dependent upon successful business operations. Historical trends have shown these types of loans to have higher delinquencies than mortgage loans. As a result of the additional risk and complexity associated with commercial and industrial loans, such loans require more thorough underwriting and servicing than loans to individuals. To manage these risks, our policy is to attempt to secure commercial and industrial loans with both the assets of the borrowing business and other additional collateral and guarantees that may be available. In addition, depending on the size of the credit, we actively monitor the financial condition of the borrower by analyzing the borrower's financial statements and assessing certain financial measures, including cash flow, collateral value and other appropriate credit factors. We also have processes in place to analyze and evaluate on a regular basis our exposure to industries, products, market changes and economic trends.

The Bank offers term financing on commercial real estate that includes retail, office, multi-family, industrial and warehouse properties. Commercial mortgage lending can involve high principal loan amounts, and the repayment of these loans is dependent, in large part, on a borrower's ongoing business operations or on income generated from the properties that are leased to third parties. Accordingly, we apply the measures described above for commercial and industrial loans to our commercial real estate lending, with increased emphasis on analysis of collateral values. As a general practice, the Bank requires its commercial mortgage loans to (i) be secured with first lien positions on the underlying property, (ii) maintain adequate equity margins, (iii) be serviced by businesses operated by an established management team and (iv) be guaranteed by the principals of the borrower. The Bank seeks lending opportunities where cash flow from the collateral provides adequate debt service coverage and/or the guarantor's net worth is comprised of assets other than the project being financed.

The Bank's mortgage warehouse lending activities consist of asset-based lending in which the Bank provides short-term, revolving lines of credit to independent mortgage bankers ("IMBs"). IMBs are generally small businesses, with mortgage loan origination and servicing as their sole or primary business. IMBs use the funds from their lines of credit to provide home loans to prospective and existing homeowners. When the IMBs subsequently sell the loans to institutional investors in the secondary market—typically within 30 days of closing the transaction—the proceeds from the sale are used to pay down and therefore replenish their lines of credit.

The Bank also offers construction financing for (i) commercial, retail, office, industrial, warehouse and multi-family developments, (ii) residential developments and (iii) single family residential properties. Construction loans involve additional risks because loan funds are advanced upon the security of a project under construction, and the project is of uncertain value prior to its completion. If the Bank is forced to foreclose on a project prior to completion, it may not be able to recover the entire unpaid portion of the loan. Additionally, the Bank may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan-to-value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. The Bank generally requires that the subject property of a construction loan for commercial real estate be pre-leased because cash flows from the completed project provide the most reliable source of repayment for the loan. Loans to finance these projects are generally secured by first liens on the underlying real property. The Bank conducts periodic completion inspections, either directly or through an agent, prior to approval of periodic draws on these loans.

In addition to the real estate lending activities described above, a portion of the Bank's real estate portfolio consists of one-to-four family residential mortgage loans typically collateralized by owner occupied properties. These residential mortgage loans are generally secured by a first lien on the underlying property and have maturities up to 30 years. These loans are shown in the loans held for investment table above as "1-4 family residential."

*Personal Banking.* The Bank offers a broad range of personal banking products and services for individuals. Similar to its business banking operations, the Bank also provides its personal banking customers with a variety of add-on features such as check cards, safe deposit boxes, online banking, bill pay, overdraft privilege services and access to automated teller machine (ATM) facilities throughout the United States. The Bank offers a variety of deposit accounts to its personal banking customers including savings, checking, interest-bearing checking, money market and certificates of deposit.

The Bank loans to individuals for personal, family and household purposes, including lines of credit, home improvement loans, home equity loans, and loans for purchasing and carrying securities.

*Private Banking and Investment Management.* The Bank's private banking team personally assists high net worth individuals and their families with their banking needs, including depository, credit, asset management, and trust and estate services. The Bank offers trust and asset management services in order to assist these customers in managing, and ultimately transferring, their wealth.

The Bank's services provide personal trust, investment management and employee benefit plan administration services, including estate planning, management and administration, investment portfolio management, employee benefit accounts and individual retirement accounts.

#### *Broker-Dealer*

The "Hilltop Broker-Dealers" include the operations of Hilltop Securities, a clearing broker-dealer subsidiary registered with the SEC and the Financial Industry Regulatory Authority ("FINRA") and a member of the NYSE, Momentum Independent Network, an introducing broker-dealer subsidiary that is also registered with the SEC and FINRA, and Hilltop Securities Asset Management, LLC. Hilltop Securities and Momentum Independent Network are both registered with the Commodity Futures Trading Commission ("CFTC") as non-guaranteed introducing brokers and as members of the National Futures Association ("NFA"). Additionally, Hilltop Securities Asset Management, LLC, Hilltop Securities and Momentum Independent Network are investment advisers registered under the Investment Advisers Act of 1940. At December 31, 2020, Hilltop Securities had consolidated assets of \$3.2 billion and net capital of \$291.2 million, which was



\$284.2 million in excess of its minimum net capital requirement of \$7.0 million. At December 31, 2020, the Hilltop Broker-Dealers employed approximately 750 people and maintained 51 locations in 19 states.

Our broker-dealer segment has four primary lines of business: (i) public finance services, (ii) structured finance, (iii) fixed income services, and (iv) wealth management, which includes retail, clearing services and securities lending. These lines of business and the respective services provided reflect the current manner in which the broker-dealer segment's operations are managed.

*Public Finance Services.* The public finance services line of business assists public entities nationwide, including cities, counties, school districts, utility districts, tax increment zones, special districts, state agencies and other governmental entities, in originating, syndicating and distributing securities of municipalities and political subdivisions. In addition, the public finance services line of business provides specialized advisory and investment banking services for airports, convention centers, healthcare institutions, institutions of higher education, housing, industrial development agencies, toll road authorities, and public power and utility providers.

Additionally, through its arbitrage rebate, treasury management and government investment pools management departments, the public finance services line of business provides state and local governments with advice and guidance with respect to arbitrage rebate compliance, portfolio management and local government investment pool administration.

*Structured Finance.* The structured finance line of business provides advisory services and centralized product expertise for derivatives and commodities. In addition, this business line participates in programs in which it issues forward purchase commitments of mortgage-backed securities to certain non-profit housing clients and sells U.S. Agency to-be-announced ("TBA") mortgage-backed securities.

*Fixed Income Services.* The fixed income services line of business specializes in sales, trading and underwriting of U.S. government and government agency bonds, corporate bonds, municipal bonds, mortgage-backed, asset-backed and commercial mortgage-backed securities and structured products to support sales and other client activities. In addition, the fixed income services line of business provides asset and liability management advisory services to community banks.

*Wealth Management.* The wealth management line of business is comprised of our retail, clearing services and securities lending groups.

*Retail.* The retail group acts as a securities broker for retail investors in the purchase and sale of securities, options, commodities and futures contracts that are traded on various exchanges or in the over-the-counter market through our employee-registered representatives or independent contractor arrangements. We extend margin credit on a secured basis to our retail customers in order to facilitate securities transactions. Through Southwest Insurance Agency, Inc. and Southwest Financial Insurance Agency, Inc., we hold insurance licenses to facilitate the sale of insurance and annuity products by Hilltop Securities and Momentum Independent Network advisors to retail clients. We retain no underwriting risk related to these insurance and annuity products. In addition, through our investment management team, the retail group provides a number of advisory programs that offer advisors a wide array of products and services for their advisory businesses. In most cases, we charge commissions to our clients in accordance with an established commission schedule, subject to certain discounts based upon the client's level of business, the trade size and other relevant factors. The Momentum Independent Network advisors may also contract directly with third party carriers to sell specified insurance products to their customers. The commissions received from these third party carriers are paid directly to the advisor. Hilltop Securities is also a fully disclosed client of two of the largest futures commission merchants in the United States. At December 31, 2020, we employed 117 registered representatives in 18 retail brokerage offices and had contracts with 189 independent retail representatives for the administration of their securities business.

*Clearing Services.* The clearing services group offers fully disclosed clearing services to FINRA- and SEC-registered member firms for trade execution and clearance as well as back office services such as record keeping, trade reporting, accounting, general back-office support, securities and margin lending, reorganization assistance and custody of securities. At December 31, 2020, we provided services to 129 financial organizations, including correspondent firms, correspondent broker-dealers, registered investment advisers, discount and full-service brokerage firms, and institutional firms.

*Securities Lending.* The securities lending group performs activities that include borrowing and lending securities for other broker-dealers, lending institutions, and internal clearing and retail operations. These activities involve borrowing

securities to cover short sales and to complete transactions in which clients have failed to deliver securities by the required settlement date, and lending securities to other broker-dealers for similar purposes.

### *Mortgage Origination*

Our mortgage origination segment operates through a wholly owned subsidiary of the Bank, PrimeLending, which is a residential mortgage banker licensed to originate and close loans in all 50 states and the District of Columbia. PrimeLending primarily originates its mortgage loans through a retail channel, with limited lending through its affiliated business arrangements (“ABAs”). During 2020, funded loan volume through ABAs was approximately 7% of the mortgage origination segment’s total loan volume. At December 31, 2020, our mortgage origination segment operated from over 290 locations in 45 states, originating 18.6%, 10.9% and 6.1%, respectively, of its mortgage loans (by dollar volume) from its Texas, California and Florida locations. The mortgage lending business is subject to variables that can impact loan origination volume, including seasonal and interest rate fluctuations. Historically, the mortgage origination segment has experienced increased loan origination volume from purchases of homes during the spring and summer, when more people tend to move and buy or sell homes. An increase in mortgage interest rates tends to result in decreased loan origination volume from refinancings, while a decrease in mortgage interest rates tends to result in increased loan origination volume from refinancings. Changes in interest rates have historically had a lesser impact on home purchases volume than on refinancing volume.

PrimeLending handles loan processing, underwriting and closings in-house. Mortgage loans originated by PrimeLending are funded through warehouse lines of credit maintained with the Bank. PrimeLending sells substantially all mortgage loans it originates to various investors in the secondary market, historically with the majority servicing released. During 2020, 2019, and 2018, the mortgage origination segment originated approximately \$193 million, \$149 million, and \$97 million, respectively, in loans on behalf of the banking segment, representing up to 1% of PrimeLending’s total loan origination volume during each year. We expect loan volume originated on behalf of the banking segment to increase during 2021 based on approved authority for up to 5% of the mortgage origination segment’s total loan volume. PrimeLending’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. PrimeLending may, from time to time, manage its related mortgage servicing rights (“MSR”) assets through different strategies, including varying the percentage of mortgage loans sold servicing released and opportunistically selling MSR assets. As mortgage loans are sold in the secondary market, PrimeLending pays down its warehouse lines of credit with the Bank. Loans sold are subject to certain standard indemnification provisions with investors, including the repurchase of loans sold and the repayment of sales proceeds to investors under certain conditions.

Our mortgage lending underwriting strategy, driven in large measure by secondary market investor standards, seeks primarily to originate conforming loans. Our underwriting practices include:

- granting loans on a sound and collectible basis;
- obtaining a balance between maximum yield and minimum risk;
- ensuring that primary and secondary sources of repayment are adequate in relation to the amount of the loan; and
- ensuring that each loan is properly documented and, if appropriate, adequately insured.

PrimeLending also acts as a primary servicer for loans originated prior to sale, loans sold to the banking segment and loans sold with servicing retained.

PrimeLending had a staff of approximately 2,700 people, including approximately 1,225 mortgage loan officers, as of December 31, 2020 that produced \$23.0 billion in closed mortgage loan volume during 2020, 58.4% of which related to home purchases volume. PrimeLending offers a variety of loan products catering to the specific needs of borrowers seeking purchase or refinancing options, including 30-year and 15-year fixed rate conventional mortgages, adjustable rate mortgages, jumbo loans, and Federal Housing Administration (“FHA”), Veterans Affairs (“VA”), and United States Department of Agriculture (“USDA”) loans. Mortgage loans originated by PrimeLending are secured by a first lien on the underlying property. PrimeLending does not currently originate subprime loans (which it defines to be conventional and government loans that (i) are ineligible for sale to the Federal National Mortgage Association (“FNMA”), Federal Home Loan Mortgage Corporation (“FHLMC”) or Government National Mortgage Association (“GNMA”), or (ii) do not comply with approved investor-specific underwriting guidelines).

## **Geographic Dispersion of our Businesses**

The Bank provides traditional banking and wealth, investment and treasury management services. The Bank has a presence in the large metropolitan markets in Texas and conducts substantially all of its banking operations in Texas.

Our broker-dealer services are provided through Hilltop Securities and Momentum Independent Network, which conduct business nationwide, with 45% of the broker-dealer segment's net revenues during 2020 generated through locations in Texas, California and Oklahoma.

PrimeLending provides residential mortgage origination products and services from over 290 locations in 45 states. During 2020, an aggregate of 61% of PrimeLending's origination volume was concentrated in ten states, with 36% concentrated in Texas, California and Florida, collectively. Other than these ten states, none of the states in which PrimeLending operated during 2020 represented more than 3% of PrimeLending's origination volume.

## **Employees and Human Capital Resources**

At December 31, 2020 we employed approximately 4,900 full-time employees and less than 50 part-time employees. Our employees are not represented by any collective bargaining group. Management believes that we have good relations with our employees.

We encourage and support the growth and development of our employees and, wherever possible, seek to fill positions by promotion and transfer from within the organization. Continual learning and career development are advanced through annual performance and development conversations with employees, internally developed training programs, customized corporate training engagements and seminars, conferences, and other training events employees are encouraged to attend in connection with their job duties.

Our human capital objectives include attracting, training, motivating, rewarding and retaining our employees. The safety, health and wellness of our employees is a top priority. The COVID-19 pandemic presented a unique challenge with regard to maintaining employee safety while continuing successful operations. Through teamwork and the adaptability of our management and staff, we were able to transition during the peak of the pandemic, over a short period of time, to a rotational work schedule allowing employees to effectively work from remote locations and ensure a safely-distanced working environment for employees performing customer-facing activities, at branches and operations centers. All employees are asked not to come to work when they experience signs or symptoms of a possible COVID-19 illness and have been provided paid time off to cover compensation during such absences. On an ongoing basis, we further promote the health and wellness of our employees by strongly encouraging work-life balance, offering flexible work schedules, and keeping the employee portion of health care premiums to a minimum.

Employee retention helps us operate efficiently and achieve one of our business objectives, which is being a high-level service provider. We believe our commitment to our core values (integrity, collaboration, adaptability, respect and excellence) as well as actively prioritizing concern for our employees' well-being, supporting our employees' career goals, offering competitive wages and providing valuable fringe benefits aids in the retention of our top-performing employees. At December 31, 2020, approximately 25% of our current staff had been with us for ten years or more.

## **Competition**

We face significant competition in the business segments in which we operate and the geographic markets we serve. Many of our competitors have substantially greater financial resources, lending limits and branch networks than we do, and offer a broader range of products and services.

Our banking segment primarily competes with national, regional and community banks within the various markets where the Bank operates. The Bank also faces competition from many other types of financial institutions, including savings and loan associations, credit unions, finance companies, pension trusts, mutual funds, insurance companies, brokerage and investment banking firms, asset-based non-bank lenders, government agencies and certain other non-financial institutions. The ability to attract and retain skilled lending professionals is critical to our banking business. Competition for deposits and in providing lending products and services to consumers and businesses in our market area is intense and pricing is important. Other factors encountered in competing for deposits are convenient office locations, interest rates and fee structures of products offered. Direct competition for deposits also comes from other commercial bank and thrift

institutions, money market mutual funds and corporate and government securities that may offer more attractive rates than insured depository institutions are willing to pay. Competition for loans is based on factors such as interest rates, loan origination fees and the range of services offered by the provider. We seek to distinguish ourselves from our competitors through our commitment to personalized customer service and responsiveness to customer needs while providing a range of competitive loan and deposit products and other services.

Within our broker-dealer segment, we face significant competition based on a number of factors, including price, perceived expertise, quality of advice, reputation, range of services and products, technology, innovation and local presence. Competition for recruiting and retaining securities traders, investment bankers, and other financial advisors is intense. Our broker-dealer business competes directly with numerous other financial advisory and investment banking firms, broker-dealers and banks, including large national and major regional firms and smaller niche companies, some of whom are not broker-dealers and, therefore, are not subject to the broker-dealer regulatory framework. Further, our broker-dealer segment competes with discount brokerage firms that do not offer equivalent services but offer discounted prices and certain free services. We seek to distinguish ourselves from our competitors through our commitment to personalized customer service and responsiveness to customer needs while providing a range of investment banking, advisory and other related financial brokerage services.

Our competitors in the mortgage origination business include large financial institutions as well as independent mortgage banking companies, commercial banks, savings banks and savings and loan associations. Our mortgage origination segment competes on a number of factors including customer service, quality and range of products and services offered, price, reputation, interest rates, closing process and duration, and loan origination fees. The ability to attract and retain skilled mortgage origination professionals is critical to our mortgage origination business. We seek to distinguish ourselves from our competitors through our commitment to personalized customer service and responsiveness to customer needs while providing a range of competitive mortgage loan products and services.

Overall, competition among providers of financial products and services continues to increase as technological advances have lowered the barriers to entry for financial technology companies, with consumers having the opportunity to select from a growing variety of traditional and nontraditional alternatives, including online checking, savings and brokerage accounts, online lending, online insurance underwriters, crowdfunding, digital wallets, and money transfer services. The ability of non-banking financial institutions to provide services previously limited to commercial banks has intensified competition. Because non-banking financial institutions are not subject to many of the same regulatory restrictions as banks and bank holding companies, they can often operate with greater flexibility and lower cost structures.

## **Government Supervision and Regulation**

### *General*

We are subject to extensive regulation under federal and state laws. The regulatory framework is intended primarily for the protection of customers and clients, and not for the protection of our stockholders or creditors. In many cases, the applicable regulatory authorities have broad enforcement power over bank holding companies, banks and their subsidiaries, including the power to impose substantial fines and other penalties for violations of laws and regulations. The following discussion describes the material elements of the regulatory framework that applies to us and our subsidiaries. References in this Annual Report to applicable statutes and regulations are brief summaries thereof, do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations.

The Dodd-Frank Act, which significantly altered the regulation of financial institutions and the financial services industry, established the Consumer Financial Protection Bureau (“CFPB”) and requires the CFPB and other federal agencies to implement many provisions of the Dodd-Frank Act. Several aspects of the Dodd-Frank Act have affected our business, including, without limitation, capital requirements, mortgage regulation, restrictions on proprietary trading in securities, restrictions on investments in hedge funds and private equity funds (the “Volcker Rule”), executive compensation restrictions, potential federal oversight of the insurance industry and disclosure and reporting requirements.

*Recent Regulatory Developments.* New regulations and statutes are regularly proposed and/or adopted that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating and doing business in the United States. Changes in leadership at various federal banking agencies, including the Federal Reserve, can also change the policy direction of these agencies. Certain of these recent proposals and changes are described below.

The CARES Act, which became law on March 27, 2020, provided over \$2 trillion to combat COVID-19 and stimulate the economy. The law had several provisions relevant to financial institutions, including the following:

- Institutions are allowed to not characterize loan modifications related to the COVID-19 pandemic as a troubled debt restructuring and are allowed to suspend the corresponding impairment determinations for accounting purposes.
- The Community Bank Leverage Ratio was temporarily reduced to eight percent (8%). This provision terminated on December 31, 2020.
- A borrower of a federally backed mortgage loan (VA, FHA, USDA, FHLMC and FNMA) experiencing financial hardship due, directly or indirectly, to the COVID-19 pandemic may request forbearance from paying such mortgage by submitting a request to the borrower's servicer affirming such borrower's financial hardship during the COVID-19 emergency. Such a forbearance will be granted 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.
- A borrower of a multi-family federally backed mortgage loan that is current as of February 1, 2020, may submit a request for forbearance to the borrower's servicer affirming that the borrower is experiencing financial hardship during the COVID-19 emergency. A forbearance will be granted for up to 30 days, which can be extended for up to two additional 30-day periods upon the request of the borrower. During that time of the forbearance, the multi-family borrower cannot evict or initiate the eviction of a tenant or charge any late fees, penalties or other charges to a tenant for late payment of rent. Additionally, a multi-family borrower that receives a forbearance may not require a tenant to vacate a dwelling unit before a date that is 30 days after the date on which the borrower provides the tenant notice to vacate and may not issue a notice to vacate until after the expiration of the forbearance.

The CARES Act provided approximately \$350 billion to fund loans to eligible small businesses through the SBA's 7(a) loan guaranty program. These loans were 100% federally guaranteed (principal and interest) through December 31, 2020. An eligible business could apply for a PPP loan up to 2.5 times its average monthly "payroll costs" limited to a loan amount of \$10.0 million. The proceeds of the loan could be used for payroll (excluding individual employee compensation over \$100,000 per year), mortgage, interest, rent, insurance, utilities and other qualifying expenses. PPP loans have: (a) an interest rate of 1.0%; (b) a two-year loan term to maturity; and (c) principal and interest payments deferred for six months from the date of disbursement. The SBA guaranteed 100% of the PPP loans made to eligible borrowers. The entire principal amount of the borrower's PPP loan, including any accrued interest, is eligible to be reduced by the loan forgiveness amount under the PPP so long as employee and compensation levels of the business are maintained and 75% of the loan proceeds are used for payroll expenses, with the remaining 25% of the loan proceeds used for other qualifying expenses.

The Paycheck Protection Program Flexibility Act (the "PPFA") enacted on June 5, 2020 modified the PPP. The PPFA increased the amount of time that borrowers have to use PPP loan proceeds and apply for loan forgiveness and made other changes to make the PPP more favorable to borrowers.

The Coronavirus Response and Relief Supplemental Appropriations Act of 2021 ("Appropriations PPP Amendments") is a pandemic relief portion of the much larger Consolidated Appropriations Act of 2021, which was signed by the President on December 27, 2020. The Appropriations PPP Amendments, among other things, reauthorize and modify the PPP by appropriating more than \$284 billion to the PPP so businesses can apply for forgivable loans for the first time; permit businesses that had previously received a PPP loan to apply for a second PPP loan subject to generally more restrictive eligibility criteria and reducing the maximum amount of proceeds available; enable debtors-in-possession or trustees of bankruptcy estates to apply for a PPP loan; appropriate funds for a \$600 stimulus check for most Americans with an adjusted gross income lower than \$75,000; extend federal unemployment benefits until March 31, 2021; extend the eviction moratorium for tenants with annual incomes of less than \$99,000 until January 31, 2021; as well as other appropriations to address the pandemic. See "Risk Factors —As a participating lender in the PPP, the Company and the Bank are subject to additional risks of litigation from the Bank's clients, or other parties regarding our originating, processing, or servicing of loans under the PPP, and risks that the SBA may not fund some or all PPP loan guaranties."

The Anti-Money Laundering Act of 2020 (the “AML Act”) was enacted as part of the National Defense Authorization Act for Fiscal Year 2021 when the U.S. House of Representatives and the U.S. Senate voted by more than a two-thirds majority to override a Presidential veto effective on January 1, 2021. The AML Act is the most significant revision to the anti-money laundering laws since the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism of 2001, as amended (the “USA PATRIOT Act”). The AML Act clarifies and streamlines the Currency and Foreign Transactions Reporting Act of 1970, as amended, (the “Bank Secrecy Act”) and anti-money laundering (“AML”) obligations in the following ways: requires U.S. entities and entities doing business in the United States to report into a national registry maintained by the Financial Crimes Enforcement Network (“FinCEN”) certain beneficial ownership information, subject to exceptions; modernizes the statutory definition of “financial institution” to include (i) entities that provide services involving “value that substitutes for currency,” which includes stored value and virtual currencies and (ii) any person engaged in the trade of antiquities, including an advisor, consultant or any other person who deals in the sale of antiquities; enhances penalties for Bank Secrecy Act and AML violations, including claw back of bonuses; increases AML whistleblower awards and expands whistleblower protections; requires the Secretary of the Treasury to establish and update every four years National AML Priorities, which are incorporated into the Bank Secrecy Act compliance programs at financial institutions subject to the Bank Secrecy Act; permits collaborative arrangements between financial institutions to participate in common activity or pool resources related to AML or Bank Secrecy Act compliance; provides for an annual review of Bank Secrecy Act regulations by the Secretary of the Treasury that is reported to Congress; and requires the Secretary of the Treasury to review the dollar thresholds and reporting requirements relating to currency transaction reports and suspicious activity; among other amendments to the Bank Secrecy Act.

On May 24, 2018, President Trump signed into law the Economic Growth, Regulatory Relief and Consumer Protection Act (“EGRRCPA”), which included amendments to the Dodd-Frank Act and other statutes that provide the federal banking agencies with the ability to tailor various provisions of the banking laws and eased the regulatory burden imposed by the Dodd-Frank Act with respect to company-run stress testing, resolutions plans, the Volcker Rule, high volatility commercial real estate exposures, and real estate appraisals.

In July 2017, the Financial Conduct Authority (“FCA”) announced that it intends to cease compelling banks to submit rates for the calculation of the London Interbank Offered Rate (“LIBOR”) after 2021. 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. Additionally, the accounting standards setter, Financial Accounting Standards Board (“FASB”) recently issued optional guidance that would help ease the potential effects of reference rate reform on financial reporting. The guidance would offer optional expedients and exceptions for applying GAAP to contracts, hedging relationships, or other transactions affected by reference rate reform. Additionally, the FASB issued specific accounting guidance which 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. 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.

We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

### *Corporate*

Hilltop is a legal entity separate and distinct from PCC and its other subsidiaries. On November 30, 2012, concurrent with the consummation of the acquisition of PlainsCapital Corporation (the “PlainsCapital Merger”), Hilltop became a financial holding company registered under the Bank Holding Company Act, as amended by the Gramm-Leach-Bliley Act (“Gramm-Leach-Bliley Act”). Accordingly, it is subject to supervision, regulation and examination by the Federal Reserve Board. The Dodd-Frank Act, Gramm-Leach-Bliley Act, the Bank Holding Company Act and other federal laws subject financial and bank holding companies to particular restrictions on the types of activities in which they may engage and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

*Changes of Control.* Federal and state laws impose additional notice, approval and ongoing regulatory requirements on any investor that seeks to acquire direct or indirect “control” of a regulated holding company, such as Hilltop. These laws

include the Bank Holding Company Act and the Change in Bank Control Act. Among other things, these laws require regulatory filings by an investor that seeks to acquire direct or indirect “control” of a regulated holding company. The determination whether an investor “controls” a regulated holding company is based on all of the facts and circumstances surrounding the investment. As a general matter, an investor is deemed to control a depository institution or other company if the investor owns or controls 25% or more of any class of voting stock, and in certain other circumstances, an investor may be presumed to control a depository institution or other company if the investor owns or controls less than 25% or more of any class of voting stock. Furthermore, these laws may discourage potential acquisition proposals and may delay, deter or prevent change of control transactions, including those that some or all of our stockholders might consider to be desirable.

*Regulatory Restrictions on Dividends; Source of Strength.* It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company’s ability to serve as a source of strength to its banking subsidiaries. The Dodd-Frank Act requires the regulatory agencies to issue regulations requiring that all bank and savings and loan holding companies serve as a source of financial and managerial strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress; however, no such proposed regulations have yet been published.

Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial strength to each of its banking subsidiaries and commit resources to their support. Such support may be required at times when, absent this Federal Reserve Board policy, a holding company may not be inclined to provide it. As discussed herein, a bank holding company, in certain circumstances and subject to certain limitations, could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

*Scope of Permissible Activities.* Under the Bank Holding Company Act, Hilltop and PCC generally may not acquire a direct or indirect interest in, or control of more than 5% of, the voting shares of any company that is not a bank or bank holding company. Additionally, the Bank Holding Company Act may prohibit Hilltop from engaging in activities other than those of banking, managing or controlling banks or furnishing services to, or performing services for, its subsidiaries, except that it may engage in, directly or indirectly, certain activities that the Federal Reserve Board has determined to be closely related to banking or managing and controlling banks as to be a proper incident thereto. In approving acquisitions or the addition of activities, the Federal Reserve Board considers, among other things, whether the acquisition or the additional activities can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh such possible adverse effects as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

Notwithstanding the foregoing, the Gramm-Leach-Bliley Act, effective March 11, 2000, eliminated the barriers to affiliations among banks, securities firms, insurance companies and other financial service providers and permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The Gramm-Leach-Bliley Act defines “financial in nature” to include: securities underwriting; dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve Board has determined to be closely related to banking. Prior to enactment of the Dodd-Frank Act, regulatory approval was not required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that were financial in nature or incidental to activities that were financial in nature, as determined by the Federal Reserve Board.

Under the Gramm-Leach-Bliley Act, a bank holding company may become a financial holding company by filing a declaration with the Federal Reserve Board if each of its subsidiary banks is “well capitalized” under the Federal Deposit Insurance Corporation Improvement Act prompt corrective action provisions, is “well managed,” and has at least a “satisfactory” rating under the Community Reinvestment Act of 1977 (the “CRA”). The Dodd-Frank Act underscores the criteria for becoming a financial holding company by amending the Bank Holding Company Act to require that bank holding companies be “well capitalized” and “well managed” in order to become financial holding companies. Hilltop became a financial holding company on December 1, 2012.

*Safe and Sound Banking Practices.* Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board’s Regulation Y, for example, generally requires a holding company to give the

Federal Reserve Board prior notice of any redemption or repurchase of its equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company's consolidated net worth. In addition, bank holding companies are required to consult with the Federal Reserve Board prior to making any redemption or repurchase, even within the foregoing parameters. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Depending upon the circumstances, the Federal Reserve Board could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries that represent unsafe and unsound banking practices or that constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing or reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as \$2.01 million for each day the activity continues. In addition, the Dodd-Frank Act authorizes the Federal Reserve Board to require reports from and examine bank holding companies and their subsidiaries, and to regulate functionally regulated subsidiaries of bank holding companies.

*Anti-tying Restrictions.* Subject to various exceptions, bank holding companies and their affiliates are generally prohibited from tying the provision of certain services, such as extensions of credit, to certain other services offered by a bank holding company or its affiliates.

*Capital Adequacy Requirements and BASEL III.* Hilltop and PlainsCapital, which includes the Bank and PrimeLending, are subject to capital adequacy requirements under the comprehensive capital framework for U.S. banking organizations known as "Basel III". Basel III, which reformed the existing frameworks under which U.S. banking organizations historically operated, became effective January 1, 2015 and was fully phased in as of January 1, 2019. Basel III was developed by the Basel Committee on Banking Supervision and adopted by the Federal Reserve, the FDIC, and the Office of the Comptroller of the Currency (the "OCC").

The federal banking agencies' risk-based capital and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria, assuming that they have the highest regulatory rating. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Final rules published by the Federal Reserve, the FDIC, and the OCC implemented the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. Among other things, Basel III increased minimum capital requirements, introduced a new minimum leverage ratio and implemented a capital conservation buffer. The regulatory agencies carefully considered the potential impacts on all banking organizations, including community and regional banking organizations such as Hilltop and PlainsCapital, and sought to minimize the potential burden of these changes where consistent with applicable law and the agencies' goals of establishing a robust and comprehensive capital framework. Under the guidelines in effect beginning January 1, 2015, a risk weight factor of 0% to 1250% is assigned to each category of assets based generally on the perceived credit risk of the asset class. The risk weights are then multiplied by the corresponding asset balances to determine a "risk-weighted" asset base.

Under Basel III, total capital consists of two tiers of capital, Tier 1 and Tier 2. Tier 1 capital consists of common equity Tier 1 capital and additional Tier 1 capital. Below is a list of certain significant components that comprise the tiers of capital for Hilltop and PlainsCapital under Basel III.

Common equity Tier 1 capital:

- includes common stockholders' equity (such as qualifying common stock and any related surplus, undivided profits, disclosed capital reserves that represent a segregation of undivided profits and foreign currency translation adjustments, excluding changes in other comprehensive income (loss) and treasury stock);
- includes certain minority interests in the equity capital accounts of consolidated subsidiaries; and
- excludes goodwill and various intangible assets.



Additional Tier 1 capital:

- includes certain qualifying minority interests not included in common equity Tier 1 capital;
- includes certain preferred stock and related surplus;
- includes certain subordinated debt; and
- excludes 50% of the insurance underwriting deduction.

Tier 2 capital:

- includes allowance for credit losses, up to a maximum of 1.25% of risk-weighted assets;
- includes minority interests not included in Tier 1 capital; and
- excludes 50% of the insurance underwriting deduction.

The following table summarizes the Basel III requirements fully phased-in as of the period beginning January 1, 2019.

<u>Item</u>	<u>Requirement</u>
Minimum common equity Tier 1 capital ratio	4.5 %
Common equity Tier 1 capital conservation buffer	2.5 %
Minimum common equity Tier 1 capital ratio plus capital conservation buffer	7.0 %
Minimum Tier 1 capital ratio	6.0 %
Minimum Tier 1 capital ratio plus capital conservation buffer	8.5 %
Minimum total capital ratio	8.0 %
Minimum total capital ratio plus capital conservation buffer	10.5 %

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

The rules also prohibit a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. A banking organization with a buffer greater than 2.5% would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The eligible retained income of a banking organization is defined as its net income for the four calendar quarters preceding the current calendar quarter, based on the organization's quarterly regulatory reports, net of any distributions and associated tax effects not already reflected in net income. When the rules were fully phased-in in 2019, the minimum capital requirements plus the capital conservation buffer should have exceeded the prompt corrective action well-capitalized thresholds.

Hilltop and PlainsCapital began transitioning to the Basel III final rules on January 1, 2015. The capital conservation buffer and certain deductions from common equity Tier 1 capital were fully phased in as of January 1, 2019. During 2020, our eligible retained income was positive and our capital conservation buffer was greater than 2.5%, and therefore, we were not subject to limits on capital distributions or discretionary bonus payments. We anticipate similar results during 2021.

At December 31, 2020, Hilltop had a total capital to risk-weighted assets ratio of 22.34%, Tier 1 capital to risk-weighted assets ratio of 19.57% and a common equity Tier 1 capital to risk-weighted assets ratio of 18.97%. 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 December 31, 2020, PlainsCapital had a total capital to risk-weighted assets ratio of 15.27%, Tier 1 capital to risk-weighted assets ratio of 14.40% and a common equity Tier 1 capital to risk-weighted assets ratio of 14.40%. 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.

*Phase-in of Current Expected Credit Losses Accounting Standard.* In June 2016, the Financial Accounting Standards Board issued an update to the accounting standards for credit losses that included the Current Expected Credit Losses (“CECL”) methodology, which replaces the existing incurred loss methodology for certain financial assets. CECL became effective January 1, 2020. In December 2018, the federal bank regulatory agencies approved a final rule modifying their regulatory capital rules and providing an option to phase-in, over a period of three years, the day-one regulatory capital effects resulting from the implementation of CECL. The final rule also revises the agencies’ other rules to reflect the update to the accounting standards. We originally elected to not exercise the option for phase-in. In March 2020, in connection with the economic uncertainties associated with the effects of COVID-19, the agencies’ issued an additional transition option that permitted banking institutions to mitigate the estimated cumulative regulatory capital effects from CECL over a five-year transitional period. We elected to exercise this option for phase-in.

*Volcker Rule.* Provisions of the Volcker Rule and the final rules implementing the Volcker Rule restrict certain activities provided by the Company, including proprietary trading and sponsoring or investing in “covered funds,” which include many venture capital, private equity and hedge funds. For purposes of the Volcker Rule, purchases or sales of financial instruments such as securities, derivatives, contracts of sale of commodities for future delivery or options on the foregoing for the purpose of short-term gain are deemed to be proprietary trading (with financial instruments held for less than 60 days presumed to be for proprietary trading unless an alternative purpose can be demonstrated), unless certain exemptions apply. Exempted activities include, among others, the following: (i) underwriting; (ii) market making; (iii) risk mitigating hedging; (iv) trading in certain government securities; (v) employee compensation plans and (vi) transactions entered into on behalf of and for the account of clients as agent, broker, custodian, or in a trustee or fiduciary capacity. On July 22, 2019, the federal banking agencies, among other agencies, published a final rule implementing provisions of EGRRCPA that exclude community banks with \$10.0 billion or less in total consolidated assets and total trading assets and liabilities of 5% or less of total consolidated assets from the restrictions of the Volcker Rule. At this time, the Bank does not qualify for this regulatory exclusion.

On November 14, 2019, the federal banking agencies, among other agencies, published a separate final rule to provide greater clarity and certainty about the activities prohibited by the Volcker Rule and to improve supervision and implementation of the Volcker Rule based on the agencies’ experience implementing these provisions since 2013. Compliance with the final rule began January 1, 2021, however, banking entities may voluntarily comply with the final rule in whole or in part prior to the compliance date, subject to the agencies’ completion of necessary technological changes.

In July 2020, the federal banking agencies published a final rule to streamline and improve the covered funds provisions of the Volcker Rule by making the following changes: permitting the activities of qualifying foreign excluded funds; revising the exclusions from the definition of “covered fund” for foreign public funds, loan securitizations, public welfare investments and small business investment companies; creating new exclusions from the definition of “covered fund” for credit funds, qualifying venture capital funds, family wealth management vehicles, and customer facilitation vehicles; permitting certain transactions that could otherwise be prohibited under affiliate transaction restrictions unique to the Volcker Rule; modifying the definition of “ownership interest”; and providing that certain investments made in parallel with a covered fund, as well as certain restricted profit interests held by an employee or director, need not be included in a banking entity’s calculation of its ownership interest in the covered fund.

While management continues to assess compliance with the Volcker Rule, we have reviewed our processes and procedures in regard to proprietary trading and covered funds activities and we believe we are currently complying with the provisions of the Volcker Rule. However, it remains uncertain how the scope of applicable restrictions and exceptions will be interpreted and administered by the relevant regulators. Absent further regulatory guidance, we are required to make certain assumptions as to the degree to which our activities, processes and procedures in these areas comply with the requirements of the Volcker Rule. If these assumptions are not accurate or if our implementation of compliance processes and procedures is not consistent with regulatory expectations, we may be required to make certain changes to our business activities, processes or procedures, which could further increase our compliance and regulatory risks and costs.

*Acquisitions by Bank Holding Companies.* The Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve Board is required to consider, among other things, the financial and managerial resources and future

prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served, and various competitive factors. In addition, the Dodd-Frank Act requires the Federal Reserve Board to consider “the risk to the stability of the U.S. banking or financial system” when evaluating acquisitions of banks and nonbanks under the Bank Holding Company Act. With respect to interstate acquisitions, the Dodd-Frank Act amends the Bank Holding Company Act by raising the standard by which interstate bank acquisitions are permitted from a standard that the acquiring bank holding company be “adequately capitalized” and “adequately managed” to the higher standard of being “well capitalized” and “well managed”.

*Control Acquisitions.* The Change in Bank Control Act prohibits a person or group of persons from acquiring “control” of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. As a general matter, an investor is deemed to control a depository institution or other company if the investor owns or controls 25% or more of any class of voting stock, and in certain other circumstances, an investor may be presumed to control a depository institution or other company if the investor owns or controls less than 25% or more of any class of voting stock.

### ***Banking***

The Bank is subject to various requirements and restrictions under the laws of the United States, and to regulation, supervision and regular examination by the Texas Department of Banking. The Bank, as a state member bank, is also subject to regulation and examination by the Federal Reserve Board. The Bank became subject to the regulations issued by the CFPB on July 21, 2011, although the Federal Reserve Board continued to examine the Bank for compliance with federal consumer protection laws. If the Bank’s total assets are over \$10.0 billion (as measured on four consecutive quarterly call reports of the Bank and any institutions it acquires), the Bank will become subject to the CFPB’s supervisory and enforcement authority with respect to federal consumer financial laws beginning in the following quarter. As of December 31, 2020, the Bank’s total assets were \$13.3 billion. Along with continued Federal Reserve consumer supervisory and enforcement, the Bank became subject to CFPB supervisory and enforcement authority, starting in the second quarter of 2020.

The Bank is also an insured depository institution and, therefore, subject to regulation by the FDIC, although the Federal Reserve Board is the Bank’s primary federal regulator. The Federal Reserve Board, the Texas Department of Banking, the CFPB and the FDIC have the power to enforce compliance with applicable banking statutes and regulations. Such requirements and restrictions include requirements to maintain reserves against deposits, restrictions on the nature and amount of loans that may be made and the interest that may be charged thereon and restrictions relating to investments and other activities of the Bank. In July 2010, the FDIC voted to revise its agreement with the primary federal regulators to enhance the FDIC’s existing backup authorities over insured depository institutions that the FDIC does not directly supervise. As a result, the Bank may be subject to increased supervision by the FDIC.

*Restrictions on Transactions with Affiliates.* Transactions between the Bank and its nonbanking affiliates, including Hilltop and PCC, are subject to Section 23A of the Federal Reserve Act. In general, Section 23A imposes limits on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties that are collateralized by the securities or obligations of Hilltop or its subsidiaries. Among other changes, the Dodd-Frank Act expands the definition of “covered transactions” and clarifies the amount of time that the collateral requirements must be satisfied for covered transactions, and amends the definition of “affiliate” in Section 23A to include “any investment fund with respect to which a member bank or an affiliate thereof is an investment adviser.”

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act, which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The Federal Reserve has also issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

*Loans to Insiders.* The restrictions on loans to directors, executive officers, principal stockholders and their related interests (collectively referred to herein as “insiders”) contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. These restrictions include conditions that must be met before insider loans can be made, limits on loans to an individual insider and an aggregate limitation on all loans to insiders and their related interests. These loans cannot exceed the institution’s total unimpaired capital and surplus, and

the Federal Reserve Board may determine that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions. The Dodd-Frank Act amends the statutes placing limitations on loans to insiders by including credit exposures to the person arising from a derivatives transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between the member bank and the person within the definition of an extension of credit.

*Restrictions on Distribution of Subsidiary Bank Dividends and Assets.* Dividends paid by the Bank have provided a substantial part of PCC's operating funds and for the foreseeable future it is anticipated that dividends paid by the Bank to PCC will continue to be PCC's and Hilltop's principal source of operating funds. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. Pursuant to the Texas Finance Code, a Texas banking association may not pay a dividend that would reduce its outstanding capital and surplus unless it obtains the prior approval of the Texas Banking Commissioner. Additionally, the FDIC and the Federal Reserve Board have the authority to prohibit Texas state banks from paying a dividend when they determine the dividend would be an unsafe or unsound banking practice. As a member of the Federal Reserve System, the Bank must also comply with the dividend restrictions with which a national bank would be required to comply. Those provisions are generally similar to those imposed by the state of Texas. Among other things, the federal restrictions require that if losses have at any time been sustained by a bank equal to or exceeding its undivided profits then on hand, no dividend may be paid.

In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its stockholders, including any depository institution holding company (such as PCC and Hilltop) or any stockholder or creditor thereof.

*Branching.* The establishment of a bank branch must be approved by the Texas Department of Banking and the Federal Reserve Board, which consider a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate powers. The regulators will also consider the applicant's CRA record. Under the Dodd-Frank Act, de novo interstate branching by banks is permitted if, under the laws of the state where the branch is to be located, a state bank chartered in that state would be permitted to establish a branch.

*Prompt Corrective Action.* The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories ("well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized") in which all institutions are placed. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category.

An institution that is categorized as "undercapitalized," "significantly undercapitalized" or "critically undercapitalized" is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets at the time it became undercapitalized or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution to a lower capital category based on supervisory factors other than capital. PlainsCapital was classified as "well capitalized" at December 31, 2020.

Pursuant to FDICIA, an "undercapitalized" bank is prohibited from increasing its assets, engaging in a new line of business, acquiring any interest in any company or insured depository institution, or opening or acquiring a new branch office, except under certain circumstances, including the acceptance by the federal banking regulators of a capital restoration plan for the Bank.

*FDIC Insurance Assessments.* The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. The system assigns an institution to one of three capital categories: (1) “well capitalized;” (2) “adequately capitalized;” or (3) “undercapitalized.” These three categories are substantially similar to the prompt corrective action categories described above, with the “undercapitalized” category including institutions that are undercapitalized, significantly undercapitalized and critically undercapitalized for prompt corrective action purposes. The FDIC also assigns an institution to one of three supervisory subgroups based on a supervisory evaluation that the institution’s primary federal regulator provides to the FDIC and information that the FDIC determines to be relevant to the institution’s financial condition and the risk posed to the deposit insurance funds. The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

The FDIC is required to maintain a designated reserve ratio of the deposit insurance fund (“DIF”) to insured deposits in the United States. The Dodd-Frank Act required the FDIC to assess insured depository institutions to achieve a DIF ratio of at least 1.35% by September 30, 2020. On November 28, 2018, the FDIC announced that the DIF reserve ratio exceeded the statutorily required minimum reserve ratio of 1.35%, ahead of the September 30, 2020 deadline. FDIC regulations provide for two changes to deposit insurance assessments upon reaching the minimum ratio: (1) surcharges on insured depository institutions with total consolidated assets of \$10.0 billion or more (large banks) will cease; and (2) small banks will receive assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from between 1.15% and 1.35%, to be applied when the reserve ratio is at or above 1.38%. Pursuant to its authority in the Dodd-Frank Act, the FDIC on December 20, 2010, published a final rule establishing a higher long-term target DIF ratio of greater than 2%. Deposit insurance assessment rates are subject to change by the FDIC and will be impacted by the overall economy and the stability of the banking industry as a whole. The FDIC will notify the Bank concerning any assessment credits and the assessment rate that we will be charged for the assessment period. As a result of the new regulations, we expect to incur lower annual deposit insurance assessments, which could have a positive impact on our financial condition and results of operations. Accruals for DIF assessments were \$1.8 million during 2020.

The Dodd-Frank Act permanently increased the standard maximum deposit insurance amount to \$250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category.

*Community Reinvestment Act.* The CRA requires, in connection with examinations of financial institutions, that federal banking regulators (in the Bank’s case, the Federal Reserve Board) evaluate the record of each financial institution in meeting the credit needs of its local community, including low and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on the Bank. Additionally, the Bank must publicly disclose the terms of various CRA-related agreements.

The Bank received a “satisfactory” CRA rating in connection with its most recent CRA performance evaluation. A CRA rating of less than “satisfactory” adversely affects a bank’s ability to establish new branches and impairs a bank’s ability to commence new activities that are “financial in nature” or acquire companies engaged in these activities. See “Risk Factors — We are subject to extensive supervision and regulation that could restrict our activities and impose financial requirements or limitations on the conduct of our business and limit our ability to generate income.”

*Privacy.* Under the Gramm-Leach-Bliley Act, financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing nonpublic personal financial information with nonaffiliated third parties except under narrow circumstances, such as the processing of transactions requested by the consumer or when the financial institution is jointly sponsoring a product or service with a nonaffiliated third party. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing to consumers. The Bank and all of its subsidiaries have established policies and procedures to comply with the privacy provisions of the Gramm-Leach-Bliley Act.

*Federal Laws Applicable to Credit Transactions.* The loan operations of the Bank are also subject to federal laws and implementing regulations applicable to credit transactions, such as the Truth-In-Lending Act, the Home Mortgage Disclosure Act of 1975, the Equal Credit Opportunity Act, the Fair Credit Reporting Act of 1978, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act, the Dodd-Frank Act and rules and regulations of the various federal

agencies charged with the responsibility of implementing these federal laws. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates.

*Federal Laws Applicable to Deposit Operations.* The deposit operations of the Bank are subject to the Right to Financial Privacy Act, the Truth in Savings Act and the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board and the CFPB to implement that act. The Dodd-Frank Act amends the Electronic Funds Transfer Act to, among other things, give the Federal Reserve Board the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

*Capital Requirements.* The Federal Reserve Board and the Texas Department of Banking monitor the capital adequacy of PlainsCapital by using a combination of risk-based guidelines and leverage ratios. The agencies consider PlainsCapital's capital levels when taking action on various types of applications and when conducting supervisory activities related to the safety and soundness of individual banks and the banking system.

On January 1, 2019, PlainsCapital fully transitioned to the final rules that substantially amended the regulatory risk-based capital rules to implement the Basel III regulatory capital reforms. For additional discussion of Basel III, see the section entitled "Government Supervision and Regulation — Corporate — Capital Adequacy Requirements and Basel III" earlier in this Item 1. At December 31, 2020, PlainsCapital's ratio of total risk-based capital to risk-weighted assets was 15.27%, PlainsCapital's ratio of Tier 1 capital to risk-weighted assets was 14.40%, PlainsCapital's common equity Tier 1 capital to risk-weighted assets ratio was 14.40%, and PlainsCapital's ratio of Tier 1 capital to average total assets was 10.44%.

On December 13, 2019, the Federal Reserve, the FDIC and the OCC published a final rule modifying the treatment of high volatility commercial real estate ("HVCRE") exposures as required by EGRRCPA. The final rule clarifies certain defined terms in the HVCRE exposure definition in a manner generally consistent with the call report instructions as well as the treatment of credit facilities that finance one- to four-family residential properties and the development of land. The final rule became effective on April 1, 2020.

*The FDIC Improvement Act.* FDICIA made a number of reforms addressing the safety and soundness of the deposit insurance system, supervision of domestic and foreign depository institutions, and improvement of accounting standards. This statute also limited deposit insurance coverage, implemented changes in consumer protection laws and provided for least-cost resolution and prompt regulatory action with regard to troubled institutions.

FDICIA requires every bank with total assets in excess of \$500 million to have an annual independent audit made of the Bank's financial statements by a certified public accountant to verify that the financial statements of the Bank are presented in accordance with GAAP and comply with such other disclosure requirements as prescribed by the FDIC.

*Brokered Deposits.* Under FDICIA, banks may be restricted in their ability to accept brokered deposits, depending on their capital classification. "Well capitalized" banks are permitted to accept brokered deposits, but banks that are not "well capitalized" are not permitted to accept such deposits. The FDIC may, on a case-by-case basis, permit banks that are "adequately capitalized" to accept brokered deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to such bank. Pursuant to a provision in EGRRCPA, the FDIC published a final rule on February 4, 2019 excepting a capped amount of reciprocal deposits from being considered as brokered deposits for certain insured depository institutions. On December 15, 2020, the FDIC also approved a final rule modernizing the FDIC's overall brokered deposit regulations, reflecting technological changes and innovations across the banking industry. The final rule clarifies when a person meets the deposit broker definition in a way that provides clear rules by which banks and third parties can evaluate whether particular activities cause deposits to be considered brokered. The final rule also identifies a number of bright line categories called "designated exceptions" for business arrangements that automatically satisfy the primary purpose exception, establishes a transparent application process for entities that seek a "primary purpose exception" and modernizes the definition and calculation of the "National Rate Cap". At December 31, 2020, PlainsCapital was "well capitalized" and therefore not subject to any limitations with respect to its brokered deposits.

*Check Clearing for the 21st Century Act.* The Check Clearing for the 21st Century Act gives "substitute checks," such as a digital image of a check and copies made from that image, the same legal standing as the original paper check.

*Federal Home Loan Bank System.* The Federal Home Loan Bank (“FHLB”) system, of which the Bank is a member, consists of regional FHLBs governed and regulated by the Federal Housing Finance Board. The FHLBs serve as reserve or credit facilities for member institutions within their assigned regions. The reserves are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system. The FHLBs make loans (i.e., advances) to members in accordance with policies and procedures established by the FHLB and the boards of directors of each regional FHLB.

As a system member, according to currently existing policies and procedures, the Bank is entitled to borrow from the FHLB of its respective region and is required to own a certain amount of capital stock in the FHLB. The Bank is in compliance with the stock ownership rules with respect to such advances, commitments and letters of credit and home mortgage loans and similar obligations. All loans, advances and other extensions of credit made by the FHLB to the Bank are secured by a portion of the respective mortgage loan portfolio, certain other investments and the capital stock of the FHLB held by the Bank.

*Fixing America’s Surface Transportation Act (FAST Act).* The FAST Act, signed by President Obama on December 4, 2015, provides for funding highways and infrastructure in the United States. Part of the funding for this law comes from a reduction of the dividends paid by the Federal Reserve to its stockholders with total consolidated assets of more than \$10 billion, effective January 1, 2016. On that date, the annual dividend on paid-in capital stock for stockholders with total consolidated assets of more than \$10 billion shall be the lesser of: (i) the rate equal to the high yield of the 10-year Treasury note auctioned at the last auction held prior to the payment of such dividend and (ii) 6 percent. The Federal Reserve Board published a final rule implementing these requirements on November 23, 2016. On December 12, 2019, the Federal Reserve published its annual adjustment to the consolidated asset threshold, increasing it to \$10.715 billion in assets through December 31, 2020. As of December 31, 2020, the Bank’s total assets were \$13.3 billion.

*Anti-terrorism and Money Laundering Legislation.* The Bank is subject to the USA PATRIOT Act, the Bank Secrecy Act and rules and regulations of the Office of Foreign Assets Control. These statutes and related rules and regulations impose requirements and limitations on specific financial transactions and account relationships intended to guard against money laundering and terrorism financing. The Bank has established a customer identification program pursuant to Section 326 of the USA PATRIOT Act and the Bank Secrecy Act, including obtaining beneficial ownership information on new legal entity customers and otherwise has implemented policies and procedures intended to comply with the foregoing rules until such time as FinCEN publishes regulations implementing the Corporate Transparency Act, which is part of the AML Act. As discussed above under “Recent Regulatory Developments,” the AML Act imposes the reporting requirements of beneficial ownership of certain business entities on those entities and not on covered financial institutions, among other amendments to the Bank Secrecy Act.

*Incentive Compensation Guidance.* On June 21, 2010, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the FDIC jointly issued comprehensive final guidance on incentive compensation policies (the “Incentive Compensation Guidance”) intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The Incentive Compensation Guidance sets expectations for banking organizations concerning their incentive compensation arrangements and related risk-management, control and governance processes. The Incentive Compensation Guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon three primary principles: (i) balanced risk-taking incentives, (ii) compatibility with effective controls and risk management, and (iii) strong corporate governance. Any deficiencies in compensation practices that are identified may be incorporated into the organization’s supervisory ratings, which can affect its ability to make acquisitions or perform other actions. In addition, under the Incentive Compensation Guidance, a banking organization’s federal regulator may initiate enforcement action if the organization’s incentive compensation arrangements pose a risk to the safety and soundness of the organization.

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

The Hilltop Broker-Dealers are broker-dealers registered with the SEC, FINRA, all 50 U.S. states and the District of Columbia. Hilltop Securities is also registered in Puerto Rico and the U.S. Virgin Islands. Much of the regulation of broker-dealers, however, has been delegated to self-regulatory organizations, principally FINRA, the Municipal Securities Rulemaking Board and national securities exchanges. These self-regulatory organizations adopt rules (which are subject to approval by the SEC) for governing its members and the industry. Broker-dealers are also subject to federal securities laws and SEC rules, as well as the laws and rules of the states in which a broker-dealer conducts business. The Hilltop Broker-Dealers are members of, and are primarily subject to regulation, supervision and regular examination by FINRA.

The regulations to which broker-dealers are subject cover all aspects of the securities business, including, but not limited to, sales and trade practices, net capital requirements, record keeping and reporting procedures, relationships and conflicts with customers, the handling of cash and margin accounts, experience and training requirements for certain employees, the conduct of investment banking and research activities and the conduct of registered persons, directors, officers and employees. Broker-dealers are also subject to the privacy and anti-money laundering laws and regulations discussed herein. Additional legislation, changes in rules promulgated by the SEC, securities exchanges, self-regulatory organizations or states or changes in the interpretation or enforcement of existing laws and rules often directly affect the method of operation and profitability of broker-dealers. The SEC, securities exchanges, self-regulatory organizations and states may conduct administrative and enforcement proceedings that can result in censure, fine, profit disgorgement, monetary penalties, suspension, revocation of registration or expulsion of broker-dealers, their registered persons, officers or employees. The principal purpose of regulation and discipline of broker-dealers is the protection of customers and the securities markets rather than protection of creditors and stockholders of broker-dealers.

*Limitation on Businesses.* The businesses that the Hilltop Broker-Dealers may conduct are limited by its agreements with, and its oversight by, FINRA, other regulatory authorities and federal and state law. Participation in new business lines, including trading of new products or participation on new exchanges or in new countries often requires governmental and/or exchange approvals, which may take significant time and resources. In addition, the Hilltop Broker-Dealers are operating subsidiaries of Hilltop, which means their activities are further limited by those that are permissible for financial holding companies and subsidiaries of financial holding companies, and as a result, the Hilltop Broker-Dealers and Hilltop may be prevented from entering new businesses that may be profitable in a timely manner, if at all.

*Net Capital Requirements.* The SEC, FINRA and various other regulatory authorities have stringent rules and regulations with respect to the maintenance of specific levels of net capital by regulated entities. Rule 15c3-1 of the Exchange Act (the “Net Capital Rule”) requires that a broker-dealer maintain minimum net capital. Generally, a broker-dealer’s net capital is net worth plus qualified subordinated debt less deductions for non-allowable (or non-liquid) assets and other adjustments and operational charges. At December 31, 2020, the Hilltop Broker-Dealers were in compliance with applicable net capital requirements.

The SEC, CFTC, FINRA and other regulatory organizations impose rules that require notification when net capital falls below certain predefined thresholds. These rules also dictate the ratio of debt-to-equity in the regulatory capital composition of a broker-dealer, and constrain the ability of a broker-dealer to expand its business under certain circumstances. If a broker-dealer fails to maintain the required net capital, it may be subject to censure, fine, monetary penalties and other regulatory sanctions, including suspension, revocation of registration or expulsion by the SEC or applicable regulatory authorities, and suspension, revocation or expulsion by these regulators could ultimately lead to the broker-dealer’s liquidation. Additionally, the Net Capital Rule and certain FINRA rules impose requirements that may have the effect of prohibiting a broker-dealer from distributing or withdrawing capital and requiring prior notice to, and approval from, the SEC and FINRA for certain capital withdrawals.

Compliance with the net capital requirements may limit our operations, requiring the intensive use of capital. Such rules require that a certain percentage of our assets be maintained in relatively liquid form and therefore act to restrict our ability to withdraw capital from our broker-dealer entities, which in turn may limit our ability to pay dividends, repay debt or redeem or purchase shares of our outstanding common stock. Any change in such rules or the imposition of new rules affecting the scope, coverage, calculation or amount of capital requirements, or a significant operating loss or any unusually large charge against capital, could adversely affect our ability to pay dividends, repay debt, meet our debt covenant requirements or to expand or maintain our operations. In addition, such rules may require us to make substantial capital contributions into one or more of the Hilltop Broker-Dealers in order for such subsidiaries to comply with such rules, either in the form of cash or subordinated loans made in accordance with the requirements of all applicable net capital rules.

*Customer Protection Rule.* The Hilltop Broker-Dealers that hold customers’ funds and securities are subject to the SEC’s customer protection rule (Rule 15c3-3 under the Exchange Act), which generally provides that such broker-dealers maintain physical possession or control of all fully-paid securities and excess margin securities carried for the account of customers and maintain certain reserves of cash or qualified securities.

*Securities Investor Protection Corporation (“SIPC”).* The Hilltop Broker-Dealers are subject to the Securities Investor Protection Act and belong to SIPC, whose primary function is to provide financial protection for the customers of failing



brokerage firms. SIPC provides protection for customers up to \$500,000, of which a maximum of \$250,000 may be in cash.

*Anti-Money Laundering.* The Hilltop Broker-Dealers must also comply with the USA PATRIOT Act and other rules and regulations discussed herein, including FINRA requirements, designed to fight international money laundering and to block terrorist access to the U.S. financial system. We are required to have systems and procedures to ensure compliance with such laws and regulations.

*CFTC Oversight.* Hilltop Securities and Momentum Independent Network are registered as introducing brokers with the CFTC and NFA. The CFTC also has net capital regulations (CFTC Rule 1.17) that must be satisfied. Our futures business is also regulated by the NFA, a registered futures association. Violation of the rules of the CFTC, the NFA or the commodity exchanges could result in remedial actions including fines, registration restrictions or terminations, trading prohibitions or revocations of commodity exchange memberships.

*Investment Advisory Activity.* Hilltop Securities Asset Management, LLC, Hilltop Securities and Momentum Independent Network are registered with, and subject to oversight and inspection by, the SEC as investment advisers under the Investment Advisers Act of 1940, as amended. The investment advisory business of our subsidiaries is subject to significant federal regulation, including with respect to wrap fee programs, the management of client accounts, the safeguarding of client assets, client fees and disclosures, transactions among affiliates and recordkeeping and reporting procedures. Legislation and changes in regulations promulgated by the SEC or changes in the interpretation or enforcement of existing laws and regulations often directly affect the method of operation and profitability of investment advisers. The SEC may conduct administrative and enforcement proceedings that can result in censure, fine, suspension, revocation of registration or expulsion of the investment advisory business of our subsidiaries, our officers or employees.

*Volcker Rule.* Provisions of the Volcker Rule and the final rules implementing the Volcker Rule also restrict certain activities provided by the Hilltop Broker-Dealers, including proprietary trading and sponsoring or investing in “covered funds.”

*Regulation Best Interest (“Regulation BI”) and Form CRS Relationship Summary (“Form CRS”).* Beginning June 2020, the “best interest” standard requires a broker-dealer to make recommendations of securities transactions to a retail customer without putting its financial interests ahead of the interests of a retail customer. The SEC Form CRS requires registered investment advisors (“RIAs”) and broker-dealers to deliver to retail investors a succinct, plain English summary about the relationship and services provided by the firm and the required standard of conduct associated with the relationship and services. Regulation BI heightens the standard of care for broker-dealers when making investment recommendations and imposes disclosure and policy and procedural obligations that could impact the compensation our wealth management line of business and its representatives receive for selling certain types of products, particularly those that offer different compensation across different share classes (such as mutual funds and variable annuities). In addition, Regulation BI prohibits a broker-dealer and its associated persons from using the term “adviser” or “advisor” if the broker-dealer is not an RIA or the associated person is not a supervised person of an RIA.

*Changing Regulatory Environment.* The regulatory environment in which the Hilltop Broker-Dealers operate is subject to frequent change. Our business, financial condition and operating results may be adversely affected as a result of new or revised legislation or regulations imposed by the U.S. Congress, the SEC, FINRA or other U.S. and state governmental and regulatory authorities. The business, financial condition and operating results of the Hilltop Broker-Dealers also may be adversely affected by changes in the interpretation and enforcement of existing laws and rules by these governmental and regulatory authorities. In the current era of heightened regulation of financial institutions, the Hilltop Broker-Dealers can expect to incur increasing compliance costs, along with the industry as a whole.

### ***Mortgage Origination***

PrimeLending and the Bank are subject to the rules and regulations of the CFPB, FHA, VA, FNMA, FHLMC and GNMA with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines which include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts, and, with respect to VA loans, fix maximum interest rates. Mortgage origination activities are subject to, among others, the Equal Credit Opportunity Act, Fair Housing Act, Federal Truth-in-Lending Act, Secure and Fair Enforcement of Mortgage Licensing Act, Home Mortgage Disclosure Act, Fair Credit Reporting Act and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder which, among other things, prohibit

discrimination and require the disclosure of certain basic information to borrowers concerning credit terms and settlement costs. PrimeLending and the Bank are also subject to regulation by the Texas Department of Banking with respect to, among other things, the establishment of maximum origination fees on certain types of mortgage loan products. PrimeLending and the Bank are also subject to the provisions of the Dodd-Frank Act. Among other things, the Dodd-Frank Act established the CFPB and provides mortgage reform provisions regarding a customer's ability to repay, restrictions on variable-rate lending, loan officers' compensation, risk retention, and new disclosure requirements. The Dodd-Frank Act also clarifies that applicable state laws, rules and regulations related to the origination, processing, selling and servicing of mortgage loans continue to apply to PrimeLending.

The final rules concerning mortgage origination and servicing address the following topics:

*Ability to Repay.* This final rule requires that for residential mortgages, creditors must make a reasonable and good faith determination based on verified and documented information that the consumer has a reasonable ability to repay the loan according to its terms. The final rule also establishes a presumption of compliance with the ability to repay determination for a certain category of mortgages called "qualified mortgages" meeting a series of detailed requirements. The final rule also provides a rebuttable presumption for higher-priced mortgage loans. On December 29, 2020, the CFPB published a final rule creating a new category of "qualified mortgage," called a seasoned qualified mortgage, for first lien, fixed rate covered loans that meet certain performance requirements, are held in portfolio by the originating creditor or first purchaser for a 36-month period, comply with general restrictions on product features and points and fees, and meet certain underwriting requirements.

*High-Cost Mortgage.* This final rule strengthens consumer protections for high-cost mortgages (generally bans balloon payments and prepayment penalties, subject to exceptions and bans or limits certain fees and practices) and requires consumers to receive information about homeownership counseling prior to taking out a high-cost mortgage.

*Appraisals for High-Risk Mortgages.* The final rule permits a creditor to extend a higher-priced (subprime) mortgage loan ("HPML") only if the following conditions are met (subject to exceptions): (i) the creditor obtains a written appraisal; (ii) the appraisal is performed by a certified or licensed appraiser; and (iii) the appraiser conducts a physical property visit of the interior of the property. The rule also requires that during the application process, the applicant receives a notice regarding the appraisal process and their right to receive a free copy of the appraisal.

*Copies of Appraisals.* This final rule requires a creditor to provide a free copy of appraisal or valuation reports prepared in connection with any closed-end loan secured by a first lien on a dwelling. The final rule requires notice to applicants of the right to receive copies of any appraisal or valuation reports and creditors must send copies of the reports whether or not the loan transaction is consummated. Creditors must provide the copies of the appraisal or evaluation reports for free, however, the creditors may charge reasonable fees for the cost of the appraisal or valuation unless applicable law provides otherwise.

*Escrow Requirements.* This final rule requires a minimum duration of five years for an escrow account on certain higher-priced mortgage loans, subject to certain exemptions for loans made by certain creditors that operate predominantly in rural or underserved areas, as long as certain other criteria are met.

*Servicing.* Two final rules, the Truth in Lending Act and the Real Estate Settlement Procedures Act, protect consumers from detrimental actions by mortgage servicers and to provide consumers with better tools and information when dealing with mortgage servicers. The final rules include a number of exemptions and other adjustments for small servicers, defined as servicers that service 5,000 or fewer mortgage loans and service only mortgage loans that they or an affiliate originated or own.

*Mortgage Loan Originator Compensation.* This final rule revises and clarifies existing regulations and commentary on loan originator compensation. The rule also prohibits, among other things: (i) certain arbitration agreements; (ii) financing certain credit insurance in connection with a mortgage loan; (iii) compensation based on a term of a transaction or a proxy for a term of a transaction; and (iv) dual compensation from a consumer and another person in connection with the transaction. The final rule also imposes a duty on individual loan officers, mortgage brokers and creditors to be "qualified" and, when applicable, registered or licensed to the extent required under applicable State and Federal law.

*Risk Retention.* This final rule requires that at least one sponsor of each securitization retains at least 5% of the credit risk of the assets collateralizing asset-backed securities. Sponsors are prohibited from hedging or transferring this credit risk,

and the rule applies in both public and private transactions. Securitizations backed by “qualified residential mortgages” or “servicing assets” are exempt from the rule, and the definition of “qualified residential mortgages” is subject to review of the joint regulators every five years.

*CARES Act.* As part of the response to the COVID-19 pandemic, Congress passed the CARES Act, which among other things, established the ability of a borrower of a federally backed mortgage loan (VA, FHA, USDA, FHLMC and FNMA) experiencing financial hardship due, directly or indirectly, to the COVID-19 pandemic to request forbearance from paying their mortgage by submitting a request to the borrower’s servicer affirming such borrower’s financial hardship during the COVID-19 emergency. Such a forbearance will be granted 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.

Any additional regulatory requirements affecting our mortgage origination operations will result in increased compliance costs and may impact revenue.

### **Item 1A. Risk Factors.**

The following discussion sets forth what management currently believes could be the material regulatory, market and economic, liquidity, legal and business and operational risks and uncertainties that could impact our business, results of operations and financial condition. Other risks and uncertainties, including those not currently known to us, could also negatively impact our business, results of operations and financial condition. Thus, the following should not be considered a complete discussion of all of the risks and uncertainties we may face, and the order of their respective significance may change. Below is a summary of our risk factors with a more detailed discussion following.

- The outbreak of COVID-19 has adversely affected, and will likely continue to adversely affect, our business, financial condition, liquidity and results of operations.
- Our allowances for credit losses for loans and debt securities may prove inadequate or we may be negatively affected by credit risk exposures. Also, future additions to our allowance for credit losses will reduce our future earnings.
- As a participating lender in the PPP, the Company and the Bank are subject to additional risks of litigation from the Bank’s clients, or other parties regarding our originating, processing, or servicing of loans under the PPP, and risks that the SBA may not fund some or all PPP loan guaranties.
- Our business is subject to interest rate risk, and fluctuations in interest rates may adversely affect our earnings, capital levels and overall results.
- Our operational systems and networks have been, and will continue to be, subject to an increasing risk of continually evolving cybersecurity or other technological risks, which could result in a loss of customer business, financial liability, regulatory penalties, damage to our reputation or the disclosure of confidential information.
- The financial services industry is characterized by rapid technological change, and if we fail to keep pace, our business may suffer.
- We are heavily reliant on technology, and a failure to effectively implement new technological solutions or enhancements to existing systems or platforms could adversely affect our business operations and the financial results of our operations.
- Our geographic concentration may magnify the adverse effects and consequences of any regional or local economic downturn.
- An adverse change in real estate market values may result in losses in our banking segment and otherwise adversely affect our profitability.
- Changes in the method of determining LIBOR, or the replacement of LIBOR with an alternative reference rate, may adversely affect interest income or expense.
- Our mortgage origination is subject to fluctuations based upon seasonal and other factors and, as a result, our results of operations for any given quarter may not be indicative of the results that may be achieved for the full fiscal year.

- Our risk management processes may not fully identify and mitigate exposure to the various risks that we face, including interest rate, credit, liquidity and market risk.
- Our hedging strategies may not be successful in mitigating our exposure to interest rate risk.
- Our bank lending, margin lending, stock lending, securities trading and execution and mortgage purchase businesses are all subject to credit risk.
- We depend on our computer and communications systems and an interruption in service would negatively affect our business.
- We are heavily dependent on dividends from our subsidiaries.
- Our indebtedness may affect our ability to operate our business, and may have a material adverse effect on our financial condition and results of operations. We may incur additional indebtedness, including secured indebtedness.
- We may not be able to generate sufficient cash to service all of our indebtedness, including the Senior Notes, and may be forced to take other actions to satisfy our obligations under our indebtedness that may not be successful.
- A reduction in our credit rating could adversely affect us or the holders of our securities.
- The indenture governing the Senior Notes contains, and any instruments governing future indebtedness would likely contain, restrictions that limit our flexibility in operating our business.
- We are subject to extensive supervision and regulation that could restrict our activities and impose financial requirements or limitations on the conduct of our business and limit our ability to generate income.
- We may be subject to more stringent capital requirements in the future.
- Our broker-dealer business is subject to various risks associated with the securities industry.
- Market fluctuations could adversely impact our broker-dealer business.
- Our investment advisory business may be affected if our investment products perform poorly.
- Our existing correspondents may choose to perform their own clearing services or move their clearing business to one of our competitors or exit the business.
- Several of our broker-dealer segment's product lines rely on favorable tax treatment and changes in federal tax law could impact the attractiveness of these products to our customers.
- Our mortgage origination segment is subject to investment risk on loans that it originates.
- The CFPB has issued "ability-to-repay" and "qualified mortgage" rules that may have a negative impact on our loan origination process and foreclosure proceedings, which could adversely affect our business, operating results, and financial condition.
- Changes in interest rates may change the value of our mortgage servicing rights portfolio, which may increase the volatility of our earnings.
- If we fail to develop, implement and maintain an effective system of internal control over financial reporting, the accuracy and timing of our financial reporting in future periods may be adversely affected.
- We ultimately may write-off goodwill and other intangible assets resulting from business combinations.
- The accuracy of our financial statements and related disclosures could be affected if we are exposed to actual conditions different from the judgments, assumptions or estimates used in our critical accounting policies.
- We are dependent on our management team, and the loss of our senior executive officers or other key employees could impair our relationship with customers and adversely affect our business and financial results.
- We are subject to losses due to fraudulent and negligent acts.
- Negative publicity regarding us, or financial institutions in general, could damage our reputation and adversely impact our business and results of operations.
- We are subject to legal claims and litigation, including potential securities law liabilities, any of which could have a material adverse effect on our business.

## Risks Related to our Business

*The outbreak of COVID-19 has adversely affected, and will likely continue to adversely affect, our business, financial condition, liquidity and results of operations.*

The worldwide COVID-19 pandemic has negatively affected the global economy and our business, and we believe that it is likely to continue to do so. Since the beginning of January 2020, the outbreak has caused significant volatility and disruption in the financial markets both globally and in the United States. If COVID-19, or another highly infectious or contagious disease, continues to spread or the response to contain it is unsuccessful, we could experience material adverse effects on our business, financial condition, liquidity, and results of operations. The extent of such effects depends on future developments that are highly uncertain and cannot be predicted, including the geographic spread of the virus, the overall severity of the disease, the duration of the outbreak, the measures that have to be taken, or future measures, by various governmental authorities in response to the outbreak (such as quarantines, shelter-in-place orders and travel restrictions) and the possible further impacts on the global economy.

We are generally exposed to the credit risk that third parties that owe us money, securities or other assets will fail to meet their obligations to us due to numerous causes, and this risk may be exacerbated by the macroeconomic effects of COVID-19. We lend to businesses and individuals, including through offering commercial and industrial loans, commercial and residential mortgage loans and other loans generally collateralized by assets. We also incur credit risk through our investments. Our credit risk and credit losses may increase to the extent our loans or investments are to borrowers or issuers who as a group may be uniquely or disproportionately affected by declining economic or market conditions as a result of COVID-19, such as those operating in the travel, lodging, retail, entertainment and energy industries. During 2020, the significant build in the allowance for credit losses at the Bank was primarily due to the market disruption and related economic uncertainties caused by COVID-19. We may incur further unexpected losses, and the deterioration of an individually large exposure due to COVID-19 could lead to additional credit loss provisions and/or charges-offs, or credit impairment of our investments, and subsequently have a material impact on our net income, regulatory capital and liquidity.

The continuation of the adverse economic conditions caused by the pandemic can be expected to have a significant adverse effect on our businesses and results of operations, including:

- further increases in the allowance for credit losses and possible recognition of credit losses, especially if businesses remain closed or substantially limited in their operating capacity, the unemployment rate remains high, consumer and business confidence remains declined, consumer trends continue to change and clients and customers draw on their lines of credit or seek additional loans to help finance their businesses;
- possible constraints on liquidity and capital, whether due to increases in risk-weighted assets related to supporting client activities or to regulatory actions; and
- the possibility that significant portions of our workforce are unable to work effectively, including because of illness, quarantines, sheltering-in-place arrangements, government actions or other restrictions related to the pandemic.

We also could experience a material reduction in trading volume and lower securities prices in times of market volatility, which would result in lower brokerage revenues, including losses on firm inventory. The fair values of certain of our investments could also be negatively impacted, resulting in unrealized or realized losses on such investments. Moreover, certain actions taken by U.S. or other governmental authorities, including the Federal Reserve, that are intended to ameliorate the macroeconomic effects of COVID-19 may cause additional harm to our business. Decreases in short-term interest rates, such as those announced by the Federal Reserve late in our 2019 fiscal year and during the first fiscal quarter of 2020, have had, and we expect that they will continue to have, a negative impact on our results of operations, as we have certain assets and liabilities that are sensitive to changes in interest rates.

The extent to which the COVID-19 pandemic negatively affects our businesses, results of operations and financial condition, as well as our regulatory capital and liquidity ratios, will depend on future developments that are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities and other third parties in response to the pandemic. To the extent the COVID-19 pandemic adversely affects our business, results of operations and financial condition, it may also have the effect of heightening many of the other risks described herein.

***Our allowances for credit losses for loans and debt securities may prove inadequate or we may be negatively affected by credit risk exposures. Also, future additions to our allowance for credit losses will reduce our future earnings.***

As a lender, we are exposed to the risk that we could sustain losses because our borrowers may not repay their loans in accordance with the terms of their loans. We maintain allowances for credit losses for loans and debt securities to provide for defaults and nonperformance, which represent an estimate of expected losses over the remaining contractual lives of the loan and debt security portfolios. This estimate is the result of our continuing evaluation of specific credit risks and loss experience, current loan and debt security portfolio quality, present economic, political and regulatory conditions, industry concentrations, reasonable and supportable forecasts for future conditions and other factors that may indicate losses. The determination of the appropriate levels of the allowances for loan and debt security credit losses inherently involves a high degree of subjectivity and judgment and requires us to make estimates of current credit risks and future trends, all of which may undergo material changes. Generally, our nonperforming loans and other real estate owned (“OREO”) reflect operating difficulties of individual borrowers and weaknesses in the economies of the markets we serve.

Under the acquisition method of accounting requirements, we were required to estimate the fair value of the loan portfolios acquired in each of the PlainsCapital Merger, the Federal Deposit Insurance Corporation (“FDIC”) -assisted transaction (the “FNB Transaction”) whereby the Bank acquired certain assets and assumed certain liabilities of FNB, the acquisition of SWS Group, Inc. in a stock and cash transaction (the “SWS Merger”) and the acquisition of The Bank of River Oaks (“BORO”) in an all-cash transaction (“BORO Acquisition”, and collectively with the PlainsCapital Merger, FNB Transaction and the SWS Merger, the “Bank Transactions”) as of the applicable acquisition date and write down the recorded value of each such acquired portfolio to the applicable estimate. For most loans, this process was accomplished by computing the net present value of estimated cash flows to be received from borrowers of such loans. The allowance for credit losses that had been maintained by PCC, FNB, SWS or BORO, as applicable, prior to their respective transactions, was eliminated in this accounting process.

The estimates of fair value as of the consummation of each of the Bank Transactions were based on economic conditions at such time and on Bank management’s projections concerning both future economic conditions and the ability of the borrowers to continue to repay their loans. If management’s assumptions and projections prove to be incorrect, however, the estimate of fair value may be higher than the actual fair value and we may suffer losses in excess of those estimated. Further, the allowance for credit losses established for new loans may prove to be inadequate to cover actual losses, especially if economic conditions worsen.

While Bank management will endeavor to estimate the allowance to cover anticipated losses over the lives of our loan and debt security portfolios, no underwriting and credit monitoring policies and procedures that we could adopt to address credit risk could provide complete assurance that we will not incur unexpected losses. These losses could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, federal regulators periodically evaluate the adequacy of our allowance for credit losses and may require us to increase our provision for credit losses or recognize further loan charge-offs based on judgments different from those of Bank management. Any such increase in our provision for (reversal of) credit losses or additional loan charge-offs could have a material adverse effect on our results of operations and financial condition.

***As a participating lender in the PPP, the Company and the Bank are subject to additional risks of litigation from the Bank’s clients, or other parties regarding our originating, processing, or servicing of loans under the PPP, and risks that the SBA may not fund some or all PPP loan guaranties.***

On March 27, 2020, President Trump signed the CARES Act, which included a \$349 billion loan program administered through the SBA referred to as the PPP. The Appropriations PPP Amendments, signed by the President on December 27, 2020, among other things, reauthorize and modify the PPP by appropriating more than \$284 billion to the PPP.

Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. The Bank is participating as a lender in the PPP. The PPP opened on April 3, 2020; however, because of the short timeframe between the passing of the CARES Act and the opening of the PPP, there is some ambiguity in the laws, rules and guidance regarding the operation of the PPP which exposes the Company to risks relating to noncompliance with the PPP. For instance, several larger banks have been subject to litigation regarding the process and procedures that such banks used in processing applications for the PPP. The Company and the Bank may be exposed to the risk of litigation, from

both clients and non-clients that solicited the Bank for PPP loans, regarding our process and procedures used to process applications for the PPP. Any financial liability, litigation costs or reputational damage caused by PPP-related litigation could have a material adverse impact on our business, financial condition and results of operations.

In addition, the Bank may be exposed to credit risk on PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which loans were originated, funded, or serviced by the Bank, such as an issue with the eligibility of a borrower to receive a PPP loan or the calculation of the maximum PPP loans to which a borrower is entitled, which may or may not be related to the ambiguity in the laws, rules and guidance regarding the operation of the PPP. If a deficiency is identified, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of any loss related to the deficiency from the Company.

In addition, the Company's participation in the PPP as a lender may adversely affect the Company's revenue and results of operations depending on the timing and amount of forgiveness, if any, to which borrowers are entitled.

***Our business is subject to interest rate risk, and fluctuations in interest rates may adversely affect our earnings, capital levels and overall results.***

The majority of our assets are monetary in nature and, as a result, we are subject to significant risk from changes in interest rates. Between December 2016 and December 2018, the Federal Open Market Committee of the Federal Reserve Board raised its target range for short-term interest rates by 200 basis points, and between August 2019 and March 2020, it decreased interest rates by 200 basis points. Changes in interest rates may impact our net interest income in our banking segment as well as the valuation of our assets and liabilities in each of our segments. Earnings in our banking segment are significantly dependent on our net interest income, which is the difference between interest income on interest-earning assets, such as loans and securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. We expect to periodically experience "gaps" in the interest rate sensitivities of our banking segment's assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to our position, this "gap" may work against us, and our results of operations and financial condition may be adversely affected. Asymmetrical changes in interest rates, such as if short-term rates increase or decrease at a faster rate than long-term rates, can affect the slope of the yield curve. A flatter or inverted yield curve, which occurred at various times throughout 2019, as measured by the difference between 10-year U.S. Treasury bond yields and 3-month yields, could adversely impact the net interest income of our banking segment as the spread between interest-earning assets and interest-bearing liabilities becomes compressed. As a result, a flattening or an inversion of the yield curve is likely to have a negative impact on our net interest income and our net interest margin over time.

An increase in the absolute level of interest rates may also, among other things, adversely affect the demand for loans and our ability to originate loans. In particular, if mortgage interest rates increase, the demand for residential mortgage loans and the refinancing of residential mortgage loans will likely decrease, which will have an adverse effect on our income generated from mortgage origination activities. Conversely, a decrease in the absolute level of interest rates, among other things, may lead to prepayments in our loan and mortgage-backed securities portfolios as well as increased competition for deposits. Accordingly, changes in the general level of market interest rates may adversely affect our net yield on interest-earning assets, loan origination volume and our overall results.

Our broker-dealer segment holds securities, principally fixed-income bonds, to support sales, underwriting and other customer activities. If interest rates increase, the value of debt securities held in the broker-dealer segment's inventory would decrease. Rapid or significant changes in interest rates could adversely affect the segment's bond sales, trading and underwriting activities. Further, the profitability of our margin and stock lending businesses depends to a great extent on the difference between interest income earned on loans and investments of customer cash balances and the interest expense paid on customer cash balances and borrowings.

In addition, we hold securities that may be sold in response to changes in market interest rates, changes in securities' prepayment risk, increases in loan demand, general liquidity needs and other similar factors. Such securities are classified as available for sale and are carried at estimated fair value, which may fluctuate with changes in market interest rates. The effects of an increase in market interest rates may result in a decrease in the value of our available for sale investment portfolio.

Market interest rates are affected by many factors outside of our control, including inflation, recession, unemployment, money supply, international disorder and instability in domestic and foreign financial markets. We may not be able to accurately predict the likelihood, nature and magnitude of such changes or how and to what extent such changes may affect our business. We also may not be able to adequately prepare for, or compensate for, the consequences of such changes. Any failure to predict and prepare for changes in interest rates, or adjust for the consequences of these changes, may adversely affect our earnings and capital levels and overall results of operations and financial condition.

***Our business and results of operations may be adversely affected by unpredictable economic, market and business conditions.***

Our business and results of operations are affected by general economic, market and business conditions. The credit quality of our loan portfolio necessarily reflects, among other things, the general economic conditions in the areas in which we conduct our business. Our continued financial success depends to a degree on factors beyond our control, including:

- national and local economic conditions, such as the level and volatility of short-term and long-term interest rates, inflation, home prices, unemployment and under-employment levels, energy prices, bankruptcies, household income and consumer spending;
- the availability and cost of capital and credit;
- incidence of customer fraud; and
- federal, state and local laws affecting these matters.

The deterioration of any of these conditions, as we have experienced with past economic downturns, could adversely affect our consumer and commercial businesses and securities portfolios, our level of loan charge-offs and provision for credit losses, the carrying value of our deferred tax assets, the investment portfolio of our insurance segment, our capital levels and liquidity, our securities underwriting business and our results of operations.

Several factors could pose risks to the financial services industry, including trade wars, restrictions and tariffs; slowing growth in emerging economies; geopolitical matters, including international political unrest, disturbances and conflicts; acts of war and terrorism; pandemics; changes in interest rates; regulatory uncertainty; continued infrastructure deterioration and low oil prices. In addition, the current environment of heightened scrutiny of financial institutions has resulted in increased public awareness of and sensitivity to banking fees and practices. Each of these factors may adversely affect our fees and costs.

Over the last several years, there have been several instances where there has been uncertainty regarding the ability of Congress and the President collectively to reach agreement on federal budgetary and spending matters. A period of failure to reach agreement on these matters, particularly if accompanied by an actual or threatened government shutdown, may have an adverse impact on the U.S. economy. Additionally, a prolonged government shutdown may inhibit our ability to evaluate borrower creditworthiness and originate and sell certain government-backed loans.

***Our operational systems and networks have been, and will continue to be, subject to an increasing risk of continually evolving cybersecurity or other technological risks, which could result in a loss of customer business, financial liability, regulatory penalties, damage to our reputation or the disclosure of confidential information.***

We rely heavily on communications and information systems to conduct our business and maintain the security of confidential information and complex transactions, which subjects us to an increasing risk of cyber incidents from these activities due to a combination of new technologies and the increasing use of the Internet to conduct financial transactions, as well as a potential failure, interruption or breach in the security of these systems, including those that could result from attacks or planned changes, upgrades and maintenance of these systems. Such cyber incidents could result in failures or disruptions in our customer relationship management, securities trading, general ledger, deposits, computer systems, electronic underwriting servicing or loan origination systems; or unauthorized disclosure of confidential and non-public information maintained within our systems. We also utilize relationships with third parties to aid in a significant portion of our information systems, communications, data management and transaction processing. These third parties with which we do business may also be sources of cybersecurity or other technological risks, including operational errors, system interruptions or breaches, unauthorized disclosure of confidential information and misuse of intellectual property. If our third-party service providers encounter any of these issues, we could be exposed to disruption of service, reputation damages, and litigation risk, any of which could have a material adverse effect on our business.



The recent occurrence of cybersecurity incidents across a range of industries has resulted in increased legislative and regulatory scrutiny over cybersecurity and calls for additional data privacy laws and regulations at both the state and federal levels. For example, in 2018, the State of California adopted the California Consumer Privacy Act of 2018, which imposes requirements on companies operating in California and provides consumers with a private right of action if covered companies suffer a data breach related to their failure to implement reasonable security measures. These laws and regulations could result in increased operating expenses or increase our exposure to the risk of litigation.

Although we devote significant resources to maintain and regularly upgrade our systems and networks to safeguard critical business applications, there is no guarantee that these measures or any other measures can provide absolute security. Our computer systems, software and networks may be adversely affected by cyber incidents such as unauthorized access; loss or destruction of data (including confidential client information); account takeovers; unavailability of service; computer viruses or other malicious code; cyber attacks; and other events. In addition, our protective measures may not promptly detect intrusions, and we may experience losses or incur costs or other damage related to intrusions that go undetected or go undetected for significant periods of time, at levels that adversely affect our financial results or reputation. Further, because the methods used to cause cyber attacks change frequently, or in some cases cannot be recognized until launched, we may be unable to implement preventative measures or proactively address these methods until they are discovered. Cyber threats may derive from human error, fraud or malice on the part of employees or third parties, or may result from accidental technological failure. For example, during the second quarter of 2018, we became the victim of a “spear phishing” attack on one of our employees in which we suffered a \$4.0 million wire fraud loss and sensitive customer information was stolen. As a result of this attack, we incurred costs to provide identity protections services, including credit monitoring, to customers who may have been impacted and other legal and professional services, and may also incur expenses in the future including legal and professional expenses and claims for damages. Additional challenges are posed by external extremist parties, including foreign state actors, in some circumstances, as a means to promote political ends. If one or more of these events occurs, it could result in the disclosure of confidential client or customer information, damage to our reputation with our clients, customers and the market, customer dissatisfaction, additional costs such as repairing systems or adding new personnel or protection technologies, regulatory penalties, fines, remediation costs, exposure to litigation and other financial losses to both us and our clients and customers. Such events could also cause interruptions or malfunctions in our operations. We maintain cyber risk insurance, but this insurance may not be sufficient to cover all of our losses from any future breaches of our systems.

We continue to evaluate our cybersecurity program and will consider incorporating new practices as necessary to meet the expectations of regulatory agencies in light of such cybersecurity guidance and regulatory actions and settlements for cybersecurity-related failures and violations by other industry participants. Such procedures include management-level engagement and corporate governance, risk management and assessment, technical controls, incident response planning, vulnerability testing, vendor management, intrusion detection monitoring, patch management and staff training. Even if we implement these procedures, however, we cannot assure you that we will be fully protected from a cybersecurity incident, the occurrence of which could adversely affect our reputation and financial condition.

***The financial services industry is characterized by rapid technological change, and if we fail to keep pace, our business may suffer.***

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively or timely implement new technology-driven products and services or be successful in marketing these products and services to our customers and clients. Failure to successfully keep pace with technological change affecting the financial services industry and avoid interruptions, errors and delays could have a material adverse impact on our business, financial condition, results of operations or cash flows.

***We are heavily reliant on technology, and a failure to effectively implement new technological solutions or enhancements to existing systems or platforms could adversely affect our business operations and the financial results of our operations.***

Like most financial services companies, we significantly depend on technology to deliver our products and services and to otherwise conduct business. To remain technologically competitive and operationally efficient, we have either begun the significant investment in or have plans to invest in new technological solutions, substantial core system upgrades and other technology enhancements within each of our operating segments and corporate. Many of these solutions and enhancements have a significant duration, include phased implementation schedules, are tied to critical systems, and

require substantial internal and external resources for design and implementation. Such external resources may be relied upon to provide expertise and support to help implement, maintain and/or service certain of our core technology solutions.

Although we take steps to mitigate the risks and uncertainties associated with these solutions and initiatives, we may encounter significant adverse developments in the completion and implementation of these initiatives. These may include significant time delays, cost overruns, loss of key personnel, technological problems, processing failures, distraction of management and other adverse developments. Further, our ability to maintain an adequate control environment may be impacted.

The ultimate effect of any adverse development could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could materially affect us, including our control environment, operating efficiency, and results of operations.

***Our geographic concentration may magnify the adverse effects and consequences of any regional or local economic downturn.***

We conduct our banking operations primarily in Texas. At December 31, 2020, substantially all of the real estate loans in our loan portfolio were secured by properties located in our four largest markets within Texas, with 40%, 23%, 15% and 5% secured by properties located in the Dallas/Fort Worth, Austin/San Antonio, Houston/Coastal Bend and Rio Grande Valley/South Texas markets, respectively. Substantially all of these loans are made to borrowers who live and conduct business in Texas. Accordingly, economic conditions in Texas have a significant impact on the ability of the Bank's customers to repay loans, the value of the collateral securing loans, our ability to sell the collateral upon any foreclosure, and the stability of the Bank's deposit funding sources. Further, low crude oil prices may have a more profound effect on the economy of energy-dominant states such as Texas. The Bank has loans extended to businesses that depend on the energy industry including those within the exploration and production, oilfield services, pipeline construction, distribution and transportation sectors. If crude oil prices remain depressed for an extended period or decrease further, the Bank could experience weaker energy loan demand and increased losses within its energy and Texas-related loan portfolios. Moreover, natural disasters, such as Hurricane Harvey in 2017, may also have an adverse impact on local economic conditions.

In addition, mortgage origination fee income is dependent to a significant degree on economic conditions in Texas and California. During 2020, 18.6% and 10.9% of our mortgage loans originated (by dollar volume) were collateralized by properties located in Texas and California, respectively. Also, in our broker-dealer segment, 69% of public finance services net revenues were from entities located in Texas, and 89% of retail brokerage service revenues were generated through locations in Texas, California and Oklahoma. Any regional or local economic downturn that affects Texas or, to a lesser extent, California or Oklahoma, whether caused by recession, inflation, unemployment, changing oil prices, natural disasters or other factors, may affect us and our profitability more significantly and more adversely than our competitors that are less geographically concentrated, and could have a material adverse effect on our results of operations and financial condition.

***An adverse change in real estate market values may result in losses in our banking segment and otherwise adversely affect our profitability.***

At December 31, 2020, 38% of the loan portfolio of our banking segment was comprised of loans with commercial or residential real estate as the primary component of collateral. The real estate collateral in each case provides a source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A decline in commercial or residential real estate values generally, and in Texas specifically, could impair the value of the collateral underlying a significant portion of the Bank's loan portfolio and our ability to sell the collateral upon any foreclosure. In the event of a default with respect to any of these loans, the amounts we receive upon sale of the collateral may be insufficient to recover the outstanding principal and interest on the loan. As a result, our results of operations and financial condition may be materially adversely affected by a decrease in real estate market values.

***Changes in the method of determining LIBOR, or the replacement of LIBOR with an alternative reference rate, may adversely affect interest income or expense.***

Certain loans we originate bear interest at a floating rate based on LIBOR. We also pay interest on certain notes and are counterparty to derivative agreements that are based on LIBOR.

As previously discussed, in July 2017, the FCA announced that it intends to cease compelling banks to submit rates for the calculation of LIBOR after 2021. 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. The ARRC has proposed that 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. 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.

It is unclear whether, or in what form, LIBOR will continue to exist after 2021. Any transition to an alternative benchmark will require careful consideration and implementation so as not to disrupt the stability of financial markets. If LIBOR ceases to exist, we may need to take a variety of actions, including negotiating certain of our agreements based on an alternative benchmark that may be established, if any. There is no guarantee that a transition from LIBOR to an alternative benchmark will not result in financial market disruptions, significant changes in benchmark rates or adverse changes in the value of certain of our loans, and our income and expense. In addition, as a result of these actions, we may incur significant expenses in effecting the transition, including, but not limited to, changes to our agreements and our agreements with customers that do not contemplate LIBOR being unavailable, systems and processes, and may be subject to disputes or litigation with customers over the appropriateness or comparability to LIBOR of the substitute indices, which could have a material adverse effect on our financial condition or results of operations.

***Our mortgage origination business is subject to fluctuations based upon seasonal and other factors and, as a result, our results of operations for any given quarter may not be indicative of the results that may be achieved for the full fiscal year.***

Our mortgage origination business is subject to several variables that can impact loan origination volume, including seasonal and interest rate fluctuations. We typically experience increased loan origination volume from purchases of homes during the second and third calendar quarters, when more people tend to move and buy or sell homes. In addition, an increase in the general level of interest rates may, among other things, adversely affect the demand for mortgage loans and our ability to originate mortgage loans. In particular, if mortgage interest rates increase, the demand for residential mortgage loans and the refinancing of residential mortgage loans will likely decrease, which will have an adverse effect on our mortgage origination activities. Conversely, a decrease in the general level of interest rates, among other things, may lead to increased competition for mortgage loan origination business.

As a result of these variables, our results of operations for any single quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

***Our risk management processes may not fully identify and mitigate exposure to the various risks that we face, including interest rate, credit, liquidity and market risk.***

We continue to refine our risk management techniques, strategies and assessment methods on an ongoing basis. However, our risk management techniques and strategies (as well as those available to the market generally) may not be fully effective in mitigating our risk exposure in all economic market environments or against all types of risk. For example, we might fail to identify or anticipate particular risks, or the systems that we use, and that are used within our business segments generally, may not be capable of identifying certain risks. Certain of our strategies for managing risk are based upon observed historical market behavior. We apply statistical and other tools to these observations to quantify our risk exposure. Any failures in our risk management techniques and strategies to accurately identify and quantify our risk exposure could limit our ability to manage risks. In addition, any risk management failures could cause our losses to be significantly greater than the historical measures indicate. Further, our quantified modeling does not take all risks into account. As a result, we also take a qualitative approach in reducing our risk, although our qualitative approach to managing those risks could also prove insufficient, exposing us to material unanticipated losses.

***Our hedging strategies may not be successful in mitigating our exposure to interest rate risk.***

We use derivative financial instruments, primarily consisting of interest rate swaps, to limit our exposure to interest rate risk within the banking and mortgage origination segments. No hedging strategy can completely protect us, and the derivative financial instruments we elect may not have the effect of reducing our interest rate risk. Poorly designed strategies, improperly executed and documented transactions, inaccurate assumptions or the failure of a counterparty to fulfill its obligations could actually increase our risks and losses. In addition, hedging strategies involve transaction and

other costs. Our hedging strategies and the derivatives that we use may not adequately offset the risks of interest rate volatility and could result in or magnify losses, which could have an adverse effect on our financial condition and results of operations.

***Our bank lending, margin lending, stock lending, securities trading and execution and mortgage purchase businesses are all subject to credit risk.***

We are exposed to credit risk in all areas of our business. The Bank is exposed to the risk that its loan customers may not repay their loans in accordance with their terms, the collateral securing the loans may be insufficient, or its credit loss reserve may be inadequate to fully compensate the Bank for the outstanding balance of the loan plus the costs to dispose of the collateral. Further, our mortgage warehousing activities subject us to credit risk during the period between funding by the Bank and when the mortgage company sells the loan to a secondary investor.

Our broker-dealer business is subject to credit risk if securities prices decline rapidly because the value of our collateral could fall below the amount of the indebtedness it secures. In rapidly appreciating markets, credit risk increases due to short positions. Our securities lending business as well as our securities trading and execution businesses subject us to credit risk if a counterparty fails to perform or if collateral securing its obligations is insufficient. In securities transactions, we are subject to credit risk during the period between the execution of a trade and the settlement by the customer.

Significant failures by our customers, including correspondents, or clients to honor their obligations, or increases in their rates of default, together with insufficient collateral and reserves, could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***We depend on our computer and communications systems and an interruption in service would negatively affect our business.***

Our businesses rely on electronic data processing and communications systems. The effective use of technology allows us to better serve customers and clients, increases efficiency and reduces costs. Our continued success will depend, in part, upon our ability to successfully maintain, secure and upgrade the capability of our systems, our ability to address the needs of our clients by using technology to provide products and services that satisfy their demands and our ability to retain skilled information technology employees. Significant malfunctions or failures of our computer systems, computer security, software or any other systems in the trading process (e.g., record retention and data processing functions performed by third parties, and third party software, such as Internet browsers) could cause delays in customer trading activity. Such delays could cause substantial losses for customers and could subject us to claims from customers for losses, including litigation claiming fraud or negligence. In addition, if our computer and communications systems fail to operate properly, regulations would restrict our ability to conduct business. Any such failure could prevent us from collecting funds relating to customer and client transactions, which would materially impact our cash flows. Any computer or communications system failure or decrease in computer system performance that causes interruptions in our operations could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***We are heavily dependent on dividends from our subsidiaries.***

We are a financial holding company engaged in the business of managing, controlling and operating our subsidiaries. Hilltop conducts limited material business other than activities incidental to holding stock in the Bank and Securities Holdings. As a result, we rely substantially on the profitability of, and dividends from, these subsidiaries to pay our operating expenses and to pay interest on our debt obligations. The Bank and Securities Holdings are subject to significant regulatory restrictions limiting their ability to declare and pay dividends to us. Accordingly, if the Bank and Securities Holdings are unable to make cash distributions to us, then we may be unable to satisfy our operating expense obligations or make interest payments on our debt obligations.

***Our broker-dealer business is subject to various risks associated with the securities industry.***

Our broker-dealer business is subject to uncertainties that are common in the securities industry. These uncertainties include:

- intense competition in the securities industry;
- the volatility of domestic and international financial, bond and stock markets;

- extensive governmental regulation;
- litigation; and
- substantial fluctuations in the volume and price level of securities.

As a result of such uncertainties, the revenues and operating results of our broker-dealer segment may vary significantly from quarter to quarter and from year to year. Unfavorable financial or economic conditions could reduce the number and size of transactions in which we provide financial advisory, underwriting and other services. Disruptions in fixed income and equity markets could lead to a decline in the volume of transactions executed for customers and, therefore, to declines in revenues from commissions and clearing services. In addition, the Hilltop Broker-Dealers are operating subsidiaries of Hilltop, which means that their activities are limited to those that are permissible for subsidiaries of a bank holding company.

***Market fluctuations could adversely impact our broker-dealer business.***

Our broker-dealer segment is subject to risks as a result of fluctuations in the securities markets. Our securities trading, market-making and underwriting activities involve the purchase and sale of securities as a principal, which subjects our capital to significant risks. Market conditions could limit our ability to sell securities purchased or to purchase securities sold in such transactions. If interest rates increase, the value of debt securities we hold in our inventory would decrease. Rapid or significant market fluctuations could adversely affect our business, financial condition, results of operations and cash flow.

In addition, during periods of market disruption, it may be difficult to value certain assets if comparable sales become less frequent or market data becomes less observable. Certain classes of assets or loan collateral that were in active markets with significant observable data may become illiquid due to the current financial environment. In such cases, asset valuations may require more estimation and subjective judgment.

***Our investment advisory business may be affected if our investment products perform poorly.***

Poor investment returns and declines in client assets in our investment advisory business, due to either general market conditions or underperformance (relative to our competitors or to benchmarks) by investment products, may affect our ability to retain existing assets, prevent clients from transferring their assets out of products or their accounts, or inhibit our ability to attract new clients or additional assets from existing clients. Any such poor performance could adversely affect our investment advisory business and the advisory fees that we earn on client assets.

***Our existing correspondents may choose to perform their own clearing services or move their clearing business to one of our competitors or exit the business.***

As the operations of our correspondents grow, our correspondents may consider the option of performing clearing functions themselves, in a process referred to as “self-clearing.” The option to convert to self-clearing operations may become more attractive as the transaction volume of a broker-dealer grows. The cost of implementing the necessary infrastructure may eventually be offset by the elimination of per transaction processing fees that would otherwise be paid to a clearing firm. Additionally, performing their own clearing services allows self-clearing broker-dealers to retain their customers’ margin balances, free credit balances and securities for use in margin lending activities. Furthermore, our correspondents may decide to use the clearing services of one of our competitors or exit the business. Any significant loss of correspondents due to self-clearing, moving their clearing business to a competitor or exiting the business could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***Several of our broker-dealer segment’s product lines rely on favorable tax treatment and changes in federal tax law could impact the attractiveness of these products to our customers.***

We offer a variety of services and products, such as individual retirement accounts and municipal bonds, which rely on favorable federal income tax treatment to be attractive to our customers. Should favorable tax treatment of these products be eliminated or reduced, sales of these products could be materially impacted, which could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***Our mortgage origination segment is subject to investment risk on loans that it originates.***

We intend to sell, and not hold for investment, substantially all residential mortgage loans that we originate through PrimeLending. At times, however, we may originate a loan or execute an interest rate lock commitment (“IRLC”) with a customer pursuant to which we agree to originate a mortgage loan on a future date at an agreed-upon interest rate without having identified a purchaser for such loan. An identified purchaser may also decline to purchase a loan for a variety of reasons. In these instances, we will bear interest rate risk on an IRLC until, and unless, we are able to find a buyer for the loan underlying such IRLC and the risk of investment on a loan until, and unless, we are able to find a buyer for such loan. In addition, in the event of a breach of any representation or warranty concerning a loan, an agency, investor or other third party could, among other things, require us to repurchase the full amount of the loan or seek indemnification for losses from us, even if the loan is not in default. Further, if a customer defaults on a mortgage payment shortly after the loan is originated, the purchaser of the loan may have a put right, whereby the purchaser can require us to repurchase the loan at the full amount that it paid. During periods of market downturn, we may choose to hold mortgage loans when the identified purchasers have declined to purchase such loans because we may not obtain an acceptable substitute bid price for such loan. The failure of mortgage loans that we hold on our books to perform adequately could have a material adverse effect on our financial condition, liquidity and results of operations. Moreover, if a property securing a mortgage loan on which we own the servicing rights is damaged, including from flooding, we may be responsible for repairs for uninsured damage.

***Changes in interest rates may change the value of our mortgage servicing rights portfolio, which may increase the volatility of our earnings.***

As a result of our mortgage servicing business, which we may expand in the future, we have a portfolio of MSR assets. A MSR is the right to service a mortgage loan – collect principal, interest and escrow amounts – for a fee. We measure and carry all of our residential MSR assets using the fair value measurement method. Fair value is determined as the present value of estimated future net servicing income, calculated based on a number of variables, including assumptions about the likelihood of prepayment by borrowers.

One of the principal risks associated with MSR assets 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, as a means to mitigate market risk associated with MSR assets. However, 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 assets.

The CARES Act was enacted as a part of an on-going legislative response to the COVID-19 virus and 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 has 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 2020, the Company has increased the amount of retained servicing on mortgage loan sales. Starting in the second quarter of 2020, PrimeLending retained servicing on 89% of total mortgage loans sold. The increased size of our MSR portfolio could result in us carrying significant asset balances. This could result in a reduction in our liquidity and cause a reduction in our capital ratios. The combination of these impacts along with other impacts, could cause us to not have sufficient liquidity or capital.

At December 31, 2020, the mortgage origination segment’s MSR asset had a fair value of \$144.2 million. All income related to retained servicing, including changes in the value of the MSR asset, is included in noninterest income. Depending on the interest rate environment, it is possible that the fair value of our MSR asset may be reduced in the future. If such changes in fair value significantly reduce the carrying value of our MSR asset, our financial condition and results of operations would be negatively affected.

***If we fail to develop, implement and maintain an effective system of internal control over financial reporting, the accuracy and timing of our financial reporting in future periods may be adversely affected.***

The Sarbanes-Oxley Act and related rules and regulations require that management report annually on the effectiveness of our internal control over financial reporting and assess the effectiveness of our disclosure controls and procedures on a quarterly basis. Effective internal controls are necessary for us to provide timely and reliable financial reports and effectively prevent fraud.

Following the identification during the fourth quarter of 2019 of a control deficiency that constituted a material weakness in our internal controls and procedures described in our Annual Report on Form 10-K for the year ended December 31, 2019, we initiated remediation measures to address the design and maintenance of effective controls over certain aspects relating to the determination of the qualitative factors considered by management in the allowance for loan losses estimation process, specifically control activities to adequately support the analysis and the impact of such support on the loss measurement. As previously reported, the remediation plan was implemented during the fourth quarter of 2019 and included an enhanced analysis to support the qualitative factors considered in the estimation of the allowance for loan losses as of December 31, 2019. Management believes that such enhanced controls, including new controls implemented as a part of the adoption of CECL on January 1, 2020, have been designed to address the material weakness and were implemented as of March 31, 2020. We consider the material weakness remediated as of December 31, 2020, as the remedial controls have operated for a sufficient period of time and we have concluded, through testing, that these controls are operating effectively. For a more detailed discussion, see Item 9A, “Controls and Procedures” herein.

If we fail to maintain adequate internal controls, our financial statements may not accurately reflect our financial condition. Any material misstatements could require a restatement of our consolidated financial statements, cause us to fail to meet our reporting obligations or cause investors to lose confidence in our reported financial information, leading to a decline in the market value of our securities.

***We ultimately may write-off goodwill and other intangible assets resulting from business combinations.***

As a result of purchase accounting in connection with acquisitions, our consolidated balance sheet at December 31, 2020, included goodwill of \$267.4 million and other intangible assets, net of accumulated amortization, of \$20.4 million. On an ongoing basis, we evaluate whether facts and circumstances indicate any impairment of value of intangible assets. As circumstances change, we may not realize the value of these intangible assets. If we determine that a material impairment has occurred, we will be required to write-off the impaired portion of intangible assets, which could have a material adverse effect on our results of operations in the period in which the write-off occurs.

The ultimate impact of the COVID-19 pandemic on our operations and financial performance depends on many factors that are not within our control. If we are unable to successfully manage our business through the challenges and uncertainty created by the COVID-19 pandemic, our business and operating results could be materially adversely affected.

If the COVID-19 pandemic results in a prolonged adverse impact on our operating results, our goodwill and other intangible assets may be at risk of future impairment.

We have goodwill and intangibles balances recorded in connection with acquisition in our banking and broker-dealer segments, which we periodically review for impairment. These assets are sensitive to any significant changes in related results of operations of the underlying businesses. Specifically, our banking segment has experienced lower-than-forecasted operating results during the year ended December 31, 2020, due to conditions discussed in detail within the discussion of banking segment that follows. However, we cannot predict the effects that any continued adverse conditions from the pandemic may have on the future impairment of these assets.

Based on the results of our annual quantitative analysis as of October 1, 2020, the fair values of each of our reporting units indicated no impairment of goodwill. Any downward revisions to current year actual and future forecasted operating performance, in conjunction with any changes to long-term growth rates or discount rates, may cause the fair value of the respective reporting unit to decline. If the estimated fair value is less than the carrying value, we would be required to recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized would not exceed the total amount of goodwill allocated to that reporting unit.

***The accuracy of our financial statements and related disclosures could be affected if we are exposed to actual conditions different from the judgments, assumptions or estimates used in our critical accounting policies.***

The preparation of financial statements and related disclosure in conformity with GAAP requires us to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, which are included in this Annual Report, describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that we consider “critical” because they require judgments, assumptions and estimates that materially impact our consolidated financial statements and related disclosures. As a result, if future events differ significantly from the judgments, assumptions and estimates in our critical accounting policies, such events or assumptions could have a material impact on our audited consolidated financial statements and related disclosures.

***We are dependent on our management team, and the loss of our senior executive officers or other key employees could impair our relationship with customers and adversely affect our business and financial results.***

Our success is dependent, to a large degree, upon the continued service and skills of our existing management team and other key employees with long-term customer relationships. Our business and growth strategies are built primarily upon our ability to retain employees with experience and business relationships within their respective segments. The loss of one or more of these key personnel could have an adverse impact on our business because of their skills, knowledge of the market, years of industry experience and the difficulty of finding qualified replacement personnel. In addition, we currently do not have non-competition agreements with certain members of management and other key employees. If any of these personnel were to leave and compete with us, our business, financial condition, results of operations and growth could suffer.

***A decline in the market for municipal advisory services could adversely affect our business and results of operations.***

Our broker-dealer segment has historically earned a material portion of its revenues from advisory fees paid to it by its clients, in large part upon the successful completion of the client’s transaction. New issuances in the municipal market by cities, counties, school districts, state and other governmental agencies, airports, healthcare institutions, institutions of higher education and other clients that the public finance services line of business serves can be subject to significant fluctuations based on factors such as changes in interest rates, property tax bases, budget pressures on certain issuers caused by uncertain economic times and other factors. A decline in the market for municipal advisory services due to the factors listed above could have an adverse effect on our business and results of operations.

***We are subject to losses due to fraudulent and negligent acts.***

Our banking and mortgage origination businesses expose us to fraud risk from our loan and deposit customers and the parties they do business with, as well as from our employees, contractors and vendors. We rely heavily upon information supplied by third parties, including the information contained in credit applications, property appraisals, title information, equipment pricing and valuation, and employment and income documentation, in deciding which loans to originate and the terms of those loans. If any of the information upon which we rely is misrepresented, either fraudulently or negligently, and the misrepresentation is not detected prior to funding, the value of the collateral may be significantly lower than expected, the source of repayment may not exist or may be significantly impaired, or we may fund a loan that we would not have funded or on terms we would not have extended. While we have underwriting and operational controls in place to help detect and prevent such fraud, no such controls are effective to detect or prevent all fraud. Whether a misrepresentation is made by the applicant, another third party or one of our own employees, we may bear the risk of loss associated with the misrepresentation. We have experienced losses resulting from fraud in the past, including loan, wire transfer, document and check fraud, and identity theft. We maintain fraud insurance, but this insurance may not be sufficient to cover all of our losses from any fraudulent acts.

Our broker-dealer activities also expose us to fraud risks. When acting as an underwriter, our broker-dealer segment may be liable jointly and severally under federal, state and foreign securities laws for false and misleading statements concerning the securities, or the issuer of the securities, that it underwrites. We are sometimes brought into lawsuits in connection with our correspondent clearing business based on actions of our correspondents. In addition, we may act as a fiduciary in other capacities that could expose us to liability under such laws or under common law fiduciary principles.



***Negative publicity regarding us, or financial institutions in general, could damage our reputation and adversely impact our business and results of operations.***

Our ability to attract and retain customers and conduct our business could be adversely affected to the extent our reputation is damaged. Reputational risk, or the risk to our business, earnings and capital from negative public opinion regarding our company, or financial institutions in general, is inherent in our business. Adverse perceptions concerning our reputation could lead to difficulties in generating and maintaining accounts as well as in financing them. In particular, such negative perceptions could lead to decreases in the level of deposits that consumer and commercial customers and potential customers choose to maintain with us. Negative public opinion could result from actual or alleged conduct in any number of activities or circumstances, including lending or foreclosure practices; sales practices; corporate governance and potential conflicts of interest; ethical failures or fraud, including alleged deceptive or unfair lending or pricing practices; regulatory compliance; protection of customer information; cyber attacks, whether actual, threatened, or perceived; negative news about us or the financial institutions industry generally; general company performance; or actions taken by government regulators and community organizations in response to such activities or circumstances. Furthermore, our failure to address, or the perception that we have failed to address, these issues appropriately could impact our ability to keep and attract customers and/or employees and could expose us to litigation and/or regulatory action, which could have an adverse effect on our business and results of operations.

***We are subject to legal claims and litigation, including potential securities law liabilities, any of which could have a material adverse effect on our business.***

We face significant legal risks in each of the business segments in which we operate, and the volume of legal claims and amount of damages and penalties claimed in litigation and regulatory proceedings against financial service companies remains high. These risks often are difficult to assess or quantify, and their existence and magnitude often remain unknown for substantial periods of time. Substantial legal liability or significant regulatory action against us or any of our subsidiaries could have a material adverse effect on our results of operations or cause significant reputational harm to us, which could seriously harm our business and prospects. Further, regulatory inquiries and subpoenas, other requests for information, or testimony in connection with litigation may require incurrence of significant expenses, including fees for legal representation and fees associated with document production. These costs may be incurred even if we are not a target of the inquiry or a party to the litigation. Any financial liability or reputational damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Further, in the normal course of business, our broker-dealer segment has been subject to claims by customers and clients alleging unauthorized trading, churning, mismanagement, suitability of investments, breach of fiduciary duty or other alleged misconduct by our employees or brokers. We are sometimes brought into lawsuits based on allegations concerning our correspondents. As underwriters, we are subject to substantial potential liability for material misstatements and omissions in prospectuses and other communications with respect to underwritten offerings of securities. Prolonged litigation producing significant legal expenses or a substantial settlement or adverse judgment could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***Because we may use a substantial portion of our remaining excess capital to make acquisitions or effect a business combination, we may become subject to risks inherent in pursuing and completing any such acquisitions or business combination.***

We may make acquisitions or effect business combinations with a substantial portion of our remaining excess capital. We may not, however, be able to identify suitable targets, consummate acquisitions or effect a combination on commercially acceptable terms or, if consummated, successfully integrate personnel and operations.

The success of any acquisition or business combination will depend upon, among other things, the ability of management and our employees to integrate personnel, operations, products and technologies effectively, to attract, retain and motivate key personnel and to retain customers and clients of targets. It is possible that the integration process could result in the loss of key employees, the disruption of ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients, customers, depositors and employees. In addition, the integration of certain operations will require the dedication of significant management resources, which may temporarily distract management's attention from our day-to-day business. Any inability to realize the full extent, or any, of the anticipated cost savings and financial benefits of any acquisitions we make, as well as any delays encountered in the integration process, could have an adverse effect on our business and results of operations, which could adversely

affect our financial condition and cause a decrease in our earnings per share or decrease or delay the expected accretive effect of the acquisitions and contribute to a decrease in the price of our common stock. In addition, any acquisition or business combination we undertake may consume available cash resources, result in potentially dilutive issuances of equity securities and divert management's attention from other business concerns. Even if we conduct extensive due diligence on a target business that we acquire or with which we merge, our diligence may not surface all material issues that may adversely affect a particular target business, and we may be forced to later write-down or write-off assets, restructure our operations or incur impairment or other charges that could result in our reporting losses. Consequently, we also may need to make further investments to support the acquired or combined company and may have difficulty identifying and acquiring the appropriate resources.

We may enter, through acquisitions or a business combination, into new lines of business or initiate new service offerings subject to the restrictions imposed upon us as a regulated financial holding company. Accordingly, there is no basis for you to evaluate the possible merits or risks of the particular target business with which we may combine or that we may ultimately acquire.

Subject to the restrictions imposed upon us as a regulated financial holding company, we may also use excess capital to make investments in companies engaged in non-financial activities. These investments could decline in value and are likely to be substantially less liquid than exchange-listed securities, if we are able to sell them at all. If we are required to sell these investments quickly, we may receive significantly less value than if we could otherwise have sold them. Losses on these investments could have an adverse impact on our profitability, results of operations and financial condition.

***We may be subject to environmental liabilities in connection with the foreclosure on real estate assets securing the loan portfolio of our banking segment.***

Hazardous or toxic substances or other environmental hazards may be located on the real estate that secures our loans. If we acquire such properties as a result of foreclosure, or otherwise, we could become subject to various environmental liabilities. For example, we could be held liable for the cost of cleaning up or otherwise addressing contamination at or from these properties. We could also be held liable to a governmental entity or third party for property damage, personal injury or other claims relating to any environmental contamination at or from these properties. In addition, we could be held liable for costs relating to environmental contamination at or from our current or former properties. We may not detect all environmental hazards associated with these properties. If we ever became subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations could be harmed.

### **Risks Related to Our Indebtedness**

***Our indebtedness may affect our ability to operate our business, and may have a material adverse effect on our financial condition and results of operations. We may incur additional indebtedness, including secured indebtedness.***

At December 31, 2020, on a consolidated basis, we had total deposits of \$11.2 billion and other indebtedness of \$1.1 billion, including \$150.0 million in aggregate principal amount of 5% senior notes due 2025 (the "Senior Notes"), \$50 million aggregate principal amount of 5.75% fixed-to-floating rate subordinated notes due 2030 (the "2030 Subordinated Notes") and \$150 million aggregate principal amount of 6.125% fixed-to-floating rate subordinated notes due 2035 (the "2035 Subordinated Notes"). Our significant amount of indebtedness could have important consequences, such as:

- limiting our ability to obtain additional financing to fund our working capital needs, acquisitions, capital expenditures or other debt service requirements or for other purposes;
- limiting our ability to use operating cash flow in other areas of our business because we must dedicate a substantial portion of these funds to service debt;
- limiting our ability to compete with other companies who are not as highly leveraged, as we may be less capable of responding to adverse economic and industry conditions;
- restricting us from making strategic acquisitions, developing properties or pursuing business opportunities;
- restricting the way in which we conduct our business because of financial and operating covenants in the agreements governing our and certain of our subsidiaries' existing and future indebtedness, including, in the case of certain indebtedness of subsidiaries, certain covenants that restrict the ability of such subsidiaries to pay dividends or make other distributions to us;

- exposing us to potential events of default (if not cured or waived) under financial and operating covenants contained in our or our subsidiaries' debt instruments that could have a material adverse effect on our business, financial condition and operating results;
- increasing our vulnerability to a downturn in general economic conditions or a decrease in pricing of our products; and
- limiting our ability to react to changing market conditions in our industry and in our customers' industries.

In addition to our debt service obligations, our operations require substantial investments on a continuing basis. Our ability to make scheduled debt payments, to refinance our obligations with respect to our indebtedness and to fund capital and non-capital expenditures necessary to maintain the condition of our operating assets and properties, as well as to provide capacity for the growth of our business, depends on our financial and operating performance, which, in turn, is subject to prevailing economic conditions and financial, business, competitive, legal and other factors.

Subject to the restrictions in the indentures governing the Senior Notes, 2030 Subordinated Notes and 2035 Subordinated Notes (collectively, the "Senior and Subordinated Notes"), we may incur significant additional indebtedness, including secured indebtedness. If new debt is added to our current debt levels, the risks described above could increase.

***We may not be able to generate sufficient cash to service all of our indebtedness, including the Senior and Subordinated Notes, and may be forced to take other actions to satisfy our obligations under our indebtedness that may not be successful.***

Our ability to satisfy our debt obligations will depend upon, among other things:

- our future financial and operating performance, which will be affected by prevailing economic conditions and financial, business, regulatory and other factors, many of which are beyond our control; and
- our future ability to refinance the Senior and Subordinated Notes, which depends on, among other things, our compliance with the covenants in the indentures governing the Senior and Subordinated Notes.

We cannot assure you that our business will generate sufficient cash flow from operations, or that we will be able to obtain financing in an amount sufficient to fund our liquidity needs.

If our cash flows and capital resources are insufficient to service our indebtedness, including the Senior and Subordinated Notes, we may be forced to reduce or delay capital expenditures, sell assets, seek additional capital or restructure or refinance our indebtedness, including the Senior and Subordinated Notes. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations, including our obligations under the Senior and Subordinated Notes. Our ability to restructure or refinance our debt will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of our debt could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business operations. In addition, the terms of existing or future debt agreements may restrict us from adopting some of these alternatives. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations, sell equity and/or negotiate with our lenders and other creditors to restructure the applicable debt in order to meet our debt service and other obligations. We may not be able to consummate those dispositions for fair market value or at all. The indentures governing the Senior and Subordinated Notes may restrict, or market or business conditions may limit, our ability to avail ourselves of some or all of these options. Furthermore, any proceeds that we could realize from any such dispositions may not be adequate to meet our debt service obligations then due.

***A reduction in our credit rating could adversely affect us or the holders of our securities.***

The credit rating agencies rating our indebtedness regularly evaluate the Company, and credit ratings are based on a number of factors, including our financial strength and ability to generate earnings, as well as factors not entirely within our control, including conditions affecting the financial services industry and the economy and changes in rating methodologies. There can be no assurance that we will maintain our current credit rating. A downgrade of our credit rating could adversely affect our access to liquidity and capital, and could significantly increase our cost of funds, trigger additional collateral or funding requirements and decrease the number of investors and counterparties willing to lend to us or purchase our securities. This could affect our growth, profitability and financial condition, including liquidity.

***The indentures governing the Senior and Subordinated Notes contain, and any instruments governing future indebtedness would likely contain, restrictions that limit our flexibility in operating our business.***

The indentures governing the Senior and Subordinated Notes contain, and any instruments governing future indebtedness would likely contain, a number of covenants that impose significant operating and financial restrictions on us, including restrictions on our ability to, among other things:

- dispose of, or issue voting stock of, certain subsidiaries; or
- incur or permit to exist any mortgage, pledge, encumbrance or lien or charge on the capital stock of certain subsidiaries.

Any of these restrictions could limit our ability to plan for or react to market conditions and could otherwise restrict corporate activities. Any failure to comply with these covenants could result in a default under the indentures governing the Senior and Subordinated Notes. Upon a default, holders of the Senior and Subordinated Notes have the ability ultimately to force us into bankruptcy or liquidation, subject to the indentures governing the Senior and Subordinated Notes. In addition, a default under the indentures governing the Senior and Subordinated Notes could trigger a cross default under the agreements governing our existing and future indebtedness. Our operating results may not be sufficient to service our indebtedness or to fund our other expenditures and we may not be able to obtain financing to meet these requirements.

### **Risks Related to our Industry**

***The soundness of other financial institutions could adversely affect our business.***

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to many different counterparties and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, credit unions, investment banks, mutual and hedge funds, and other institutional clients. As a result, defaults by, or even negative speculation about, one or more financial services institutions, or the financial services industry in general, have led to market-wide liquidity problems in the past and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when we hold collateral that cannot be realized or is liquidated at prices not sufficient to recover the full amount of the receivable due to us. Any such losses could be material and could materially and adversely affect our business, financial condition, results of operations or cash flows.

***We face strong competition from other financial institutions and financial service companies, which may adversely affect our operations and financial condition.***

Our banking segment primarily competes with national, regional and community banks within various markets where the Bank operates. The Bank also faces competition from many other types of financial institutions, including savings and loan associations, savings banks, finance companies and credit unions. A number of these banks and other financial institutions have substantially greater resources and lending limits, larger branch systems and a wider array of banking services than we do. We also compete with other providers of financial services, such as money market mutual funds, brokerage and investment banking firms, consumer finance companies, pension trusts and governmental organizations, each of which may offer more favorable financing than we are able to provide. In addition, some of our non-bank competitors are not subject to the same extensive regulations that govern us. The banking business in Texas has remained competitive over the past several years, and we expect the level of competition we face to further increase. Competition for deposits and in providing lending products and services to consumers and businesses in our market area is intense and pricing is important. Other factors encountered in competing for savings deposits are convenient office locations, interest rates and fee structures of products offered. Direct competition for savings deposits also comes from other commercial bank and thrift institutions, money market mutual funds and corporate and government securities that may offer more attractive rates than insured depository institutions are willing to pay. Competition for loans is based on factors such as interest rates, loan origination fees and the range of services offered by the provider. We seek to distinguish ourselves from our competitors through our commitment to personalized customer service and responsiveness to customer needs while providing a range of competitive loan and deposit products and other services. Our profitability depends on our

ability to compete effectively in these markets. This competition may reduce or limit our margins on banking services, reduce our market share and adversely affect our results of operations and financial condition.

The financial advisory and investment banking industries also are intensely competitive industries and will likely remain competitive. Our broker-dealer business competes directly with numerous other financial advisory and investment banking firms, broker-dealers and banks, including large national and major regional firms and smaller niche companies, some of whom are not broker-dealers and, therefore, not subject to the broker-dealer regulatory framework. In addition to competition from firms currently in the industry, there has been increasing competition from others offering financial services, including automated trading and other services based on technological innovations. Our broker-dealer business competes on the basis of a number of factors, including the quality of advice and service, technology, product selection, innovation, reputation, client relationships and price. Increased pressure created by any current or future competitors, or by competitors of our broker-dealer business collectively, could materially and adversely affect our business and results of operations. Increased competition may result in reduced revenue and loss of market share. Further, as a strategic response to changes in the competitive environment, our broker-dealer business may from time to time make certain pricing, service or marketing decisions that also could materially and adversely affect our business and results of operations.

Our mortgage origination business faces vigorous competition from banks and other financial institutions, including large financial institutions as well as independent mortgage banking companies, commercial banks, savings banks and savings and loan associations. Our mortgage origination segment competes on a number of factors including customer service, quality and range of products and services offered, price, reputation, interest rates, closing process and duration, and loan origination fees. The ability to attract and retain skilled mortgage origination professionals is critical to our mortgage origination business. We seek to distinguish ourselves from our competitors through our commitment to personalized customer service and responsiveness to customer needs while providing a range of competitive mortgage loan products and services.

Overall, competition among providers of financial products and services continues to increase as technological advances have lowered the barriers to entry for financial technology companies, with consumers having the opportunity to select from a growing variety of traditional and nontraditional alternatives, including online checking, savings and brokerage accounts, online lending, online insurance underwriters, crowdfunding, digital wallets, and money transfer services. The ability of non-banking financial institutions to provide services previously limited to commercial banks has intensified competition. Because non-banking financial institutions are not subject to many of the same regulatory restrictions as banks and bank holding companies, they can often operate with greater flexibility and lower cost structures. This competition could result in the loss of customer deposits and brokerage accounts and lower mortgage originations which could have a material adverse effect on our financial condition and results of operations.

***Acquisitions may be delayed, impeded, or prohibited due to regulatory issues.***

Acquisitions by financial institutions are subject to approval by a variety of federal and state regulatory agencies. The process for obtaining these required regulatory approvals has become substantially more difficult in recent years. Regulatory approvals could be delayed, impeded, restrictively conditioned or denied due to existing or new regulatory issues we have, or may have, with regulatory agencies, including, without limitation, issues related to Bank Secrecy Act compliance, Community Reinvestment Act issues, fair lending laws, fair housing laws, consumer protection laws, unfair, deceptive, or abusive acts or practices regulations and other similar laws and regulations. We may fail to pursue, evaluate or complete strategic and competitively significant acquisition opportunities as a result of our inability, or perceived or anticipated inability, to obtain regulatory approvals in a timely manner, under reasonable conditions or at all. Difficulties associated with potential acquisitions that may result from these factors could have a material adverse effect on our business, financial condition and results of operations.

## Legal and Regulatory Risks

***We are subject to extensive supervision and regulation that could restrict our activities and impose financial requirements or limitations on the conduct of our business and limit our ability to generate income.***

We are subject to extensive federal and state regulation and supervision, including that of the Federal Reserve Board, the Texas Department of Banking, the FDIC, the CFPB, the SEC and FINRA. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not stockholders or other debt holders. Likewise, regulations promulgated by the SEC and FINRA are primarily intended to protect the securities markets and customers of broker-dealer businesses rather than stockholders or other debt holders. Further, because the Bank's total assets were over \$10.0 billion (as measured on four consecutive quarterly call reports of the Bank) as of June 30, 2020, along with the continued Federal Reserve consumer supervisory and enforcement, the Bank became subject to the CFPB's supervisory and enforcement authority with respect to federal consumer financial laws, beginning in the second quarter of 2020.

These regulations affect our lending practices, capital structure, capital requirements, investment practices, brokerage and investment advisory activities, dividends and growth, among other things. Failure to comply with laws, regulations or policies could result in money damages, civil money penalties or reputational damage, as well as sanctions and supervisory actions by regulatory agencies that could subject us to significant restrictions on or suspensions of our business and our ability to expand through acquisitions or branching. Further, our clearing contracts generally include automatic termination provisions that are triggered in the event we are suspended from any of the national exchanges of which we are a member for failure to comply with the rules or regulations thereof. While we have implemented policies and procedures designed to prevent any such violations of rules and regulations, such violations may occur from time to time, which could have a material adverse effect on our financial condition and results of operations.

The U.S. Congress, state legislatures, and federal and state regulatory agencies frequently revise banking and securities laws, regulations and policies. For example, several aspects of the Dodd-Frank Act have affected our business, including, without limitation, increased capital requirements, increased mortgage regulation, restrictions on proprietary trading in securities, restrictions on investments in hedge funds and private equity funds, executive compensation restrictions, potential federal oversight of the insurance industry and disclosure and reporting requirements. Although the EGRRCPA is intended to ease the regulatory burden imposed by the Dodd-Frank Act with respect to company-run stress testing, resolution plans, the Volcker Rule, high volatility commercial real estate exposures, and real estate appraisals, at this time, it remains difficult to predict the full extent to which the Dodd-Frank Act, the EGRRCPA, the CARES Act, the AML Act or the resulting rules and regulations will affect our business. Compliance with new laws and regulations has resulted and likely will continue to result in additional costs, which could be significant and may adversely impact our results of operations, financial condition, and liquidity.

The Bank received a "satisfactory" CRA rating in connection with its most recent CRA performance evaluation. A CRA rating of less than "satisfactory" adversely affects a bank's ability to establish new branches and impairs a bank's ability to commence new activities that are "financial in nature" or acquire companies engaged in these activities. Other regulatory exam ratings or findings also may adversely impact our ability to branch, commence new activities or make acquisitions.

We cannot predict whether or in what form any other proposed regulations or statutes will be adopted or the extent to which our business may be affected by any new regulation or statute. These changes become less predictable, yet more likely to occur, following the transition of power from one presidential administration to another, especially as in 2021, when it involves a change in political party. Any such changes could subject our business to additional costs, limit the types of financial services and products we may offer and increase the ability of non-banks to offer competing financial services and products, among other things.

***We may be subject to more stringent capital requirements in the future.***

We are subject to regulatory requirements specifying minimum amounts and types of capital that we must maintain. From time to time, the regulators change these regulatory capital adequacy guidelines. If we fail to meet these minimum capital guidelines and other regulatory requirements, we or our subsidiaries may be restricted in the types of activities we may conduct and we may be prohibited from taking certain capital actions, such as paying dividends and repurchasing or redeeming capital securities.

In particular, under the Basel III capital framework, we are required to satisfy additional, more stringent, capital adequacy standards than we had in the past. Further, because we had less than \$15 billion in assets as of December 31, 2009, we have been allowed to include the debentures issued to the PCC Statutory Trusts I, II, III and IV (the “Trusts”), less the common stock of the Trusts, in Tier 1 capital. However, because Hilltop has grown above \$15 billion in assets, if we make an acquisition in the future, the debentures issued to the Trusts may be phased out of Tier 1 and into Tier 2 capital. Failure to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have an adverse material effect on our financial condition and results of operations. The application of more stringent capital requirements for Hilltop and PlainsCapital could, among other things, adversely affect our results of operations and growth, require the raising of additional capital, restrict our ability to pay dividends or repurchase shares and result in regulatory actions if we were to be unable to comply with such requirements.

Periodically, the SEC adopts amendments to Rules 15c3-1 and 15c3-3 under the Exchange Act related to our broker-dealer segment. The implementation of any new requirements from these amendments may increase our cost of regulatory compliance.

***The CFPB has issued “ability-to-repay” and “qualified mortgage” rules that may have a negative impact on our loan origination process and foreclosure proceedings, which could adversely affect our business, operating results, and financial condition.***

The CFPB’s “qualified mortgage” rule requires mortgage lenders to consider consumers’ ability to repay home loans before extending them credit. The rule describes certain minimum requirements for lenders making ability-to-repay determinations, but does not dictate that they follow particular underwriting models. Lenders are presumed to have complied with the ability-to-repay rule if they issue “qualified mortgages,” which are generally defined as mortgage loans prohibiting or limiting certain risky features. Loans that do not meet the ability-to-repay standard can be challenged in court by borrowers who default and the absence of ability-to-repay status can be used against a lender in foreclosure proceedings. Any loans that we make outside of the “qualified mortgage” criteria, including the newly created “seasoned qualified mortgage” criteria could expose us to an increased risk of liability and reduce or delay our ability to foreclose on the underlying property. Any increases in compliance and foreclosure costs caused by the rule could negatively affect our business, operating results and financial condition.

### **Risks Related to Our Common Stock**

***We may issue shares of preferred stock or additional shares of common stock to complete an acquisition or effect a combination or under an employee incentive plan after consummation of an acquisition or business combination, which would dilute the interests of our stockholders and likely present other risks.***

The issuance of shares of preferred stock or additional shares of common stock:

- may significantly dilute the equity interest of our stockholders;
- may subordinate the rights of holders of common stock if preferred stock is issued with rights senior to those afforded our common stock;
- could cause a change in control if a substantial number of shares of common stock are issued, which may affect, among other things, our ability to use our net operating loss carry forwards; and
- may adversely affect prevailing market prices for our common stock.

Our board of directors, in its sole discretion, may designate and issue one or more series of preferred stock from the authorized and unissued shares of preferred stock. Subject to limitations imposed by law or our articles of incorporation, our board of directors is empowered to determine the designation and number of shares constituting each series of preferred stock, as well as any designations, qualifications, privileges, limitations, restrictions or special or relative rights of additional series. The rights of preferred stockholders may supersede the rights of common stockholders. Preferred stock could be issued with voting and conversion rights that could adversely affect the voting power of the shares of our common stock. The issuance of preferred stock could also result in a series of securities outstanding that would have preferences over the common stock with respect to dividends and in liquidation.

***Our common stock price may experience substantial volatility, which may affect your ability to sell our common stock at an advantageous price.***

Price volatility of our common stock may affect your ability to sell our common stock at an advantageous price. Market price fluctuations in our common stock may arise due to acquisitions, dispositions or other material public announcements, including those regarding dividends or changes in management, along with a variety of additional factors, including, without limitation, other risks identified in “Forward-looking Statements” and these “Risk Factors.” In addition, the stock markets in general, including the NYSE, have experienced extreme price and trading fluctuations. These fluctuations have resulted in volatility in the market prices of securities that often have been unrelated or disproportionate to changes in operating performance. These broad market fluctuations may adversely affect the market price of our common stock.

***Existing circumstances may result in several of our directors having interests that may conflict with our interests.***

A director who has a conflict of interest with respect to an issue presented to our board will have no inherent legal obligation to abstain from voting upon that issue. We do not have provisions in our bylaws or charter that require an interested director to abstain from voting upon an issue, and we do not expect to add provisions in our charter and bylaws to this effect. Although each director has a duty to act in good faith and in a manner he or she reasonably believes to be in our best interests, there is a risk that, should interested directors vote upon an issue in which they or one of their affiliates has an interest, their vote may reflect a bias that could be contrary to our best interests. In addition, even if an interested director abstains from voting, the director’s participation in the meeting and discussion of an issue in which he or she has, or companies with which he or she is associated have, an interest could influence the votes of other directors regarding the issue.

***Our rights and the rights of our stockholders to take action against our directors and officers are limited.***

We are organized under Maryland law, which provides that a director or officer has no liability in that capacity if he or she performs his or her duties in good faith, in a manner he or she reasonably believes to be in our best interests and with the care that an ordinarily prudent person in a like position would use under similar circumstances. In addition, our charter eliminates our directors’ and officers’ liability to us and our stockholders for money damages, except for liability resulting from actual receipt of an improper benefit or profit in money, property or services or active and deliberate dishonesty established by a final judgment and that is material to the cause of action. Our bylaws require us to indemnify our directors and officers for liability resulting from actions taken by them in those capacities to the maximum extent permitted by Maryland law. As a result, our stockholders and we may have more limited rights against our directors and officers than might otherwise exist under common law. In addition, we may be obligated to fund the defense costs incurred by our directors and officers.

***Our charter and bylaws contain provisions that could discourage acquisition bids or merger proposals, which may adversely affect the market price of our common stock.***

Authority to Issue Additional Shares. Under our charter, our board of directors may issue up to an aggregate of ten million shares of preferred stock without stockholder action. The preferred stock may be issued, in one or more series, with the preferences and other terms designated by our board of directors that may delay or prevent a change in control of us, even if the change is in the best interests of stockholders. At December 31, 2020, no shares of preferred stock were outstanding.

Banking Laws. Any change in control of our company is subject to prior regulatory approval under the Bank Holding Company Act or the Change in Bank Control Act, which may delay, discourage or prevent an attempted acquisition or change in control of us.

FINRA. Any change in control (as defined under FINRA rules) of any of the Hilltop Broker-Dealers, including through acquisition, is subject to prior regulatory approval by FINRA which may delay, discourage or prevent an attempted acquisition or other change in control of such broker-dealers.

Restrictions on Calling Special Meeting, Cumulative Voting and Director Removal. Our bylaws include a provision prohibiting holders that do not or have not owned, continuously for at least one year as of the record date of such proposed meeting, capital stock representing at least 15% of the shares entitled to be voted at such proposed meeting, from calling a special meeting of stockholders. Our charter does not provide for the cumulative voting in the election of directors. In addition, our charter provides that our directors may only be removed for cause and then only by an



affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors. Any amendment to our charter relating to the removal of directors requires the affirmative vote of two-thirds of all of the votes entitled to be cast on the matter. These provisions of our bylaws and charter may delay, discourage or prevent an attempted acquisition or change in control of us.

***There can be no assurance that we will continue to declare cash dividends or repurchase stock.***

In October 2016, we announced that our board of directors authorized a dividend program under which we intend to pay quarterly dividends on our common stock, subject to quarterly declarations by our board of directors. During 2020, we declared and paid cash dividends of \$0.36 per common share.

In January 2020, the Hilltop board of directors authorized a stock repurchase program through January 2021, pursuant to which the Company was authorized to repurchase, in the aggregate, up to \$75.0 million of its outstanding common stock. As previously announced on April 30, 2020, in light of the uncertain outlook for 2020 due to the COVID-19 pandemic, Hilltop's board of directors suspended its stock repurchase program. During 2020, prior to its suspension, the Company paid \$15.2 million to repurchase an aggregate of 720,901 shares of common stock at a weighted average price of \$21.13 per share associated with the stock repurchase program. These shares were returned to the pool of authorized but unissued shares of common stock.

On September 23, 2020, the Company announced the commencement of a modified "Dutch auction" tender offer to purchase shares of its 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.

Based on Hilltop's ability to maintain strong capital and liquidity to meet the needs of its customers and communities during this exceptional period of economic uncertainty, in January 2021, our board of directors authorized a new stock repurchase program through January 2022, pursuant to which we are authorized to repurchase, in the aggregate, up to \$75.0 million of our outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation.

Any future declarations, amount and timing of any dividends and/or the amount and timing of such stock repurchases are subject to capital availability and the discretion of our board of directors, which must evaluate, among other things, whether cash dividends and/or stock repurchases are in the best interest of our stockholders and are in compliance with all applicable laws and any agreements containing provisions that limit our ability to declare and pay cash dividends and/or repurchase stock. Our ability to pay dividends and/or repurchase stock will depend upon, among other factors, our cash balances and potential future capital requirements for strategic transactions, including acquisitions, the ability of our subsidiaries to pay dividends to Hilltop, capital adequacy requirements and other regulatory restrictions on us and our subsidiaries, policies of the Federal Reserve Board, equity and debt service requirements senior to our common stock, earnings, financial condition, the general economic and regulatory climate and other factors beyond our control that our board of directors may deem relevant. In addition, the amount we spend and the number of shares we are able to repurchase under our stock repurchase program may further be affected by a number of other factors, including the stock price and blackout periods in which we are restricted from repurchasing shares. Our dividend payments and/or stock repurchases may change from time to time, and we cannot provide assurance that we will continue to declare dividends and/or repurchase stock in any particular amounts or at all. A reduction in or elimination of our dividend payments, our dividend program and/or stock repurchases could have a negative effect on our stock price.

***An investment in our common stock is not an insured deposit.***

An investment in our common stock is not a bank deposit and is not insured or guaranteed by the FDIC, SIPC or any other government agency. Accordingly, you should be capable of affording the loss of any investment in our common stock.

#### **Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

During 2018, we made an investment in land and a mixed-use real estate development in the City of University Park, Texas, which has served as headquarters for both Hilltop and the Bank since February 2020. In addition to our principal office, our various business segments conduct business at various locations. We have options to renew leases at most locations that we do not own.

*Banking.* At December 31, 2020, our banking segment conducted business at 65 locations throughout Texas, including four support facilities. The Bank leases 37 banking locations, including its principal offices, and owns the remaining 28 banking locations.

*Broker-Dealer.* At December 31, 2020, our broker-dealer segment conducted business from 51 locations in 19 states. Each of these locations is leased by Hilltop Securities.

*Mortgage Origination.* At December 31, 2020, our mortgage origination segment conducted business from over 290 locations in 45 states. Each of these locations is leased by PrimeLending.

**Item 3. Legal Proceedings.**

For a description of material pending legal proceedings, see the discussion set forth under the heading “Legal Matters” in Note 21 to our Consolidated Financial Statements, which is incorporated by reference herein.

**Item 4. Mine Safety Disclosures.**

Not applicable.

## PART II

### Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

#### Securities, Stockholder and Dividend Information

Our common stock is listed on the New York Stock Exchange under the symbol “HTH”. At February 16, 2021, there were 82,188,513 shares of our common stock outstanding with 372 stockholders of record.

In October 2016, we announced that our board of directors authorized a dividend program under which we pay quarterly dividends on our common stock, subject to quarterly declarations by our board of directors. During 2020, we declared and paid cash dividends of \$0.36 per common share. On January 28, 2021, we announced that our board of directors increased our quarterly dividend to \$0.12 per common share. Although we expect to continue to pay dividends, we may elect not to pay dividends. Any declarations of dividends, and the amount and timing thereof, will be at the discretion of our board of directors, which must evaluate, among other things, whether cash dividends are in the best interest of our stockholders and are in compliance with all applicable laws and any agreements containing provisions that limit our ability to declare and pay cash dividends. Our ability to pay dividends will depend upon, among other factors, our cash balances and potential future capital requirements for strategic transactions, including acquisitions, equity and debt service requirements senior to our common stock, earnings, financial condition, the general economic and regulatory climate and other factors beyond our control that our board of directors may deem relevant. Our dividend payments may change from time to time, and we cannot provide assurance that we will continue to declare dividends in any particular amounts or at all. A reduction in or elimination of our dividend payments and/or our dividend program could have a negative effect on our stock price. See Item 1A, “Risk Factors — Risks Related to our Common Stock — There can be no assurance that we will continue to declare cash dividends or repurchase stock.”

#### Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth information at December 31, 2020 with respect to compensation plans under which shares of our common stock may be issued. Additional information concerning our stock-based compensation plans is presented in Note 23, Stock-Based Compensation, in the notes to our consolidated financial statements.

Equity Compensation Plan Information			
Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column)
Equity compensation plans approved by security holders*	—	\$ —	3,428,547
<b>Total</b>	<b>—</b>	<b>\$ —</b>	<b>3,428,547</b>

\* Represents shares available for future issuance under the Hilltop Holdings Inc. 2020 Equity Incentive Plan (the “2020 Plan”). Shares may become available for awards under the 2020 Plan upon the future forfeiture, expiration, cancellation or settlement in cash of awards outstanding under the Hilltop Holdings Inc. 2012 Equity Incentive Plan.

#### Issuer Repurchases of Equity Securities

The following table details our repurchases of shares of common stock during the three months ended December 31, 2020.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 1 - October 31, 2020	—	\$ —	—	\$ 59,750,234
November 1 - November 30, 2020	8,058,947	24.00	8,058,947	59,750,234
December 1 - December 31, 2020	—	—	—	59,750,234
Total	8,058,947	\$ 24.00	8,058,947	

- (1) On January 30, 2020, we announced that our board of directors authorized a stock repurchase program under which we could repurchase, in the aggregate, up to \$75.0 million of our outstanding common stock through January 2021, which was inclusive of repurchases to offset dilution related to grants of stock-based compensation. As previously announced on April 30, 2020, in light of the uncertain outlook for 2020 due to the COVID-19 pandemic, Hilltop's board of directors suspended the stock repurchase program. Additionally, on September 23, 2020, we announced the Company would purchase shares of our common stock up to \$350 million, through a modified "Dutch auction" tender offer. 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. The number of shares eligible for purchase under the tender offer was indeterminable and therefore is not included in this column. In January 2021, our board of directors authorized a new stock repurchase program through January 2022, pursuant to which we are authorized to repurchase, in the aggregate, up to \$75.0 million of our outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation. With the adoption of the new stock repurchase plan in January 2021, the stock repurchase plan authorized in January 2020 expired.

## Item 6. Selected Financial Data.

Our historical consolidated balance sheet data at December 31, 2020 and 2019 and our consolidated statement of operations data for the years ended December 31, 2020, 2019 and 2018 have been derived from our historical consolidated financial statements included elsewhere in this Annual Report. The following table shows our selected historical financial data for the periods indicated. You should read our selected historical financial data, together with the notes thereto, in conjunction with the more detailed information contained in our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Annual Report. The insurance segment's operating results and assets and liabilities that were sold on June 30, 2020 are presented as discontinued operations for all periods presented in the following table. The operations acquired in the BORO Acquisition are included in our operating results beginning August 1, 2018 (dollars in thousands, except per share data and weighted average shares outstanding).

	2020	2019	2018	2017	2016
<b>Statement of Operations Data:</b>					
Total interest income	\$ 546,495	\$ 610,696	\$ 574,623	\$ 502,329	\$ 450,502
Total interest expense	122,329	171,717	141,324	83,442	56,135
Net interest income	424,166	438,979	433,299	418,887	394,367
Provision for credit losses	96,491	7,206	5,088	14,271	40,620
Net interest income after provision for credit losses	327,675	431,773	428,211	404,616	353,747
Total noninterest income	1,690,480	1,062,817	880,130	1,053,594	1,122,396
Total noninterest expense	1,453,803	1,211,889	1,153,328	1,210,901	1,265,870
Income from continuing operations before income taxes	564,352	282,701	155,013	247,309	210,273
Income tax expense	133,071	63,714	34,227	113,189	76,004
Income from continuing operations before income taxes	431,281	218,987	120,786	134,120	134,269
Income (loss) from discontinued operations, net of income taxes	38,396	13,990	4,941	(976)	13,675
Net Income	469,677	232,977	125,727	133,144	147,944
Less: Net income attributable to noncontrolling interest	21,841	7,686	4,286	600	2,050
Income applicable to Hilltop common stockholders	<u>\$ 447,836</u>	<u>\$ 225,291</u>	<u>\$ 121,441</u>	<u>\$ 132,544</u>	<u>\$ 145,894</u>
<b>Per Share Data:</b>					
Earnings per common share from continuing operations- basic	\$ 4.59	\$ 2.29	\$ 1.23	\$ 1.37	\$ 1.34
Earnings (losses) per common share from discontinued operations- basic	0.43	0.15	0.05	(0.01)	0.14
Net income	<u>\$ 5.02</u>	<u>\$ 2.44</u>	<u>\$ 1.28</u>	<u>\$ 1.36</u>	<u>\$ 1.48</u>
Weighted average shares outstanding - basic	89,280	92,345	94,969	97,137	98,404
Earnings per common share from continuing operations- diluted	\$ 4.58	\$ 2.29	\$ 1.23	\$ 1.37	\$ 1.34
Earnings (losses) per common share from discontinued operations- diluted	0.43	0.15	0.05	(0.01)	0.14
Net income	<u>\$ 5.01</u>	<u>\$ 2.44</u>	<u>\$ 1.28</u>	<u>\$ 1.36</u>	<u>\$ 1.48</u>
Weighted average shares outstanding - diluted	89,304	92,394	95,067	97,353	98,629
Book value per common share	\$ 28.28	\$ 23.20	\$ 20.83	\$ 19.92	\$ 18.98
Tangible book value per common share	\$ 24.77	\$ 19.65	\$ 17.31	\$ 16.92	\$ 15.97
Cash dividends declared per common share	\$ 0.36	\$ 0.32	\$ 0.28	\$ 0.24	\$ 0.06
Dividend payout ratio <sup>(1)</sup>	7.18 %	13.12 %	21.90 %	17.59 %	4.05 %
<b>Balance Sheet Data:</b>					
Total assets of continuing operations	\$ 16,944,264	\$ 14,924,019	\$ 13,430,059	\$ 13,074,147	\$ 12,409,086
Cash and due from banks	1,062,560	433,626	598,999	423,726	546,807
Securities	2,468,544	1,987,561	1,871,660	1,717,236	1,093,850
Loans held for sale	2,788,386	2,106,361	1,393,246	1,715,357	1,795,463
Loans held for investment, net of unearned income	7,693,141	7,381,400	6,930,458	6,455,798	6,099,626
Allowance for credit losses	(149,044)	(61,136)	(59,486)	(63,686)	(54,599)
Goodwill and other intangible assets, net	287,811	294,113	305,452	284,067	272,515
Total deposits	11,242,319	9,032,214	8,536,156	7,978,119	7,063,811
Notes payable	381,987	256,269	228,872	208,809	317,912
Junior subordinated debentures	67,012	67,012	67,012	67,012	67,012
Total stockholders' equity	2,350,647	2,128,796	1,973,893	1,914,807	1,874,520
Total assets of discontinued operations	—	248,429	253,513	291,639	328,976

	2020	2019	2018	2017	2016
<b>Performance Ratios (2)(3):</b>					
Return on average stockholders' equity (4)	20.03 %	11.18 %	6.33 %	7.00 %	8.13 %
Return on average assets (4)	2.88 %	1.66 %	0.93 %	1.03 %	1.21 %
Net interest margin (5)	2.85 %	3.48 %	3.55 %	3.61 %	3.68 %
Net interest margin (taxable equivalent) (6)	2.85 %	3.48 %	3.56 %	3.63 %	3.71 %
<b>Asset Quality Ratios (2)(3):</b>					
Total nonperforming assets to total loans and other real estate	0.96 %	0.73 %	0.89 %	1.33 %	1.39 %
Allowance for credit losses to nonperforming loans	186.46 %	169.28 %	175.22 %	139.58 %	193.05 %
Allowance for credit losses to total loans	1.94 %	0.83 %	0.86 %	0.99 %	0.90 %
Net charge-offs to average loans outstanding	0.28 %	0.08 %	0.14 %	0.08 %	0.57 %
<b>Capital Ratios (3):</b>					
Equity to assets ratio	13.72 %	13.86 %	14.25 %	14.31 %	14.68 %
Tangible common equity to tangible assets	12.22 %	12.00 %	12.13 %	12.42 %	12.65 %
<b>Regulatory Capital Ratios (3):</b>					
Hilltop - Leverage ratio	12.64 %	12.71 %	12.53 %	12.94 %	13.51 %
Hilltop - Common equity Tier 1 risk-based capital ratio	18.97 %	16.70 %	16.58 %	17.71 %	18.30 %
Hilltop - Tier 1 risk-based capital ratio	19.57 %	17.13 %	17.04 %	18.24 %	18.87 %
Hilltop - Total risk-based capital ratio	22.34 %	17.55 %	17.47 %	18.78 %	19.34 %
PlainsCapital - Leverage ratio	10.44 %	11.61 %	12.47 %	12.32 %	12.35 %
PlainsCapital - Common equity Tier 1 risk-based capital ratio	14.40 %	13.45 %	13.90 %	14.47 %	14.64 %
PlainsCapital - Tier 1 risk-based capital ratio	14.40 %	13.45 %	13.90 %	14.47 %	14.64 %
PlainsCapital - Total risk-based capital ratio	15.27 %	14.13 %	14.63 %	15.29 %	15.38 %
<b>Other Data:</b>					
<b>Banking Segment:</b>					
Efficiency ratio (7)	53.78 %	54.99 %	61.93 %	58.24 %	58.87 %
Return on average assets (4)	0.63 %	1.36 %	1.23 %	0.85 %	0.94 %
Net interest margin (5)	3.31 %	4.00 %	4.23 %	4.31 %	4.65 %
Net interest margin (taxable equivalent) (6)	3.31 %	4.01 %	4.24 %	4.33 %	4.68 %
<b>Broker-Dealer Segment:</b>					
Net revenue (8)	\$ 531,267	\$ 455,719	\$ 352,592	\$ 412,156	\$ 416,938
Compensation as a % of net revenue	58.7 %	58.7 %	62.0 %	60.8 %	60.6 %
<b>Mortgage Origination Segment:</b>					
Mortgage loan originations volume - Home purchases	\$ 13,413,545	\$ 11,718,772	\$ 11,798,804	\$ 11,974,571	\$ 11,276,378
Mortgage loan originations volume - Refinancings	9,556,649	3,860,665	1,893,680	2,483,342	4,183,835
Mortgage loan originations volume - Total	22,970,194	15,579,437	13,692,484	14,457,913	15,460,213
Mortgage loan sales volume - Total	22,514,170	14,591,727	13,735,885	14,454,260	15,155,340

- (1) Dividend payout ratio is defined as cash dividends declared per common share divided by basic earnings per common share.
- (2) Noted measures are typically used for measuring the performance of banking and financial institutions.
- (3) Ratios and financial data presented on a consolidated basis and includes discontinued operations and those assets and liabilities classified as discontinued.
- (4) Noted measures during 2017 include estimated non-cash, non-recurring charges to Hilltop consolidated and banking segment results of \$28.4 million and \$25.7 million, respectively, primarily attributable to the revaluation of deferred tax assets as a result of the enactment of the Tax Cuts and Jobs Act of 2017 ("the Tax Legislation"). Deferred tax asset amounts recorded in December 2017 following enactment of the Tax Legislation were final as of September 30, 2018.
- (5) Net interest margin is defined as net interest income divided by average interest-earning assets.
- (6) 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 a 21% federal income tax rate for 2020, 2019 and 2018 periods presented and 35% federal income tax rate for 2017 and 2016 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. For the periods presented, the taxable equivalent adjustments to interest income for Hilltop consolidated were \$1.2 million, \$0.6 million, \$0.9 million, \$2.2 million and \$2.4 million, respectively, and for the banking segment were \$0.8 million, \$0.6 million, \$0.8 million, \$1.6 million and \$1.5 million, respectively.
- (7) Efficiency ratio is defined as noninterest expenses divided by the sum of total noninterest income and net interest income for the year.
- (8) Net revenue is defined as the sum of total broker-dealer net interest income plus total broker-dealer noninterest income.

## GAAP Reconciliation and Management's Explanation of Non-GAAP Financial Measures

We present certain measures in our selected financial data that are not measures of financial performance recognized by GAAP. "Tangible book value per common share" is defined as our total stockholders' equity, excluding preferred stock, reduced by goodwill and other intangible assets, divided by total common shares outstanding. "Tangible common equity to tangible assets" is defined as our total stockholders' equity, excluding preferred stock, reduced by goodwill and other intangible assets divided by total assets reduced by goodwill and other intangible assets. These measures are important to investors interested in changes from period to period in tangible common equity per share exclusive of changes in intangible assets. For companies such as ours that have engaged in business combinations, purchase accounting can result in the recording of significant amounts of goodwill and other intangible assets related to those transactions.

You should not view this disclosure as a substitute for results determined in accordance with GAAP, and our disclosure is not necessarily comparable to that of other companies that use non-GAAP measures.

The following table reconciles these non-GAAP financial measures to the most comparable GAAP financial measures, "book value per common share" and "equity to total assets" (dollars in thousands, except per share data).

	December 31,				
	2020	2019	2018	2017	2016
Book value per common share	\$ 28.28	\$ 23.20	\$ 20.83	\$ 19.92	\$ 18.98
Effect of goodwill and intangible assets per share	(3.51)	(3.55)	(3.52)	(3.00)	(3.01)
Tangible book value per common share	\$ 24.77	\$ 19.65	\$ 17.31	\$ 16.92	\$ 15.97
Hilltop stockholders' equity	\$ 2,323,939	\$ 2,103,039	\$ 1,949,470	\$ 1,912,081	\$ 1,870,509
Less: goodwill and intangible assets, net	287,811	321,590	329,440	288,240	296,503
Tangible common equity	\$ 2,036,128	\$ 1,781,449	\$ 1,620,030	\$ 1,623,841	\$ 1,574,006
Total assets	\$ 16,944,264	\$ 15,172,448	\$ 13,683,572	\$ 13,365,786	\$ 12,738,062
Less: goodwill and intangible assets, net	287,811	321,590	329,440	288,240	296,503
Tangible assets	\$ 16,656,453	\$ 14,850,858	\$ 13,354,132	\$ 13,077,546	\$ 12,441,559
Equity to assets	13.72 %	13.86 %	14.25 %	14.31 %	14.68 %
Tangible common equity to tangible assets	12.22 %	12.00 %	12.13 %	12.42 %	12.65 %

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

*The following discussion is intended to help the reader understand our results of operations and financial condition and is provided as a supplement to, and should be read in conjunction with, our audited consolidated financial statements and the accompanying notes thereto commencing on page F-1. In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our results and the timing of selected events may differ materially from those anticipated in these forward-looking statements as a result of many factors, including those discussed under "Item 1A. Risk Factors" and elsewhere in this Annual Report. See "Forward-Looking Statements."*

*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., formerly Hilltop Securities 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.*

## 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.

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. As a result, NLC's results and its assets and liabilities have been presented as discontinued operations in the consolidated financial statements, and we no longer have an insurance segment. 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 2020, our income from continuing operations to common stockholders was \$409.4 million, or \$4.58 per diluted share. We declared and paid total common dividends of \$0.36 per share, or \$32.5 million, during 2020, which resulted in a dividend payout ratio of 7.18%. Dividend payout ratio is defined as cash dividends declared per common share divided by basic earnings per common share. We also paid an aggregate of \$208.7 million to repurchase shares of our common stock during 2020, including shares purchased in the tender offer completed in November 2020.

We reported \$564.4 million of income from continuing operations before income taxes during 2020, including the following contributions from our reportable business segments.

- The banking segment contributed \$103.5 million of income before income taxes during 2020;
- The broker-dealer segment contributed \$115.6 million of income before income taxes during 2020; and
- The mortgage origination segment contributed \$408.0 million of income before income taxes during 2020.

Our insurance segment, the results of which have been presented within discontinued operations in the consolidated financial statements, contributed \$2.1 million of income before income taxes during 2020.

At December 31, 2020, on a consolidated basis, we had total assets of \$16.9 billion, total deposits of \$11.2 billion, total loans, including loans held for sale, of \$10.3 billion and stockholders' equity of \$2.4 billion.

On January 28, 2021, our board of directors declared a quarterly cash dividend of \$0.12 per common share, payable on February 26, 2021 to all common stockholders of record as of the close of business on February 15, 2021.

## ***Recent Developments***

### **COVID-19**

COVID-19 has spread globally, including to every state in the United States, and has resulted in the WHO declaring COVID-19 to be a global pandemic. On March 13, 2020, the United States declared a national emergency with respect to COVID-19. The U.S. federal government issued social distancing guidelines as a measure to reduce the escalation of the spread of COVID-19 in the United States. A majority of states and certain U.S. territories, including the District of Columbia, issued orders requiring the closure of non-essential businesses and/or requiring residents to stay at home. The effects of COVID-19 and the governmental and societal response to the virus have negatively impacted financial markets and overall economic conditions on an unprecedented scale, resulting in the shuttering of businesses across the country and significant job loss. Many of these businesses reopened but may be operating at limited capacity levels. We are following guidelines established by the Centers for Disease Control and WHO and orders issued by the state and local governments where we operate. 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. On March 23, 2020, most of our employees began working remotely, with only certain operationally critical employees working on site at our principal business headquarters and business segment locations. In early September 2020, a majority of our employees began the process of returning to their respective office locations based on rotational team schedules to better ensure that appropriate social distancing measures are available. However, in November 2020, given the escalation of COVID-19 cases, most of our employees returned to working remotely, with only certain operationally critical employees working on site at our principal business headquarters and business segment locations. We are monitoring and assessing the impact of the COVID-19 pandemic on a daily basis to ensure that we continue to adhere to guidelines and orders issued by federal, state and local governments.

In March and April 2020, President Trump signed into law two relief bills, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) and the Paycheck Protection Program and Health Care Enhancement Act (the “PPP/HCE Act”), which are 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 is 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. The PPP/HCE Act included an additional \$310 billion for PPP funding. The CARES Act also provides for relief related to the adoption of certain accounting principles as well as tax provisions that may support the improvement of working capital levels. We will continue to evaluate the provisions of the CARES Act and the PPP/HCE Act and their impact on Hilltop and our employees as well as our customers and clients.

In light of the extreme volatility and disruptions in the capital and credit markets in March 2020 resulting from the COVID-19 crisis and its negative impact on the economy, including a significant decline in corporate debt and equity issuances and a deterioration in the mortgage servicing and commercial paper markets, we took a number of precautionary actions in March to enhance our financial flexibility by bolstering our cash position to ensure we have adequate cash readily available to meet both expected and unexpected funding needs without adversely affecting our daily operations. Additionally, as previously announced on April 30, 2020, in light of the uncertain outlook for 2020 due to the COVID-19 pandemic, Hilltop’s board of directors suspended its stock repurchase program. Hilltop’s board of directors has the ability to reinstate the stock repurchase program at its discretion as circumstances warrant.

The Federal Open Market Committee (“FOMC”) reduced the target range for short-term rates by 150 basis points to a range of 0% to 0.25% during March 2020 to support the economy and potentially reduce the impacts from the COVID-19 pandemic. As a result of these rate adjustments and the stressed economic outlook, 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 that totaled \$731 million at December 31, 2020, down from \$1.4 billion at June 30, 2020. Further, beginning in March 2020, an additional \$200 million of deposits was swept from Hilltop Securities into the Bank, bringing the total funds swept from Hilltop Securities to approximately \$1.5 billion until June 2020 when the total funds swept was reduced back to \$1.3 billion at June 30, 2020. During the third and fourth quarters of 2020, given the continued strong cash and liquidity levels at the



Bank, the total funds swept from Hilltop Securities into the Bank was reduced further to approximately \$700 million as of December 31, 2020.

Further, during March 2020, we substantially reduced the trading portfolio inventory limits at Hilltop Securities in an effort to protect capital, minimize losses and ensure target liquidity levels throughout the crisis. During March 2020, the capital markets experienced significant friction and in certain portions of the market, liquidity was not prevalent. In particular for us, the market for municipal securities, collateralized mortgage obligations, mortgage derivatives and Government National Mortgage Association (“GNMA”) mortgage pools experienced significant liquidity stress at points during the month. The Federal Reserve, in partnership with the Treasury of the United States, stepped in to provide additional liquidity in each of these critical markets. We will continue to evaluate market conditions and determine the appropriateness of capital market inventory limits.

#### *Asset Valuation*

At each reporting date between annual impairment tests, the Company considers potential indicators of impairment. Given the current economic uncertainty and volatility surrounding COVID-19, the Company assessed 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 banking industry; government intervention and regulatory updates; the impact of recent events to financial performance and cost factors of the reporting unit; performance of the Company’s stock and other relevant events. Specifically, our banking segment experienced lower-than-forecasted operating results during 2020, due to conditions discussed in detail within the discussion of banking segment results that follows.

Given the potential impacts as a result of COVID-19, actual results may differ materially from our current estimates as the scope of COVID-19 evolves or if the duration of business disruptions is longer than currently anticipated. The Company further considered the amount by which fair value exceeded book value in the most recent quantitative analysis and sensitivities performed. At the conclusion of the annual assessment, the Company determined that as of October 1, 2020 it was more likely than not that the fair value of goodwill and other intangible assets exceeded their respective carrying values.

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.

In addition, the COVID-19 crisis could cause a further and 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 CARES Act was passed in March 2020, which among other things, allows the Bank to suspend the requirements for certain loan modifications to be categorized as a troubled debt restructuring (“TDR”). Starting in March, 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 deferment 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 originally included approval of approximately \$968 million in COVID-19 related loan modifications as of June 30, 2020.

As noted in the table below, during the third and fourth quarters of 2020, the Bank continued to support its impacted banking clients through the approval of COVID-19 related loan modifications, which resulted in an additional \$75 million

of new COVID-19 related loan modifications since June 30, 2020. The portfolio of active deferrals that have not reached the end of their deferral period was approximately \$240 million as of December 31, 2020, of which approximately \$90 million had received an additional deferral. COVID-19 related loan modifications of approximately \$714 million have returned to agreed-upon contractual terms and had made at least one required principal and/or interest payment since the end of their initial deferral period. Such loans represent elevated risk, therefore management continues to monitor these loans. The extent to which these measures will impact the Bank is 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 could experience adverse impacts due to the COVID-19 pandemic, certain of our loan portfolio industry sectors and subsectors, including real estate collateralized by office buildings, 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).

December 31, 2020	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
			(\$)	(#)				
Hotel	\$ 104,978	\$ 27,251	\$ 132,229	17	\$ 104,978	\$ 19,851	15.0 %	18.9 %
Restaurants	72,930	—	72,930	12	72,930	14,537	19.9 %	19.9 %
Transportation & Warehousing	8,312	—	8,312	12	8,312	1,276	15.4 %	15.4 %
1-4 Family Residential	—	7,727	7,727	73	5,692	225	2.9 %	3.9 %
Retail	—	6,625	6,625	1	—	76	1.1 %	— %
Real Estate & Rental & Leasing	2,139	889	3,028	2	889	457	15.1 %	51.4 %
All Other	9,353	—	9,353	8	9,353	5,074	54.3 %	54.3 %
	<u>\$ 197,712</u>	<u>\$ 42,491</u>	<u>\$ 240,203</u>	<u>125</u>	<u>\$ 202,154</u>	<u>\$ 41,496</u>	17.3 %	20.5 %

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. The sharp decline in crude oil prices coupled with the economic uncertainties associated with COVID-19 have increased pressures on this portfolio. The following table summarizes energy loan portfolio exposures by sector (dollars in thousands).

December 31, 2020	Loans Held for Investment Balances					Allowance For Credit Losses as a Percentage of	
	Total Loans Held For Investment	Unfunded Commitments	Total Commitments	Classified and Criticized Loans	For Credit Losses	Total Loans Held For Investment	Classified and Criticized Loans
Exploration / Production	\$ 9,700	\$ 7,460	\$ 17,160	\$ —	\$ 2,095	21.6 %	— %
Midstream	12,075	2,500	14,575	4,031	12	0.1 %	0.3 %
Services	28,511	8,460	36,971	7,175	1,320	4.6 %	18.4 %
Other	29,051	21,172	50,223	3,000	104	0.4 %	3.5 %
	<u>\$ 79,337</u>	<u>\$ 39,592</u>	<u>\$ 118,929</u>	<u>\$ 14,206</u>	<u>\$ 3,531</u>	4.5 %	24.9 %

As noted above, the Bank's actions during the second quarter of 2020 also included supporting our impacted banking clients through the PPP effort. These efforts included approval and funding of over 2,800 PPP loans ranging from approximately \$1 thousand to \$8.4 million, with approximately \$487 million remaining outstanding at December 31, 2020. 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 PPP forgiveness applications and remitting forgiveness payments to PPP lenders for PPP borrowers. Through February 12, 2021, the SBA had approved approximately 1,500 PPP forgiveness applications totaling approximately \$294 million, with PPP loans of approximately \$171 million pending SBA review and approval. In addition, given recent updates from the SBA regarding the second round of the PPP effort, the Bank is accepting new applications from impacted banking clients. Through February 12, 2021, these efforts have included review of approximately \$193 million in second round PPP loan application submissions, of which approximately \$127 million have been approved.

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 spread of COVID-19 has had, and is expected to continue to have, adverse effects on our business and operations. The broader adverse implications of COVID-19 on the operations and overall financial performance of our clients is uncertain due to the currently unknowable duration and severity of the COVID-19 pandemic. The extent of the impact of COVID-19 on our operational and financial performance in 2021 is likewise currently uncertain and will depend on certain developments, including, among others, the ultimate impact of COVID-19 on our customers and clients, potential further disruption and deterioration in the global economy and the financial services industry, including the mortgage servicing and commercial paper markets, and additional, or extended, federal, state and local government orders and regulations that might be imposed in response to the pandemic, all of which are uncertain.

See “Item 1A. Risk Factors” for additional discussion of the potential adverse impact of COVID-19 on our business, results of operations and financial condition.

### **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.

### **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 and its assets and liabilities have been presented as discontinued operations in the consolidated financial statements.

### **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.

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 Secured Overnight Financing Rate (“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.

### ***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***

#### **Changes in Management and Efficiency Initiative-Related Charges**

In 2019, we successfully completed several leadership transitions through effective succession planning. During 2019, the broker-dealer segment's results reflected aggregate pre-tax charges of \$2.2 million within employees' compensation and benefits noninterest expenses, all of which were recognized in the first quarter of 2019, related to the resignation of Hill A. Feinberg as President and Chief Executive Officer of Hilltop Securities and the appointment of his successor, M. Bradley Wings. Also, corporate recognized a pre-tax charge of \$5.8 million within employees' compensation and benefits noninterest expenses in the first quarter of 2019 related to the retirement of Alan B. White, our former Vice Chairman and Co-Chief Executive Officer. Lastly, the mortgage origination segment recognized a pre-tax charge of \$1.25 million within employees' compensation and benefits noninterest expenses in the fourth quarter of 2019 related to the resignation of Todd Salmans as Chief Executive Officer of PrimeLending and the appointment of his successor, Steve Thompson. These management changes and the related impact on our results of operations are collectively referred to as the "Leadership Changes." For additional information regarding the Leadership Changes, refer to the section captioned "Factors Affecting the Current Year — Changes in Management and Efficiency Initiative-Related Changes" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2019 Form 10-K.

In addition to the costs associated with the Leadership Changes, during 2019, corporate and the broker-dealer segment recognized \$1.0 million and \$0.7 million, respectively, in efficiency initiative-related charges resulting in aggregated charges of \$1.7 million.

#### **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 represents a significant portion of our noninterest expenses throughout 2020, and we believe this trend will continue into 2021, but we are making 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.

## **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. 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 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 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 originate bear interest at a floating rate based on LIBOR. We also pay interest on certain borrowings, are counterparty to derivative agreements that are based on LIBOR and have existing contracts with payment calculations that use LIBOR as the reference rate. These changes 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, in November 2020, Intercontinental Exchange announced that ICE Benchmark Administration Limited (“IBA”) will consult on its intention to cease the publication of the one-week and two-month settings of United States Dollar (“USD”) LIBOR immediately after December 31, 2021, and cease publishing remaining USD LIBOR settings on June 30, 2023, providing time for many legacy LIBOR-referencing contracts to mature.

We have made an assessment of areas across the organization that will be affected by the migration away from LIBOR. We have assembled individuals from across the organization and established a governance process as part of a coordinated effort to prepare for the cessation of LIBOR. During the third quarter of 2020, PrimeLending began originating conventional adjustable-rate mortgage, or ARM, loan products utilizing a SOFR rate with terms consistent with government-sponsored enterprise guidelines. In addition, the Bank’s management team is currently working with its commercial relationships who have LIBOR-based contracts maturing after 2021 to amend terms and establish an alternative benchmark rate. We are also continuing work on an enterprise-wide contract model and software review to better evaluate both the impacts of the LIBOR phase-out and transition requirements. As a result of this ongoing effort, we may incur significant expenses in effecting the transition, including, but not limited to, changes to our agreements and our agreements with customers that do not contemplate LIBOR being unavailable, as well as changes to systems and processes.

### ***Company Background***

In January 2007, we acquired NLC, a property and casualty insurance holding company. As a result, our subsequent primary operations through November 2012 were limited to providing fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the southern United States through NLC’s wholly owned insurance subsidiaries. As previously discussed, on June 30, 2020, we completed the sale of all of the outstanding capital stock of NLC.

On November 30, 2012, we acquired PlainsCapital Corporation pursuant to a plan of merger whereby PlainsCapital Corporation merged with and into our wholly owned subsidiary (the “PlainsCapital Merger”), which continued as the surviving entity under the name “PlainsCapital Corporation”. Concurrent with the consummation of the PlainsCapital Merger, Hilltop became a financial holding company registered under the Bank Holding Company Act of 1956.

On September 13, 2013 (the “Bank Closing Date”), the Bank assumed substantially all of the liabilities, including all of the deposits, and acquired substantially all of the assets of Edinburg, Texas-based FNB from the FDIC, as receiver, and reopened former branches of FNB acquired from the FDIC under the “PlainsCapital Bank” name (the “FNB

Transaction”). Pursuant to the Purchase and Assumption Agreement by and among the FDIC as receiver for FNB, the FDIC and the Bank (the “P&A Agreement”), the Bank and the FDIC entered into loss-share agreements whereby the FDIC agreed to share in the losses of certain loans and real estate acquired through foreclosure (“OREO”) that the Bank acquired in the FNB Transaction. The loss-share agreements with the FDIC were terminated in the fourth quarter of 2018.

On January 1, 2015, we acquired SWS in a stock and cash transaction (the “SWS Merger”), whereby SWS’s broker-dealer subsidiaries became subsidiaries of Securities Holdings and SWS’s banking subsidiary, Southwest Securities, FSB, was merged into the Bank. On October 5, 2015, Southwest Securities, Inc. was renamed “Hilltop Securities Inc.”

On August 1, 2018, we acquired privately-held, Houston-based BORO in an all-cash transaction (“BORO Acquisition”). In connection with the BORO Acquisition, we merged BORO into the Bank, and all customer accounts were converted to the PlainsCapital Bank platform.

### ***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 former insurance segment. As a result, insurance segment results and its assets and liabilities 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 accounting principles generally accepted in the United States (“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. 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 30, 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.

	Year Ended December 31,			Variance 2020 vs 2019		Variance 2019 vs 2018	
	2020	2019	2018	Amount	Percent	Amount	Percent
Net interest income (expense):							
Banking	\$ 390,871	\$ 379,258	\$ 370,732	\$ 11,613	3 %	\$ 8,526	2 %
Broker-Dealer	39,912	51,308	50,878	(11,396)	(22)%	430	1 %
Mortgage Origination	(10,489)	(6,273)	1,485	(4,216)	(67)%	(7,758)	(522)%
Corporate	(14,192)	(5,541)	(9,176)	(8,651)	(156)%	3,635	40 %
All Other and Eliminations	18,064	20,227	19,380	(2,163)	(11)%	847	4 %
Hilltop Continuing Operations	\$ 424,166	\$ 438,979	\$ 433,299	\$ (14,813)	(3)%	\$ 5,680	1 %
Provision for (reversal of) credit losses:							
Banking	\$ 96,326	\$ 7,280	\$ 5,319	\$ 89,046	NM	\$ 1,961	37 %
Broker-Dealer	165	(74)	(231)	239	NM	157	68 %
Mortgage Origination	—	—	—	—	—	-	- %
Corporate	—	—	—	—	—	-	- %
All Other and Eliminations	—	—	—	—	—	-	- %
Hilltop Continuing Operations	\$ 96,491	\$ 7,206	\$ 5,088	\$ 89,285	NM	\$ 2,118	42 %
Noninterest income:							
Banking	\$ 41,376	\$ 41,753	\$ 43,588	\$ (377)	(1)%	\$ (1,835)	(4)%
Broker-Dealer	491,355	404,411	301,714	86,944	21 %	102,697	34 %
Mortgage Origination	1,172,450	634,992	551,860	537,458	85 %	83,132	15 %
Corporate	3,945	2,104	4,798	1,841	88 %	(2,694)	(56)%
All Other and Eliminations	(18,646)	(20,443)	(21,830)	1,797	9 %	1,387	6 %
Hilltop Continuing Operations	\$ 1,690,480	\$ 1,062,817	\$ 880,130	\$ 627,663	59 %	\$ 182,687	21 %
Noninterest expense:							
Banking	\$ 232,447	\$ 231,524	\$ 256,577	\$ 923	0 %	\$ (25,053)	(10)%
Broker-Dealer	415,463	366,031	320,241	49,432	14 %	45,790	14 %
Mortgage Origination	753,917	563,998	540,474	189,919	34 %	23,524	4 %
Corporate	53,040	50,968	36,628	2,072	4 %	14,340	39 %
All Other and Eliminations	(1,064)	(632)	(592)	(432)	(68)%	(40)	(7)%
Hilltop Continuing Operations	\$ 1,453,803	\$ 1,211,889	\$ 1,153,328	\$ 241,914	20 %	\$ 58,561	5 %
Income (loss) from continuing operations before taxes:							
Banking	\$ 103,474	\$ 182,207	\$ 152,424	\$ (78,733)	(43)%	\$ 29,783	20 %
Broker-Dealer	115,639	89,762	32,582	25,877	29 %	57,180	175 %
Mortgage Origination	408,044	64,721	12,871	343,323	530 %	51,850	403 %
Corporate	(63,287)	(54,405)	(41,006)	(8,882)	(16)%	(13,399)	(33)%
All Other and Eliminations	482	416	(1,858)	66	16 %	2,274	122 %
Hilltop Continuing Operations	\$ 564,352	\$ 282,701	\$ 155,013	\$ 281,651	100 %	\$ 127,688	82 %

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. Fluctuations in interest rates, as well as the amounts and types of interest-earning assets and interest-bearing liabilities we hold, affect net interest income. We generated \$424.2 million in net interest income during 2020, compared with net interest income of \$439.0 million and \$433.3 million during 2019 and 2018, respectively. Changes in net interest income during 2020, compared with 2019, primarily included increases within our banking segment, partially offset by decreases in our broker-dealer, mortgage origination and corporate segments.

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

- (i) *Income from broker-dealer operations.* Through Securities Holdings, we provide investment banking and other related financial services that generated \$274.0 million, \$241.5 million and \$241.0 million in securities brokerage commissions and fees and investment advisory fees and commissions, and \$203.1 million, \$150.0 million and \$47.8 million in gains from derivative and trading portfolio activities (included within other noninterest income) during 2020, 2019 and 2018, respectively.
- (ii) *Income from mortgage operations.* Through PrimeLending, we generate noninterest income by originating and selling mortgage loans. During 2020, 2019 and 2018, we generated \$1.2 billion, \$634.9 million and \$548.7 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 generated \$1.7 billion, \$1.1 billion and \$0.9 billion in noninterest income during 2020, 2019 and 2018, respectively. The increase in noninterest income during 2020, compared with 2019, was predominantly attributable to increases of \$537.9 million in net gains from sale of loans, other mortgage production income and mortgage loan origination fees within our mortgage origination segment and \$53.0 million in gains from derivative and trading portfolio activities within 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 2020 was \$409.4 million, or \$4.58 per diluted share, compared with \$211.3 million, or \$2.29 per diluted share, during 2019, and \$116.5 million, or \$1.23 per diluted share, during 2018. Hilltop's financial results from continuing operations during 2020 reflect both a significant increase in mortgage origination segment net gains from sales of loans and other mortgage production income and a significant build in the allowance for credit losses associated with the deterioration of the economic outlook attributable to the market disruption and economic uncertainties caused by COVID-19. Results during 2019 included the costs incurred associated with the significant Leadership Changes and other efficiency initiative-related charges which, in the aggregate, totaled \$11.0 million before income taxes.

Including income from discontinued operations, net of income taxes, income applicable to common stockholders was \$447.8 million, or \$5.01 per diluted share, during 2020, compared to \$225.3 million, or \$2.44 per diluted share, during 2019, and \$121.4 million, or \$1.28 per diluted share, during 2018.

Certain items included in net income during 2020, 2019 and 2018 resulted from purchase accounting associated with the PlainsCapital Merger, the FNB Transaction, the SWS Merger and the BORO Acquisition (collectively, the "Bank Transactions"). Income before income taxes during 2020, 2019 and 2018 included net accretion on earning assets and liabilities of \$18.9 million, \$28.5 million and \$37.6 million, respectively, and amortization of identifiable intangibles of \$6.3 million, \$7.6 million and \$8.0 million, respectively, related to the Bank Transactions.



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

	Year Ended December 31,		
	2020	2019	2018
Return on average stockholders' equity <sup>(1)</sup>	20.03 %	11.18 %	6.33 %
Return on average assets <sup>(2)</sup>	2.88 %	1.66 %	0.93 %
Net interest margin <sup>(3) (4)</sup>	2.85 %	3.48 %	3.55 %
Leverage ratio <sup>(5)</sup> (end of period)	12.64 %	12.71 %	12.53 %
Common equity Tier 1 risk-based capital ratio <sup>(6)</sup> (end of period)	18.97 %	16.70 %	16.58 %

- (1) Return on average stockholders' equity ratio is defined as consolidated income attributable to Hilltop divided by average total Hilltop stockholders' equity.
- (2) Return on average assets ratio 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 net interest margin by 25 basis points, 40 basis points and 42 basis points during 2020, 2019 and 2018, 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 rates 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 2020, 2019 and 2018, purchase accounting contributed 14, 25 and 34 basis points to our consolidated taxable equivalent net interest margin of 2.85%, 3.48% and 3.56%, respectively. The purchase accounting activity is primarily related to the accretion of discount of loans which totaled \$18.8 million, \$28.7 million and \$39.1 million during 2020, 2019 and 2018, respectively, associated with the Bank Transactions.

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

	Year Ended December 31,								
	2020			2019			2018		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	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	\$ 2,306,203	\$ 74,467	3.23 %	\$ 1,501,154	\$ 64,830	4.32 %	\$ 1,472,772	\$ 68,536	4.65 %
Loans held for investment, gross <sup>(1)</sup>	7,618,723	358,844	4.71 %	7,088,208	395,641	5.58 %	6,601,453	368,189	5.58 %
Investment securities - taxable	1,897,859	49,936	2.63 %	1,803,622	61,983	3.44 %	1,680,976	50,860	3.03 %
Investment securities - non-taxable <sup>(2)</sup>	231,824	7,918	3.42 %	233,713	6,803	2.91 %	247,651	7,752	3.13 %
Federal funds sold and securities purchased under agreements to resell	90,961	138	0.15 %	63,598	1,236	1.94 %	189,183	2,831	1.50 %
Interest-bearing deposits in other financial institutions	1,257,902	3,165	0.25 %	371,312	8,469	2.28 %	459,628	8,683	1.89 %
Securities borrowed	1,435,572	51,360	3.58 %	1,550,322	69,582	4.49 %	1,542,539	66,914	4.34 %
Other	59,412	3,687	6.21 %	75,298	6,869	9.12 %	74,684	6,535	8.75 %
Interest-earning assets, gross <sup>(2)</sup>	14,898,456	549,515	3.69 %	12,687,227	615,413	4.85 %	12,268,886	580,300	4.73 %
Allowance for credit losses	(122,148)			(57,690)			(62,681)		
Interest-earning assets, net	14,776,308			12,629,537			12,206,205		
Noninterest-earning assets	1,537,269			1,397,420			1,288,718		
<b>Total assets</b>	<b>\$ 16,313,577</b>			<b>\$ 14,026,957</b>			<b>\$ 13,494,923</b>		
<b>Liabilities and Stockholders' Equity</b>									
Interest-bearing liabilities									
Interest-bearing deposits	\$ 7,397,121	\$ 47,040	0.64 %	\$ 5,916,491	\$ 71,509	1.21 %	\$ 5,568,473	\$ 46,002	0.83 %
Securities loaned	1,336,873	42,817	3.20 %	1,423,847	60,086	4.22 %	1,395,947	56,733	4.06 %
Notes payable and other borrowings	1,222,044	33,249	2.72 %	1,398,559	41,928	3.00 %	1,477,966	40,369	2.73 %
Total interest-bearing liabilities	9,956,038	123,106	1.24 %	8,738,897	173,523	1.99 %	8,442,386	143,104	1.70 %
Noninterest-bearing liabilities									
Noninterest-bearing deposits	3,304,475			2,635,924			2,504,599		
Other liabilities	791,002			614,164			617,227		
Total liabilities	14,051,515			11,988,985			11,564,212		
Stockholders' equity	2,235,690			2,014,535			1,919,940		
Noncontrolling interest	26,372			23,437			10,771		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 16,313,577</b>			<b>\$ 14,026,957</b>			<b>\$ 13,494,923</b>		
<b>Net interest income</b> <sup>(2)</sup>		<b>\$ 426,409</b>			<b>\$ 441,890</b>			<b>\$ 437,196</b>	
<b>Net interest spread</b> <sup>(2)</sup>			2.45 %			2.86 %			3.03 %
<b>Net interest margin</b> <sup>(2)</sup>			2.85 %			3.48 %			3.56 %

(1) Average balance includes non-accrual loans.

(2) Presented on a taxable equivalent basis with taxable equivalent adjustments based on a 21% federal income tax rate for all periods presented. The adjustment to interest income was \$1.2 million, \$0.6 million and \$0.9 million during 2020, 2019 and 2018, respectively.

The banking segment's net interest margin exceeds our consolidated net interest margin shown above. Our consolidated net interest margin includes certain items that are not reflected in the calculation of our net interest margin within our banking segment and reduce our consolidated net interest margin, such as the borrowing costs of Hilltop and the yields and costs associated with certain items within interest-earning assets and interest-bearing liabilities in the broker-dealer segment, including items related to securities financing operations that particularly decrease net interest margin. In addition, yields and costs on certain interest-earning assets, such as warehouse lines of credit extended to subsidiaries (operating segments) by the banking segment, are eliminated from the consolidated financial statements. Our consolidated net interest margin during 2020 was also negatively impacted by certain actions taken by management 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 as the pandemic created significant uncertainty in the banking and capital markets.

Net interest income from continuing operations decreased during 2020, compared with 2019, primarily due to decreases in interest earned on loans held for investment, interest incurred beginning in May 2020 related to the new Subordinated Notes at corporate and decreases in net interest income from our stock lending business, customer margin loans and other customer activities within the broker-dealer segment. The increase in net interest income during 2019, compared with 2018, was primarily related to changes attributable to both volumes and yields within our banking segment, partially

offset by a decrease in accretion of discount on loans within the banking segment and declining net yields on mortgage loans held for sale within our mortgage origination 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 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 2020, the provision for credit losses was significantly impacted by the banking segment’s build in reserves associated with the increase in the expected lifetime credit losses under the Current Expected Credit Losses (“CECL”) methodology on both individually evaluated loans and collectively evaluated loans within the portfolio attributable to the market disruption and related economic uncertainties caused by COVID-19 during 2020. 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. During 2019, the provision for (reversal of) credit losses was impacted by the banking segment’s release during the first quarter of 2019 of a \$2.0 million reserve associated with previously estimated hurricane loss exposures due to improved customer performance.

Noninterest income from continuing operations increased during 2020, compared with 2019, primarily due to increases in total mortgage loan sales volume and changes in net fair value and related derivative activity within our mortgage origination segment, as well as increases in fixed income services, public finance services and structured finance net revenues with our broker-dealer segment. The increase in noninterest income from continuing operations during 2019, compared with 2018, was primarily due to increases in noninterest income within our mortgage origination and broker-dealer segments.

Noninterest expense from continuing operations increased during 2020, compared with 2019, primarily due to increases in variable compensation and segment operating costs associated with the increased mortgage loan originations within our mortgage origination segment and increases in variable compensation within our broker-dealer segment. Noninterest expense increased during 2019, compared with 2018, primarily due to increases in noninterest expense within our broker-dealer and mortgage origination segments as well as corporate, partially offset by a decrease within our banking segment.

Effective income tax rates from continuing operations were 23.6%, 22.5% and 22.1% for 2020, 2019 and 2018, respectively. The increase in the effective tax rate during 2020 was primarily attributable to the percentage of income at subsidiaries with higher state effective tax rates, while the effective tax rates for 2019 and 2018 approximated statutory rates and includes the effect of investments in tax-exempt instruments, offset by nondeductible expenses.

## Segment Results from Continuing Operations

### Banking Segment

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

	Year Ended December 31,			Variance	
	2020	2019	2018	2020 vs 2019	2019 vs 2018
Net interest income	\$ 390,871	\$ 379,258	\$ 370,732	\$ 11,613	\$ 8,526
Provision for credit losses	96,326	7,280	5,319	89,046	1,961
Noninterest income	41,376	41,753	43,588	(377)	(1,835)
Noninterest expense	232,447	231,524	256,577	923	(25,053)
Income before income taxes	\$ 103,474	\$ 182,207	\$ 152,424	\$ (78,733)	\$ 29,783

The decline in income before income taxes during 2020, compared with 2019, was primarily due to the significant increase in the provision for credit losses associated with the adoption of CECL and the market disruption caused by COVID-19 during 2020. 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.

	Year Ended December 31,		
	2020	2019	2018
Efficiency ratio <sup>(1)</sup>	53.78 %	54.99 %	61.93 %
Return on average assets <sup>(2)</sup>	0.63 %	1.36 %	1.23 %
Net interest margin <sup>(3)</sup>	3.31 %	4.00 %	4.23 %
Net recoveries (charge-offs) to average loans outstanding <sup>(4)</sup>	(0.30)%	(0.08)%	(0.15)%

(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 of average assets ratio 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) The net charge-offs to average loans outstanding ratio is defined as 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 rates 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 2020, 2019 and 2018, purchase accounting contributed 18, 33 and 48 basis points, respectively, to the banking segment's taxable equivalent net interest margin of 3.31%, 4.01% and 4.24%, respectively. These purchase accounting items are primarily related to accretion of discount of loans associated with the Bank Transactions as discussed in the Consolidated Operating Results section.

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

	Year Ended December 31,								
	2020			2019			2018		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	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>	\$ 7,152,783	\$ 341,383	4.77 %	\$ 6,564,748	\$ 367,903	5.60 %	\$ 6,032,767	\$ 342,098	5.67 %
Subsidiary warehouse lines of credit	2,073,087	79,488	3.83 %	1,374,051	61,812	4.50 %	1,364,577	58,551	4.29 %
Investment securities - taxable	1,377,578	27,651	2.01 %	1,181,198	29,879	2.53 %	965,937	22,451	2.32 %
Investment securities - non-taxable <sup>(2)</sup>	111,471	3,789	3.40 %	96,186	3,267	3.40 %	110,386	3,707	3.36 %
Federal funds sold and securities purchased under agreements to resell	460	1	0.18 %	447	1	0.17 %	1,049	16	1.54 %
Interest-bearing deposits in other financial institutions	1,038,647	1,888	0.18 %	202,478	4,525	2.23 %	241,124	4,429	1.84 %
Other	42,977	377	0.88 %	55,403	2,534	4.57 %	51,906	2,282	4.40 %
Interest-earning assets, gross <sup>(2)</sup>	11,797,003	454,577	3.85 %	9,474,511	469,921	4.96 %	8,767,746	433,534	4.94 %
Allowance for credit losses	(121,770)			(57,546)			(62,306)		
Interest-earning assets, net	11,675,233			9,416,965			8,705,440		
Noninterest-earning assets	967,690			938,663			906,586		
<b>Total assets</b>	<b>\$ 12,642,923</b>			<b>\$ 10,355,628</b>			<b>\$ 9,612,026</b>		
<b>Liabilities and Stockholders' Equity</b>									
Interest-bearing liabilities									
Interest-bearing deposits	\$ 7,306,143	\$ 60,297	0.83 %	\$ 5,654,663	\$ 79,805	1.41 %	\$ 5,237,014	\$ 55,060	1.05 %
Notes payable and other borrowings	205,448	2,642	1.29 %	481,924	10,233	2.12 %	417,534	7,000	1.68 %
Total interest-bearing liabilities	7,511,591	62,939	0.84 %	6,136,587	90,038	1.47 %	5,654,548	62,060	1.10 %
Noninterest-bearing liabilities									
Noninterest-bearing deposits	3,412,212			2,622,229			2,492,728		
Other liabilities	128,795			93,861			48,847		
Total liabilities	11,052,598			8,852,677			8,196,123		
Stockholders' equity	1,590,325			1,502,951			1,415,903		
<b>Total liabilities and stockholders' equity</b>	<b>\$ 12,642,923</b>			<b>\$ 10,355,628</b>			<b>\$ 9,612,026</b>		
<b>Net interest income <sup>(2)</sup></b>		<b>\$ 391,638</b>			<b>\$ 379,883</b>			<b>\$ 371,474</b>	
<b>Net interest spread <sup>(2)</sup></b>			<b>3.01 %</b>			<b>3.49 %</b>			<b>3.85 %</b>
<b>Net interest margin <sup>(2)</sup></b>			<b>3.31 %</b>			<b>4.01 %</b>			<b>4.24 %</b>

(1) Average balance includes non-accrual loans.

(2) Presented on a taxable equivalent basis with taxable equivalent adjustments based on the applicable corporate federal income tax rates of 21% for all periods presented. The adjustment to interest income was \$0.8 million, \$0.6 million and \$0.8 million during 2020, 2019 and 2018, 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 margins during 2020 were also negatively impacted by certain actions taken by management to strengthen the Bank's 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 as the pandemic created significant uncertainty in the banking and capital markets.

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).

	Year Ended December 31,					
	2020 vs. 2019			2019 vs. 2018		
	Change Due To <sup>(1)</sup>			Change Due To <sup>(1)</sup>		
	Volume	Yield/Rate	Change	Volume	Yield/Rate	Change
Interest income						
Loans held for investment, gross	\$ 32,930	\$ (59,450)	\$ (26,520)	\$ 30,163	\$ (4,358)	\$ 25,805
Subsidiary warehouse lines of credit	31,446	(13,770)	17,676	407	2,854	3,261
Investment securities - taxable	4,968	(7,196)	(2,228)	5,003	2,425	7,428
Investment securities - non-taxable <sup>(2)</sup>	519	3	522	(477)	37	(440)
Federal funds sold and securities purchased under agreements to resell	—	—	—	(9)	(6)	(15)
Interest-bearing deposits in other financial institutions	18,685	(21,322)	(2,637)	(710)	806	96
Other	(568)	(1,589)	(2,157)	154	98	252
Total interest income <sup>(2)</sup>	<u>87,980</u>	<u>(103,324)</u>	<u>(15,344)</u>	<u>34,531</u>	<u>1,856</u>	<u>36,387</u>
Interest expense						
Deposits	\$ 23,308	\$ (42,816)	\$ (19,508)	\$ 4,391	\$ 20,354	\$ 24,745
Notes payable and other borrowings	(5,871)	(1,720)	(7,591)	1,080	2,153	3,233
Total interest expense	<u>17,437</u>	<u>(44,536)</u>	<u>(27,099)</u>	<u>5,471</u>	<u>22,507</u>	<u>27,978</u>
Net interest income <sup>(2)</sup>	<u>\$ 70,543</u>	<u>\$ (58,788)</u>	<u>\$ 11,755</u>	<u>\$ 29,060</u>	<u>\$ (20,651)</u>	<u>\$ 8,409</u>

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

(2) Taxable equivalent.

Changes in the yields earned on interest-earning assets decreased taxable equivalent net interest income during 2020, compared with 2019, primarily as a result of lower loan yields due to decreased market rates, the addition of 1% note rate PPP loans, and the decrease in accretion of discount on loans of \$9.9 million. Accretion of discount on loans is expected to continue to decrease in future periods as loans acquired in the Bank Transactions are repaid, refinanced or renewed. Changes in the volume of interest-earning assets, primarily due to the significant increase in mortgage warehouse lending volume and new PPP loan originations, increased taxable equivalent net interest income during 2020, compared with 2019. Changes in rates paid on interest-bearing liabilities increased taxable equivalent net interest income during 2020, compared with 2019, 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.

Changes in the yields earned on interest-earning assets increased taxable equivalent net interest income during 2019, compared with 2018, primarily as a result of higher yields due to increased market rates, significantly offset by a decrease in accretion of discount on loans of \$10.3 million. Changes in the volume of interest-earning assets, primarily due to an increase in the loan portfolio as a result of the BORO Acquisition, and seasonal increases in mortgage warehouse lending volume increased taxable equivalent net interest income during 2019, compared with 2018. Changes in rates paid on interest-bearing liabilities decreased taxable equivalent net interest income during 2019, compared with 2018, due to increases in market interest rates and increased competitive pressure for deposits.

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 extent to which these measures will impact the Bank is uncertain. The adverse economic conditions caused by the COVID-19 pandemic have had and can be expected to continue to have a significant adverse effect on the banking segment's business and results of operations, including significantly reduced demand for loan products and services from customers, deposit balance attrition, possible recognition of credit losses and increases in allowance for credit losses, especially if businesses remain limited in their operating capacity, unemployment remains elevated and customers draw on their lines of credit or seek additional loans to help finance their businesses, and possible constraints on liquidity and capital, whether due to increases in risk-weighted assets related to supporting customer activities or to regulatory actions. In the event future operating performance is below our projections, there are negative changes to projected provision for credit losses on loans, long-term loan and deposit growth rates or discount rates increase, the fair value of the banking reporting unit may decline, and we may be required to record a goodwill impairment charge. Additionally, with regards 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. The extent to which the COVID-19 pandemic negatively affects the banking segment's business, results of operations and financial condition, as well as its regulatory capital and liquidity ratios, will depend on future developments that are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities and other third parties in response to the pandemic, as discussed in more detail in the "Recent Developments" section above.

During 2020, 2019 and 2018, the banking segment retained approximately \$193 million, \$149 million and \$97 million, 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. We expected loans originated by the mortgage origination segment on behalf of and retained by the banking segment to increase during 2020 based on approved authority for up to 5% of the mortgage origination segment's total origination volume. However, 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 began purchasing and retaining mortgage loans originated by the mortgage origination segment again. 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 credit losses during 2020 included a significant build in the provision for credit losses on individually evaluated loans of \$20.1 million, while the provision for credit losses on expected losses of collectively evaluated loans accounted for \$76.1 million of the total 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 change in provision for credit losses during 2020 was 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 2020 was also impacted by net charge-offs of \$21.1 million, primarily associated with loans specifically reserved for during the first quarter of 2020. 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 was relatively flat during 2020, compared to 2019, primarily due to sales activity in our available-for-sale investment portfolio as well as changes in our intercompany financing charges. The decrease in noninterest income during 2019, compared to 2018, was primarily due to sales activity in our available-for-sale investment portfolio.

The banking segment's noninterest expenses were relatively flat during 2020, compared to 2019, primarily due to an increase in the reserve for unfunded commitments attributable to macroeconomic uncertainties associated with the impact of market disruption caused by COVID-19 conditions, offset by a reduction in legal, business development and other operating expenses. The decrease in noninterest expense during 2019, compared to 2018, was primarily due to a reduction in the previously mentioned BORO Acquisition-related transaction expenses and expenses related to a wire fraud incident, as well as a reduction in net expenses related to previously covered assets.

## Broker-Dealer Segment

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

	Year Ended December 31,			Variance	
	2020	2019	2018	2020 vs 2019	2019 vs 2018
<b>Net interest income:</b>					
Wealth management:					
Retail	\$ 8,544	\$ 9,496	\$ 10,181	\$ (952)	\$ (685)
Clearing services	6,916	11,530	13,038	(4,614)	(1,508)
Structured finance <sup>(5)</sup>	6,200	8,460	12,122	(2,260)	(3,662)
Fixed income services	12,173	6,180	477	5,993	5,703
Other <sup>(5)</sup>	6,079	15,642	15,060	(9,563)	582
Total net interest income	39,912	51,308	50,878	(11,396)	430
<b>Noninterest income:</b>					
Securities commissions and fees by business line <sup>(1)</sup> :					
Fixed income services <sup>(5)</sup>	49,573	36,997	40,396	12,576	(3,399)
Wealth management:					
Retail <sup>(5)</sup>	69,718	71,934	78,672	(2,216)	(6,738)
Clearing services	30,018	33,787	35,605	(3,769)	(1,818)
Structured finance <sup>(5)</sup>	1,820	1,793	1,982	27	(189)
Other <sup>(5)</sup>	4,765	4,664	5,568	101	(904)
Total	155,894	149,175	162,223	6,719	(13,048)
Investment and securities advisory fees and commissions by business line:					
Public finance services <sup>(5)</sup>	95,193	76,519	63,808	18,674	12,711
Fixed income services <sup>(5)</sup>	6,395	2,936	1,542	3,459	1,394
Wealth management:					
Retail	24,023	20,820	19,037	3,203	1,783
Clearing services	1,649	1,264	1,190	385	74
Structured finance <sup>(5)</sup>	3,725	2,063	4,354	1,662	(2,291)
Other <sup>(5)</sup>	342	185	135	157	50
Total	131,327	103,787	90,066	27,540	13,721
Other:					
Structured finance <sup>(5)</sup>	157,466	114,190	35,265	43,276	78,925
Fixed income services <sup>(5)</sup>	45,365	35,859	12,881	9,506	22,978
Other <sup>(5)</sup>	1,303	1,400	1,279	(97)	121
Total	204,134	151,449	49,425	52,685	102,024
Total noninterest income	491,355	404,411	301,714	86,944	102,697
Net revenue <sup>(2)</sup>	531,267	455,719	352,592	75,548	103,127
<b>Noninterest expense:</b>					
Variable compensation <sup>(3)</sup>	205,464	163,840	115,948	41,624	47,892
Non-variable compensation and benefits	106,314	103,823	102,519	2,491	1,304
Segment operating costs <sup>(4)</sup>	103,850	98,294	101,543	5,556	(3,249)
Total noninterest expense	415,628	365,957	320,010	49,671	45,947
Income before income taxes	\$ 115,639	\$ 89,762	\$ 32,582	\$ 25,877	\$ 57,180

- (1) Securities commissions and fees includes income of \$13.2 million, \$11.4 million, and \$11.3 million during 2020, 2019, and 2018, respectively, that is eliminated in consolidation.
- (2) Net revenue is defined as the sum of total net interest income and total noninterest income. 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 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.

Despite the economic disruptions related to the pandemic, during the second half of 2020, the broker-dealer's public finance services business line experienced improved results in line with modest improvements in both Texas and national issuance activity and market share compared to the same period during the prior year. The structured finance business line experienced robust results given strong issuance volumes and improved demand for mortgage products following market volatility in the first quarter of 2020. Structuring activity results also improved as demand for structured agency products rebounded starting in the second quarter of 2020. Additionally, the fixed income services business line demonstrated improved operating results. During 2020, transactional revenues in the fixed income business line improved compared with the same period in 2019 as we experienced relative strength in municipal and taxable products. The wealth management business line's net revenues were lower during 2020, compared to 2019, as customer balance revenues were driven lower due to the current low interest rate environment. Additional information related to the impact of COVID-19 is included within the "Recent Developments" section above.



The specific components of the overall increase in the broker-dealer segment's income before income taxes 2020, compared with 2019, was primarily as a result of the following:

- a \$40.6 million increase in net revenue in our fixed income services business line due to strong performances in our municipal and taxable products, which noted significant increases beginning in March 2020 through December 2020. Improved client demand combined with active position management and effective hedging tools led to improved municipal revenue. The broker-dealer segment wound-down the equity capital market business line, resulting in an offsetting decline of net revenues of \$9.1 million during 2020 for a net increase of \$31.5 million in net revenue in our fixed income services business line year over year;
- a \$44.1 million increase in compensation expense, of which \$41.6 million was due to the increase in variable compensation, resulting from increases in our public finance services, fixed income services and structured finance business line revenues;
- an \$8.6 million decrease in net revenue in our wealth management business line during 2020 was primarily due to lower customer balance based revenues, including FDIC insured investment products' fees and net interest on other customer balances as a result of the low interest rate environment. During 2020, the decrease in the wealth management business line's net revenues was partially offset by the activity in the first quarter of 2020 from improved transactional revenues due to the significant re-allocation of customer assets into cash and cash equivalents as clients exited risk markets and increases in other production and fee income during 2020 compared to 2019; and
- a \$42.7 million increase in the broker-dealer segment's structured finance net revenues. During 2020, activity in March 2020 was weaker as demand for structured agency products declined, resulting in a \$14.4 million decrease in the business line's other noninterest income in the first quarter of 2020 compared to the first quarter of 2019. After March 2020, structured finance revenues improved in line with increased volumes reflecting robust activity in mortgage originations combined with improved product demand from the buy-side and other changes in the business line, resulting in a \$57.6 million increase in the business line's other noninterest income for the period from April 1 to December 31, 2020 compared to the same period in 2019. As a result, the structured finance business produced a \$43.2 million increase in noninterest income during 2020 compared to the same period in 2019.

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 decrease in net interest income during 2020, compared with 2019, was primarily due to decreases in net interest income from our stock lending business, customer margin loans and other customer activities. The decrease in net interest income was partially offset by an increase in net interest earned from the broker-dealer's taxable securities. The increase in net interest income during 2019, compared with 2018, was primarily due to an increase in net interest earned on trading securities as a result of increases in market interest rates. The increase in net interest income was partially offset by decreases in net interest income from our structured finance operations due to a decline in pool inventory from December 31, 2018 to December 31, 2019 and decreases in average customer margin balances within the segment's clearing business of 19% during 2019.

Noninterest income increased during 2020 compared to 2019 primarily due to increases in securities commissions and fees, investment and securities advisory fees and commissions, and other noninterest income. Noninterest income increased during 2019 compared to 2018 primarily due to increases in other noninterest income and investments and securities advisory fees and commissions, partially offset by decreases in securities commissions and fees.

Securities commissions and fees increased during 2020 compared to 2019 primarily due to the increases in commissions earned in our fixed income service line of business of \$18.1 million offset by the decreases in commissions earned through the wind-down of our equity capital markets business line, which resulted in a decrease of \$5.5 million. Additionally, the overall increase in securities commissions and fees was offset by the decreases in commissions and fees earned by our wealth management business line from declines in our money market and FDIC sweep revenues, primarily in the wealth management business line. Securities commissions and fees decreased during 2019 compared to 2018, primarily due to decreases in commissions earned in our retail group and fixed income services business line and fees related to our FDIC insured investment products, as well as commissions earned on insurance and mutual fund transactions, and fees earned from correspondent transactions.

Investment and securities advisory fees and commissions increased during 2020 compared to 2019, primarily due to increases in municipal advisory and underwriting transactions. Investment and securities advisory fees and commissions increased during 2019, compared with 2018, primarily due to the increase in the number of issues and the aggregate amount of those issues by our public finance services business line.

Other noninterest income increased during 2020, compared to 2019. The increase during the period was primarily the result of a \$43.2 million increase in trading gains earned from our structured finance business line's derivative activities due to strong year-over-year volumes and robust customer demand despite heightened market volatility in the first quarter of 2020. Additionally, other noninterest income within our fixed income services business line increased \$9.5 million during the year associated with both our taxable and municipal securities trading portfolio activities, partially offset by a decrease in our securitized mortgage backed securities portfolio. The increase in other noninterest income during 2019, compared with 2018, was primarily the result of a \$102.3 million increase in trading gains earned from our derivative and trading portfolio activities, most notably in our structured finance business, which accounted for \$79.2 million of the increase, as well as our fixed income services business line, which accounted for \$23.0 million of the increase. The increases in our structured finance business were primarily due to the 77 basis-point decline in the 10-year treasury bond yield during 2019 compared to a 29 basis-point increase during 2018, and a 22% increase in the business line's TBA mortgage-backed securities volume. The \$23.0 million increase in our fixed income services business line was attributable to an improved market environment, improved spreads and a 26% increase in trading volume.

Noninterest expenses increased during 2020 compared to 2019 primarily due to increases in variable compensation, partially offset by \$2.9 million in pre-tax costs associated with the Leadership Changes and efficiency initiative-related charges in 2019 as noted in the "Factors Affecting Results of Operations" section above. Other noninterest expenses increased during the period primarily due to deployment of a new back-office system on June 1, 2020. Noninterest expenses increased during 2019, compared with 2018, primarily due to an increase in variable compensation and the pre-tax costs associated with the Leadership Changes and efficiency initiative-related charges as noted in the "Factors Affecting Results of Operations" section above.

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

	Year Ended December 31,		
	2020	2019	2018
Total compensation as a % of net revenue <sup>(1)</sup>	58.7 %	58.7 %	62.0 %
Pre-tax margin <sup>(2)</sup>	21.8 %	19.7 %	9.2 %
FDIC insured program balances at the Bank (end of period)	\$ 700,006	\$ 1,304,333	\$ 1,302,558
Other FDIC insured program balances (end of period)	\$ 1,892,974	\$ 666,418	\$ 905,503
Customer funds on deposit, including short credits (end of period)	\$ 480,200	\$ 329,743	\$ 394,005
Public finance services:			
Number of issues	1,252	1,179	1,123
Aggregate amount of offerings	\$ 57,107,263	\$ 54,394,943	\$ 53,559,396
Structured finance:			
Lock production/TBA volume	\$ 9,075,232	\$ 5,876,466	\$ 4,829,687
Fixed income services:			
Total volumes	\$ 169,559,201	\$ 83,571,542	\$ 66,370,939
Net inventory (end of period)	\$ 613,413	\$ 643,371	\$ 659,237

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Wealth management (Retail and Clearing services groups):			
Retail employee representatives (end of period)	117	122	120
Independent registered representatives (end of period)	189	195	208
Correspondents (end of period)	129	145	152
Correspondent receivables (end of period)	\$ 180,173	\$ 264,201	\$ 243,179
Customer margin balances (end of period)	\$ 256,682	\$ 310,752	\$ 333,054
Wealth management (Securities lending group):			
Interest-earning assets - stock borrowed (end of period)	\$ 1,338,855	\$ 1,634,782	\$ 1,365,547
Interest-bearing liabilities - stock loaned (end of period)	\$ 1,245,066	\$ 1,555,964	\$ 1,186,073

- (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).

	<u>Year Ended December 31,</u>			<u>Variance</u>	
	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2020 vs 2019</u>	<u>2019 vs 2018</u>
Net interest income (expense)	\$ (10,489)	\$ (6,273)	\$ 1,485	\$ (4,216)	\$ (7,758)
Noninterest income	1,172,450	634,992	551,860	537,458	83,132
Noninterest expense	753,917	563,998	540,474	189,919	23,524
Income before income taxes	<u>\$ 408,044</u>	<u>\$ 64,721</u>	<u>\$ 12,871</u>	<u>\$ 343,323</u>	<u>\$ 51,850</u>

The mortgage lending business is subject to variables that can impact loan origination volume, including seasonal and interest rate fluctuations. Historically, the mortgage origination segment has experienced increased loan origination volume from purchases of homes during the spring and summer, when more people tend to move and buy or sell homes. An increase in mortgage interest rates tends to result in decreased loan origination volume from refinancings, while a decrease in mortgage interest rates tends to result in increased loan origination volume from refinancings. Average mortgage interest rates decreased during both 2020 and 2019, which resulted in refinancing volume as a percentage of total origination volume increasing in each period when compared to 2019 and 2018, respectively. See details regarding refinancing volume in the table below. Changes in mortgage interest rates have historically had a lesser impact on home purchases volume than on refinancing volume. An increase in mortgage interest rates during 2021 could impact the percentage mix of refinancing and purchase volumes relative to total loan origination volume compared to 2020.

In response to the COVID-19 pandemic, during the first quarter of 2020, the FOMC reduced short-term rates by 150 basis points to a range of 0% to 0.25%. Further, 10-year interest rates also declined significantly during the first quarter 2020, which led to a steady decrease in mortgage interest rates during the remainder of the year. This decrease in mortgage interest rates was the primary driver of a significant increase in mortgage loan applications and resulting increases in interest rate lock commitments (“IRLCs”) and loan sales volume. In addition, an increase in average loans sales margin was recognized as a result of 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. As a result, income before income taxes increased \$343.3 million, or 530.5%, during 2020, compared with 2019.

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 has 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 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. 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 2020. PrimeLending utilizes a third-party to manage its servicing portfolio and we therefore have not experienced additional infrastructure costs to manage the increase in PrimeLending’s servicing portfolio. PrimeLending’s liquidity has not been, and we do not expect that it will be, significantly impacted by recent forbearance requests. In addition, 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, which could result in PrimeLending seeking non-agency investors or choosing to retain these loans.

As average mortgage interest rates decreased between, 2019 and 2020, refinancing volume as a percentage of total origination volume increased from 24.8% during 2019 to 41.6% during 2020. As average mortgage interest rates decreased between 2018 and 2019, refinancing volume as a percentage of total origination volume increased from 13.8% during 2018 to 24.8% during 2019. See details regarding refinancing volume in the table below. A higher refinance percentage could also be driven by a slowing of purchase volume due to the negative impact on new and existing home sales resulting from the COVID-19 pandemic. While PrimeLending experienced an increase in purchase volume as a percentage of total loan origination volume between the second and third quarters of 2020, purchase volume as a percentage of total loan origination volume decreased during the fourth quarter of 2020. We are uncertain whether this trend will continue.

The mortgage origination segment primarily originates its mortgage loans through a retail channel, with limited lending through its affiliated business relationships (“ABAs”). For 2020, funded loan volume through ABAs was approximately 7% of the mortgage origination segment’s total loan volume. During the nine months ended September 30, 2020, PrimeLending had a 51% membership interest in four ABAs. On October 1, 2020, the mortgage origination segment divested its interest in one of its ABAs, resulting in three ABAs remaining as of December 31, 2020. We expect total production within the ABA channel to decrease slightly to 6% loan volume of the mortgage origination segment during 2021.

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

	Year Ended December 31,						Variance	
	2020		2019		2018			
	Amount	% of Total	Amount	% of Total	Amount	% of Total	2020 vs 2019	2019 vs 2018
Mortgage Loan Originations - units	84,209		61,045		57,186		23,164	3,859
Mortgage Loan Originations - volume	\$ 22,970,194		\$ 15,579,437		\$ 13,692,484		\$ 7,390,757	\$ 1,886,953
Mortgage Loan Originations:								
Conventional	\$ 16,519,498	71.92 %	\$ 9,503,044	61.00 %	\$ 8,262,800	60.35 %	\$ 7,016,454	\$ 1,240,244
Government	4,473,763	19.48 %	3,860,802	24.78 %	3,413,300	24.93 %	612,961	447,502
Jumbo	1,219,492	5.31 %	1,309,317	8.40 %	1,181,353	8.63 %	(89,825)	127,964
Other	757,441	3.29 %	906,274	5.82 %	835,031	6.09 %	(148,833)	71,243
	<u>\$ 22,970,194</u>	<u>100.00 %</u>	<u>\$ 15,579,437</u>	<u>100.00 %</u>	<u>\$ 13,692,484</u>	<u>100.00 %</u>	<u>\$ 7,390,757</u>	<u>\$ 1,886,953</u>
Home purchases	\$ 13,413,545	58.40 %	\$ 11,718,772	75.22 %	\$ 11,798,804	86.17 %	\$ 1,694,773	\$ (80,032)
Refinancings	9,556,649	41.60 %	3,860,665	24.78 %	1,893,680	13.83 %	5,695,984	1,966,985
	<u>\$ 22,970,194</u>	<u>100.00 %</u>	<u>\$ 15,579,437</u>	<u>100.00 %</u>	<u>\$ 13,692,484</u>	<u>100.00 %</u>	<u>\$ 7,390,757</u>	<u>\$ 1,886,953</u>
Texas	\$ 4,280,831	18.64 %	\$ 2,999,633	19.25 %	\$ 2,594,585	18.95 %	\$ 1,281,198	\$ 405,048
California	2,497,066	10.87 %	1,561,926	10.03 %	1,511,931	11.04 %	935,140	49,995
Florida	1,403,196	6.11 %	1,113,827	7.15 %	1,026,157	7.49 %	289,369	87,670
Arizona	1,045,298	4.55 %	681,486	4.37 %	567,202	4.14 %	363,812	114,284
South Carolina	929,710	4.05 %	604,546	3.88 %	474,844	3.47 %	325,164	129,702
Ohio	869,393	3.78 %	642,130	4.12 %	588,199	4.30 %	227,263	53,931
Maryland	811,706	3.53 %	485,098	3.11 %	403,086	2.94 %	326,608	82,012
Missouri	777,389	3.38 %	510,025	3.27 %	454,517	3.32 %	267,364	55,508
Washington	736,135	3.20 %	631,549	4.05 %	520,543	3.80 %	104,586	111,006
North Carolina	719,936	3.13 %	485,682	3.12 %	413,686	3.02 %	234,254	71,996
All other states	8,899,534	38.76 %	5,863,535	37.65 %	5,137,734	37.53 %	3,035,999	725,801
	<u>\$ 22,970,194</u>	<u>100.00 %</u>	<u>\$ 15,579,437</u>	<u>100.00 %</u>	<u>\$ 13,692,484</u>	<u>100.00 %</u>	<u>\$ 7,390,757</u>	<u>\$ 1,886,953</u>
Mortgage Loan Sales - volume:								
External third parties	\$ 22,321,599	99.14 %	\$ 14,442,929	98.98 %	\$ 13,639,215	99.30 %	\$ 7,878,670	\$ 803,714
Banking segment	192,571	0.86 %	148,798	1.02 %	96,670	0.70 %	43,773	52,128
	<u>\$ 22,514,170</u>	<u>100.00 %</u>	<u>\$ 14,591,727</u>	<u>100.00 %</u>	<u>\$ 13,735,885</u>	<u>100.00 %</u>	<u>\$ 7,922,443</u>	<u>\$ 855,842</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, other mortgage production income and mortgage loan origination fees. 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 2020 increased 47.4% compared with 2019, while income before income taxes during 2020 increased 530.5%, compared with 2019. The increase in income before income taxes during 2020 was primarily due to an increase in net gains from sale of loans. These changes were partially offset by an increase in compensation that varies with the volume of mortgage loan originations ("variable compensation"), an increase in non-variable compensation, a decrease in change in net fair value of mortgage servicing rights ("MSR") assets, and an increase in segment operating costs.

The mortgage origination segment's total loan origination volume increased 13.8% between 2019 and 2018, while income before income taxes during 2019 increased 402.8%, compared with 2018. The increase in income before income taxes during 2019 was primarily due to an increase in the change in net fair value of IRLCs and loans held for sale, an increase in mortgage loan origination fees and other related income, an increase in net gains from sale of loans and a decrease in segment operating costs. These changes were partially offset by an increase in variable compensation, a decrease in change in net fair value of MSR assets, and an increase in net interest expense.

Net interest expense was comprised of interest income earned on loans held for sale, offset by interest incurred on warehouse lines of credit held with the Bank and related intercompany financing costs. The increase in net interest expense during 2020, compared with 2019, included the effects of declining net yields on mortgage loans held for sale.

Noninterest income was comprised of the following (in thousands).

	Year Ended December 31,			Variance	
	2020	2019	2018	2020 vs 2019	2019 vs 2018
Net gains from sale of loans	\$ 913,474	\$ 473,380	\$ 450,515	\$ 440,094	\$ 22,865
Mortgage loan origination fees and other related income	172,096	130,208	104,463	41,888	25,745
Other mortgage production income:					
Change in net fair value and related derivative activity:					
IRLCs and loans held for sale	81,560	21,253	(20,608)	60,307	41,861
Mortgage servicing rights asset	(30,119)	(15,166)	(5,856)	(14,953)	(9,310)
Servicing fees	35,439	25,317	23,346	10,122	1,971
Total noninterest income	\$ 1,172,450	\$ 634,992	\$ 551,860	\$ 537,458	\$ 83,132

The increases in net gains from sale of loans during 2020, compared with 2019, were 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 increases in loan sales volume during 2020 are consistent with increases in loan origination volume during 2020. The increase in average loans sales margin 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. The increases in mortgage loan origination fees during 2020, compared with 2019, were 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 margins, including loans sold to the banking segment, during 2020, 2019 and 2018 were 406 bps, 324 bps and 328 bps, respectively. During 2020, 2019 and 2018, the mortgage origination segment originated approximately \$193 million, \$149 million and \$97 million, respectively, in loans on behalf of the banking segment, representing up to 1% of PrimeLending's total loan origination volume during each respective year. 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 the banking segment at par was to reduce this margin 3 bps in 2019, while the impact on 2020 and 2018 was de minimis. Loan volumes to be originated on behalf of and retained by the banking segment are evaluated each quarter. We anticipate an increase in loans sold to the banking segment during 2021 as compared to 2020. The mortgage origination segment has been approved to sell up to 5% of its total loan volume to the banking segment. In March 2020, the mortgage origination segment executed a letter of intent with the banking segment to purchase mortgage loans previously sold to the banking segment with an unpaid principal balance of approximately \$210 million. Such original sales of approximately \$121 million and \$91 million are reflected in the previous mortgage loan details table within the mortgage loan sales volume to the banking segment in 2020 and 2019, respectively. 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. This sale is reflected in the previous mortgage loan details table within the mortgage loan sales volume to external third parties in 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 loans held for sale. The increase during 2020 was the result of an increase in the total volume of individual IRLCs and loans held for sale, as well as an increase in the average value of individual IRLCs and loans held for sale. The decreases during 2019 and 2018 were the result of decreases in the average value and the total volume of individual IRLCs and loans held for sale at the end of these periods.

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 2020, 2019 and 2018, the mortgage origination segment retained servicing on approximately 67%, 6% and 13% of loans sold, respectively. The increase in rates of retained servicing during 2020 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. We expect that PrimeLending will retain servicing on approximately 50% to 60% of its mortgage loan sales during 2021. The related MSR asset was valued at \$144.2 million on \$14.7 billion of serviced loan volume at December 31, 2020, compared with a value of \$56.7 million on \$5.1 billion of serviced loan volume at December 31, 2019. The mortgage origination segment may, from time to time, manage its MSR asset through different strategies, including varying the percentage of mortgage loans sold servicing released and opportunistically selling MSR assets. The mortgage origination segment has also retained servicing on certain loans sold to the banking segment. Gains and losses associated with such sales to the banking segment and the related MSR asset are eliminated in consolidation. The mortgage origination segment uses derivative financial instruments, including U.S. Treasury bond futures and options, as a means to mitigate interest rate risk associated with its MSR asset. Changes in the net fair value of the MSR asset and the related derivatives associated with normal customer payments, changes in discount rates, prepayment speed assumptions and customer payoffs resulted in net losses as noted in the table above. Additionally, net servicing income was \$15.0 million, \$12.3 million and \$10.9 million during 2020, 2019 and 2018, respectively. In October 2020, February 2020, and March 2018, the mortgage origination segment sold MSR assets of \$18.1 million, \$18.7 million, and \$9.3 million, respectively, which represented \$2.3 billion, \$1.5 billion, and \$834.3 million, respectively, of its serviced loan volume at the time. There were no sales of MSR assets during 2019. On February 12, 2021, the mortgage origination segment executed a letter of intent to sell MSR assets of approximately \$53 million, which represented approximately \$5 billion of its current serviced loan volume. The MSR sale is scheduled to close in March 2021.

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

	Year Ended December 31,			Variance	
	2020	2019	2018	2020 vs 2019	2019 vs 2018
Variable compensation	\$ 405,116	\$ 252,956	\$ 216,038	\$ 152,160	\$ 36,918
Non-variable compensation and benefits	181,597	166,179	173,093	15,418	(6,914)
Segment operating costs	125,104	112,128	118,630	12,976	(6,502)
Lender paid closing costs	21,696	19,698	20,294	1,998	(596)
Servicing expense	20,404	13,037	12,419	7,367	618
Total noninterest expense	<u>\$ 753,917</u>	<u>\$ 563,998</u>	<u>\$ 540,474</u>	<u>\$ 189,919</u>	<u>\$ 23,524</u>

Total employees' compensation and benefits accounted for the majority of the noninterest expenses incurred during all periods presented. Specifically, variable compensation comprised 69.0% and 60.4% of the total employees' compensation and benefits expenses during 2020 and 2019, respectively. Variable compensation increased \$152.2 million during 2020, compared to 2019, and increased \$36.9 million during 2019, compared with 2018. The increases in the percentage concentration of variable compensation and benefits were 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. In addition to an increase in loan origination volume primarily driving the increase in variable compensation and benefits, an increase in the average

incentive rate paid and the impact of incentive plans driven by non-mortgage production criteria contributed to the increase in variable compensation.

While total loan origination volumes increased 47.4% during 2020, compared with 2019, the aggregate non-variable compensation and benefits of the mortgage origination segment increased by 9.3%. The aforementioned increase during 2020, compared with 2019, was primarily due to an increase in overtime expense incurred due to increased loan volume and an increase in salaries resulting from increased underwriting and loan fulfillment staff, to support the increase in loan origination volume beginning in the second quarter of 2020.

While total loan origination volumes increased 13.8% during 2019, compared with 2018, the mortgage origination segment's operating costs decreased 5.0%. The decrease in segment operating costs during 2019, compared to 2018, was primarily due to decreases in non-variable compensation and related benefits, depreciation, professional fees, and business development. These decreases were partially offset by increases in loan origination costs, as well as software license and maintenance expense. The decrease in non-variable compensation and benefits during 2019, compared to 2018, was due to reductions in corporate headcount, loan processing, and loan fulfillment primarily resulting from PrimeLending's cost reduction plan initiated during the third quarter of 2018, partially offset by \$1.25 million in pre-tax costs associated with the Leadership Changes discussed in the "Factors Affecting Results of Operations" section.

In exchange for a higher interest rate, customers may opt to have PrimeLending pay certain costs associated with the origination of their mortgage loan ("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, 2011 and December 31, 2020, the mortgage origination segment sold mortgage loans totaling \$137.2 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 2011, it does not anticipate experiencing significant losses in the future on loans originated prior to 2011 because 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, 2011 and December 31, 2020 (dollars in thousands).

	Original Loan Balance		Loss Recognized	
	Amount	% of Loans Sold	Amount	% of Loans Sold
Claims resolved with no payment	\$ 211,865	0.15%	\$ —	0.00%
Claims resolved because of a loan repurchase or payment to an investor for losses incurred <sup>(1)</sup>	241,296	0.18%	9,750	0.01%
	<u>\$ 453,161</u>	<u>0.33%</u>	<u>\$ 9,750</u>	<u>0.01%</u>

(1) Losses incurred include refunded purchased servicing rights.

For each loan it 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, 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.

At December 31, 2020 and 2019, the mortgage origination segment's total indemnification liability reserve totaled \$21.5 million and \$11.8 million, respectively. The related provision for indemnification losses was \$11.2 million, \$3.1 million, and \$3.2 million during 2020, 2019 and 2018, respectively.

On October 23, 2018, PrimeLending entered into a Settlement Agreement and an Indemnification Agreement with the DOJ and HUD, respectively. These agreements provide for payments of \$13.5 million, in the aggregate, to the DOJ and HUD. In exchange for these payments, each of the DOJ and HUD released any civil claims they may have related to certain loans originated by PrimeLending. The payments were made to the DOJ and HUD during the fourth quarter of 2018, and the indemnification liability related to this matter was released. The mortgage origination segment's operating results or financial condition will not be impacted by this matter in future periods.

## Corporate

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

	Year Ended December 31,			Variance	
	2020	2019	2018	2020 vs 2019	2019 vs 2018
Net interest income (expense)	\$ (14,192)	\$ (5,541)	\$ (9,176)	\$ (8,651)	\$ 3,635
Noninterest income	3,945	2,104	4,798	1,841	(2,694)
Noninterest expense	53,040	50,968	36,628	2,072	14,340
Income (loss) from continuing operations before income taxes	<u>\$ (63,287)</u>	<u>\$ (54,405)</u>	<u>\$ (41,006)</u>	<u>\$ (8,882)</u>	<u>\$ (13,399)</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 2020 was primarily comprised of dividend income from merchant banking investment activities, in addition to interest income earned on intercompany notes.

Interest expense during 2020, 2019 and 2018 was primarily associated with recurring annual interest expense of \$7.7 million incurred on our \$150.0 million aggregate principal amount of 5% senior notes due 2025 ("Senior Notes"). During 2020, we incurred interest expense of \$7.9 million on our \$200 million aggregate principal amount of Subordinated Notes, which we issued in May 2020. Additionally, we incurred interest expense of \$2.8 million, \$3.9 million and \$3.7 million during 2020, 2019 and 2018, respectively, on junior subordinated debentures of \$67.0 million issued by PCC (the "Debentures").

Noninterest income from continuing operations during 2020 and 2019 included activity related to our investment in a new real estate development in Dallas' University Park, Hilltop Plaza, which also serves as headquarters for both Hilltop and the Bank, and net noninterest income associated with activity within our merchant bank subsidiary. Noninterest income during 2018 included a \$5.3 million pre-tax gain on the sale of a merchant bank investment, partially offset by a \$2.5 million charge on a legacy merchant bank equity investment as a result of our periodic fair value assessment, as well as activity related to the Hilltop Plaza investment.

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. During 2020, compared with 2019, the increase in noninterest expenses was primarily due to increased employees' compensation and benefits costs associated with the consolidation of certain common back office functions into corporate and improved operating results, and professional fees, partially offset by a decrease of \$6.8 million of aggregate pre-tax costs associated with the Leadership Changes and efficiency initiative-related charges discussed in the "Factors Affecting Comparability



of Results of Operations” section. During 2019, compared with 2018, the \$14.3 million increase in noninterest expenses was primarily due to Core System Improvements and the Leadership Changes and efficiency initiative-related charges as previously discussed.

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

#### **Insurance Segment**

As previously discussed, on June 30, 2020, we completed the sale of NLC. Accordingly, insurance segment results and its assets and liabilities 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. Income from discontinued operations before income taxes was \$2.1 million, \$17.6 million and \$5.8 million during 2020, 2019 and 2018, respectively.

#### **Corporate**

As a result of the previously noted sale of NLC on June 30, 2020 for cash proceeds of \$154.1 million, 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 was \$36.8 million.

### ***Financial Condition***

The following discussion contains a more detailed analysis of our financial condition at December 31, 2020 as compared to December 31, 2019 and December 31, 2018.

#### **Securities Portfolio**

At December 31, 2020, 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 from continuing operations (in thousands).

	<b>December 31,</b>		
	<b>2020</b>	<b>2019</b>	<b>2018</b>
<b>Trading securities, at fair value</b>			
U.S. Treasury securities	\$ 40,491	\$ —	\$ 7,945
U.S. government agencies:			
Bonds	40	24,680	1,494
Residential mortgage-backed securities	336,081	331,601	309,455
Commercial mortgage-backed securities	876	2,145	4,239
Collateralized mortgage obligations	69,172	191,154	206,813
Corporate debt securities	62,481	36,973	59,293
States and political subdivisions	171,573	93,117	126,748
Unit investment trusts	—	3,468	19,913
Private-label securitized product	8,571	2,992	5,680
Other	4,970	3,446	3,887
	<u>694,255</u>	<u>689,576</u>	<u>745,467</u>
<b>Securities available for sale, at fair value</b>			
U.S. Treasury securities	—	—	11,538
U.S. government agencies:			
Bonds	82,806	85,575	85,611
Residential mortgage-backed securities	641,611	437,029	385,074
Commercial mortgage-backed securities	124,538	12,031	11,772
Collateralized mortgage obligations	565,908	335,616	276,399
Corporate debt securities	—	—	53,302
States and political subdivisions	47,342	41,242	51,962
	<u>1,462,205</u>	<u>911,493</u>	<u>875,658</u>
<b>Securities held to maturity, at amortized cost</b>			
U.S. Treasury securities	—	—	9,903
U.S. government agencies:			
Bonds	—	24,020	39,018
Residential mortgage-backed securities	13,547	17,776	21,993
Commercial mortgage-backed securities	152,820	161,624	87,065
Collateralized mortgage obligations	74,932	113,894	142,474
States and political subdivisions	70,645	69,012	50,649
	<u>311,944</u>	<u>386,326</u>	<u>351,102</u>
<b>Equity securities, at fair value</b>	<u>140</u>	<u>166</u>	<u>19,679</u>
<b>Total securities portfolio</b>	<u>\$ 2,468,544</u>	<u>\$ 1,987,561</u>	<u>\$ 1,991,906</u>

We had net unrealized gains of \$26.3 million and \$11.7 million at December 31, 2020 and 2019, respectively, compared with net unrealized losses of \$10.3 million at December 31, 2018, related to the available for sale investment portfolio. We had net unrealized gains of \$14.7 million and \$2.6 million at December 31, 2020 and 2019, respectively, compared with net unrealized losses associated with the securities held to maturity portfolio of \$9.9 million at December 31, 2018. Equity securities included net unrealized gains of \$0.1 million at both December 31, 2020 and 2019, respectively, compared with net unrealized gains of \$0.1 million at December 31, 2018.

### *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 December 31, 2020, the banking segment's securities portfolio of \$1.8 billion was comprised of trading securities of \$1.1 million, available for sale securities of \$1.5 billion, held to maturity securities of \$311.9 million and equity securities of \$0.1 million, in addition to \$14.8 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 \$693.2 million at December 31, 2020. 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 \$79.8 million at December 31, 2020.

### Corporate

At December 31, 2020, the corporate portfolio included other investments, including those associated with merchant banking, of \$39.0 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 December 31, 2020. In addition, as of December 31, 2020, 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 December 31, 2020.

The following table sets forth the estimated maturities of our debt securities, excluding trading securities, at December 31, 2020. Contractual maturities may be different (dollars in thousands, yields are tax-equivalent).

	<u>One Year Or Less</u>	<u>One Year to Five Years</u>	<u>Five Years to Ten Years</u>	<u>Greater Than Ten Years</u>	<u>Total</u>
<b>U.S. government agencies:</b>					
<b>Bonds:</b>					
Amortized cost	\$ 3,729	\$ 52,684	\$ 5,232	\$ 20,391	\$ 82,036
Fair value	\$ 3,795	\$ 53,710	\$ 5,231	\$ 20,070	\$ 82,806
Weighted average yield	2.83 %	1.18 %	0.79 %	1.00 %	1.18 %
<b>Residential mortgage-backed securities:</b>					
Amortized cost	—	\$ 10	\$ 53,236	\$ 585,164	\$ 638,410
Fair value	—	\$ 11	\$ 55,020	\$ 600,835	\$ 655,866
Weighted average yield	—	2.25 %	3.27 %	1.86 %	1.98 %
<b>Commercial mortgage-backed securities:</b>					
Amortized cost	—	\$ 75,959	\$ 115,853	\$ 85,937	\$ 277,749
Fair value	—	\$ 80,000	\$ 121,178	\$ 85,385	\$ 286,563
Weighted average yield	—	2.78 %	2.05 %	1.51 %	2.08 %
<b>Collateralized mortgage obligations:</b>					
Amortized cost	—	\$ 3,143	\$ 37,601	\$ 593,550	\$ 634,294
Fair value	—	\$ 3,228	\$ 38,315	\$ 601,333	\$ 642,876
Weighted average yield	—	1.84 %	1.14 %	1.09 %	1.09 %
<b>States and political subdivisions:</b>					
Amortized cost	\$ 1,915	\$ 9,723	\$ 20,511	\$ 83,225	\$ 115,374
Fair value	\$ 1,923	\$ 10,200	\$ 21,473	\$ 87,169	\$ 120,765
Weighted average yield	2.56 %	3.63 %	3.50 %	3.44 %	3.45 %
<b>Total securities portfolio:</b>					
Amortized cost	\$ 5,644	\$ 141,519	\$ 232,433	\$ 1,368,267	\$ 1,747,863
Fair value	\$ 5,718	\$ 147,149	\$ 241,217	\$ 1,394,792	\$ 1,788,876
Weighted average yield	2.74 %	2.22 %	2.28 %	1.58 %	1.73 %

## Loan Portfolio

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

Loan Held for Investment	December 31,				
	2020	2019	2018	2017	2016
Commercial real estate	\$ 3,133,903	\$ 3,000,523	\$ 2,940,120	\$ 2,617,520	\$ 2,415,041
Commercial and industrial	2,627,774	2,025,720	1,752,257	1,682,260	1,844,275
Construction and land development	828,852	940,564	932,909	964,320	795,811
1-4 family residential	629,938	791,020	679,263	573,363	501,070
Consumer	35,667	47,046	47,546	40,446	41,352
Broker-dealer	437,007	576,527	578,363	577,889	502,077
	7,693,141	7,381,400	6,930,458	6,455,798	6,099,626
Allowance for credit losses	(149,044)	(61,136)	(59,486)	(63,686)	(54,599)
Loans held for investment, net of allowance	<u>\$ 7,544,097</u>	<u>\$ 7,320,264</u>	<u>\$ 6,870,972</u>	<u>\$ 6,392,112</u>	<u>\$ 6,045,027</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 \$9.6 billion, \$8.6 billion and \$7.5 billion at December 31, 2020, 2019 and 2018, respectively. The banking segment's loan portfolio includes warehouse lines of credit extended to PrimeLending of \$3.3 billion, of which \$2.5 billion, \$1.8 billion and \$1.2 billion was drawn at December 31, 2020, 2019 and 2018, respectively. 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 \$486.7 million in PPP loans at December 31, 2020. While these loans have terms up to 60 months, borrowers can apply for forgiveness of these loans with the SBA. Through February 12, 2021, the SBA had approved approximately 1,500 PPP forgiveness applications totaling approximately \$294 million, with PPP loans of approximately \$171 million pending SBA review and approval. We anticipate a significant amount of these remaining loans pending approval to be forgiven over the next two quarters. The forgiveness or payoff of these loans would generate an increase in interest income as we would recognize the remaining unamortized origination fee at the time of payoff.

At December 31, 2020, 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 and construction and land development loans, which represented 43.2% and 11.4%, respectively, of the banking segment's total loans held for investment at December 31, 2020. The banking segment's loan concentrations were within regulatory guidelines at December 31, 2020.

The following table provides information regarding the maturities of the banking segment's real estate and commercial and industrial gross loans held for investment, net of unearned income (in thousands).

	December 31, 2020			
	Due Within One Year	Due From One To Five Years	Due After Five Years	Total
Real estate	\$ 900,342	\$ 2,164,612	\$ 1,527,739	\$ 4,592,693
Commercial and industrial	4,033,583	976,001	143,613	5,153,197
Total	<u>\$ 4,933,925</u>	<u>\$ 3,140,613</u>	<u>\$ 1,671,352</u>	<u>\$ 9,745,890</u>
Fixed rate loans	\$ 4,647,948	\$ 2,854,709	\$ 1,601,098	\$ 9,103,755
Floating rate loans	285,977	285,904	70,254	642,135
Total	<u>\$ 4,933,925</u>	<u>\$ 3,140,613</u>	<u>\$ 1,671,352</u>	<u>\$ 9,745,890</u>

In the table above, real estate includes commercial real estate, construction and land development and 1-4 family residential loans. Commercial and industrial includes amounts advanced against the warehouse lines of credit extended to PrimeLending, mortgage warehouse lending and PPP loans. Floating rate loans that have reached their applicable rate floor or ceiling are classified as fixed rate loans rather than floating rate loans. As of December 31, 2020, floating rate loans totaling \$2.86 billion had reached their applicable rate floor. The majority of floating rate loans carry an interest rate tied to The Wall Street Journal Prime Rate, as published in The Wall Street Journal.

#### *Broker-Dealer Segment*

The loan portfolio of the broker-dealer segment consists primarily of 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 \$436.8 million, \$576.5 million and \$578.2 million at December 31, 2020, 2019 and 2018, respectively. The decrease during 2020, compared to 2019, was primarily attributable to a decrease of \$54.1 million, or 17.4%, in customer margin accounts and a decrease of \$84.0 million, or 31.8%, in receivables from correspondents. The decrease during 2019, compared to 2018, was primarily attributable to a decrease of \$22.3 million in customer margin accounts, partially offset by an increase of \$20.5 million in receivables from correspondents.

#### *Mortgage Origination Segment*

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

	<b>December 31,</b>		
	<u>2020</u>	<u>2019</u>	<u>2018</u>
Loans held for sale:			
Unpaid principal balance	\$ 2,411,626	\$ 1,878,231	\$ 1,213,068
Fair value adjustment	109,778	57,482	44,707
	<u>\$ 2,521,404</u>	<u>\$ 1,935,713</u>	<u>\$ 1,257,775</u>
IRLCs:			
Unpaid principal balance	\$ 2,470,013	\$ 914,526	\$ 677,267
Fair value adjustment	76,048	18,222	17,421
	<u>\$ 2,546,061</u>	<u>\$ 932,748</u>	<u>\$ 694,688</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 December 31, 2020, 2019 and 2018 were \$4.0 billion, \$2.2 billion and \$1.4 billion, respectively, while the related estimated fair values were (\$28.0) million, (\$3.8) million and (\$11.6) 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” included in this 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 and the Bank’s board of directors.

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 repayment assumptions and macroeconomic conditions and forecasts.

The COVID-19 pandemic has resulted in a weak labor market and weak overall economic conditions that will affect borrowers across our lending portfolios and significant judgment is required to estimate the severity and duration of the current economic downturn, as well as its potential impact on borrower defaults and loss severity. In particular, macroeconomic conditions and forecasts regarding the duration and severity of the economic downturn are rapidly changing and remain highly uncertain as the resurgence of COVID-19 cases evolves 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 government stimulus, customer relief and enhanced unemployment benefits should help mitigate in the short term, but the extent and duration of government stimulus as well as performance of payment deferral programs 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 December 31, 2020, we utilized a single macroeconomic baseline scenario published by a third party in December 2020.

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

		As of			
		December 31, 2020	September 30, 2020	June 30, 2020	March 31, 2020
GDP growth rates:					
	Q1 2020				(2.5)%
	Q2 2020			(33.4)%	(18.3)%
	Q3 2020		26.6%	19.8%	10.9%
	Q4 2020	4.0%	2.9%	0.1%	2.4%
	Q1 2021	1.6%	3.6%	0.2%	2.6%
	Q2 2021	4.5%	3.1%	1.8%	3.3%
	Q3 2021	4.7%	4.4%	8.5%	5.1%
	Q4 2021	5.8%	6.0%	7.3%	
	Q1 2022	4.8%	5.5%		
	Q2 2022	4.4%			
Unemployment rates:					
	Q1 2020				3.8%
	Q2 2020			14.0%	8.7%
	Q3 2020		8.9%	9.1%	6.3%
	Q4 2020	6.7%	9.1%	9.5%	6.5%
	Q1 2021	6.9%	8.9%	9.7%	6.7%
	Q2 2021	7.1%	8.7%	9.7%	6.7%
	Q3 2021	7.0%	8.3%	9.2%	6.6%
	Q4 2021	6.8%	7.8%	8.7%	
	Q1 2022	6.5%	7.3%		
	Q2 2022	6.2%			

The baseline economic forecast used to determine our best estimate of expected credit losses as of March 31, 2020 assumed a severe, but short U.S. recession during the first half of 2020 with growth rates down, followed by a strong economic recovery as businesses re-open, consumer spending increases during the second half of 2020 and positive GDP growth rates. The unemployment rates were expected to remain elevated into the fourth quarter of 2021, then revert to historical data in the fourth quarter of 2022. Management’s recovery assumptions included some expected benefit of COVID-19 related fiscal and monetary stimulus measures and the expected beneficial impacts of the CARES Act and certain regulatory interagency guidance.

As of June 30, 2020, our best estimate of expected credit losses used a baseline economic forecast that continued to assume the Federal Reserve target range of the federal funds rate at 0% to 0.25% into 2023, but was updated for continued deterioration in the U.S. economic outlook due to COVID-19 conditions. Compared to assumptions as of March 31, 2020, GDP growth rates declined significantly in the second quarter of 2020, but reflected higher recovery in the third quarter of 2020. Unemployment rates were forecasted to be at higher levels than those assumed as of March 31, 2020 into the fourth quarter of 2022. The timing of the release in early June 2020 of the third party’s baseline forecast utilized did not assume a second wave of COVID-19 cases into the summer months, so the model results as of June 30, 2020 were qualitatively adjusted to consider recent developments in Texas, uncertainty in Texas’ economic re-opening plan and such impacts on our most adversely impacted loan portfolios. Qualitative adjustments considered both significant government relief programs and stimulus, as well as certain model limitations with the current economic forecast and recent commodity price shocks not observed in historical data.

As of September 30, 2020, our near-term baseline economic forecast improved from June 30, 2020, reflecting better than expected economic data as states progressed with their re-opening plans. Projected real GDP growth rates were revised for the third quarter of 2020 as economic data suggested the assumed peak-to-trough decline in real GDP during the second quarter of 2020 was significant, but not as severe as expected. As such, projected real GDP growth in the third and fourth quarters of 2020 were revised upward to reflect monthly recovery trends in consumer and government spending observed in July and August. Projected near-term unemployment rates were adjusted lower to reflect the initial phase of the labor market recovery as states re-opened and temporarily furloughed workers are recalled to their jobs. Our interest rate expectations continued to assume monetary policy supported the Federal Reserve target range of the federal funds rate at 0% to 0.25% into late 2023. However, baseline assumptions around fiscal policy and additional government

stimulus were revised lower as it was uncertain whether additional stimulus legislation would be passed before early 2021 and how its delay would affect our most adversely impacted loan portfolios.

As of December 31, 2020, our near-term baseline 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 fourth quarter of 2020 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 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 levels in late 2024. Prior quarter forecasts as of September 30, 2020 assumed declines through 2021 and recovery to pre-COVID levels in mid-2023. Our interest rate expectations continued to assume monetary policy supported the Federal Reserve target range of the federal funds rate at 0% to 0.25% into late 2023.

Since December 31, 2019, our baseline economic forecast changed significantly year-over-year in response to weak economic conditions caused by the COVID pandemic as developments occurred rapidly in February and March 2020. 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 Q4 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 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 is 3.1% higher than the unemployment rate as of December 31, 2019. Annualized real GDP growth rates declined -31.4% in Q2 2020 and increased 33.4% in Q3 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 Q4 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 2020, the significant build in the allowance included provision for credit losses on individually evaluated loans of \$20.2 million, while the provision for credit losses on expected losses of collectively evaluated loans accounted for \$76.1 million of the total provision primarily due to the identified changes in the Bank's loan portfolio composition and credit quality and 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 change in the allowance for credit losses during 2020 was primarily attributable to the Bank and also reflected other factors including, but not limited to, loan growth, loan mix, and changes in risk rating grades, macroeconomic factor assumptions and qualitative factors. The change in the allowance during 2020 was also impacted by net charge-offs of \$21.1 million, primarily associated with loans specifically reserved for during the first quarter of 2020.

As discussed under the section entitled "Loan Portfolio" earlier in this Item 7, the Bank's actions, beginning in the second quarter 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 2.48%.



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).

December 31, 2020	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
Commercial real estate	\$ 3,133,903	\$ 109,629	3.50 %	\$ 192,801	\$ 34,239	17.76 %
Commercial and industrial <sup>(1)</sup>	1,348,253	27,298	2.02 %	14,721	6,370	43.27 %
Construction and land development	828,852	6,677	0.81 %	24,954	662	2.65 %
1-4 family residential	629,938	3,946	0.63 %	7,727	225	2.91 %
Consumer	35,667	876	2.46 %	—	—	— %
	<u>5,976,613</u>	<u>148,426</u>	2.48 %	<u>240,203</u>	<u>41,496</u>	17.28 %
Broker-dealer	437,007	213	0.05 %	—	—	— %
Mortgage warehouse lending	792,806	405	0.05 %	—	—	— %
Paycheck Protection Program	486,715	—	— %	—	—	— %
	<u>\$ 7,693,141</u>	<u>\$ 149,044</u>	1.94 %	<u>\$ 240,203</u>	<u>\$ 41,496</u>	17.28 %

(1) Commercial and industrial portfolio amounts reflect balances excluding broker-dealer segment margin loans and 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 December 31, 2020, excluding loans in the broker-dealer segment margin, 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 baseline economic forecast, the upside scenario assumes consumer and business confidence increases as successful developments in vaccines and medical treatments slow the progression of the virus and most businesses affected by local restrictions reopen earlier than expected. Real GDP growth is expected to grow 5.1% in the first quarter of 2021, 8.0% in the second quarter of 2021, 7.0% in the third quarter of 2021 and 8.7% in the fourth quarter of 2021. Average unemployment rates decline to 5.0% by the end of 2021 and 3.8% by the end of 2022. Monetary and fiscal policy assumptions include the Federal Reserve maintaining a near 0% target for the federal funds rate through mid-2022 and \$900 billion of additional stimulus payments are approved consistent with the baseline economic forecast.

Compared to our baseline economic forecast, the downside scenario assumes consumer and business confidence continues to decline as infections rise, while consumer concerns regarding vaccines and medical treatments increase in the short-term. As the number of new cases rise, some nonessential businesses are forced to close again, and most businesses affected by local restrictions reopen slower than expected. Real GDP growth is expected to decrease 4.9% in the first quarter of 2021, 3.2% in the second quarter of 2021 and 0.3% in the third quarter of 2021, then is expected to grow 2.3% in the fourth quarter of 2021 and 2.3% in the first quarter of 2022. Average unemployment rates increase to 9.8% by the fourth quarter of 2021 and improve modestly to 8.6% by the end of 2022. Unemployment is expected to remain elevated, but improve to 6.4% in 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 early 2025, while disagreements in Congress prevent any additional stimulus from being enacted at all, resulting in no expanded programs for unemployment insurance benefits or state and local governments.

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 \$26 million or a weighted average expected loss rate of 1.77% 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 \$94 million or a weighted average expected loss rate of 3.83% 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 development 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 present 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.

<b>Loans Held for Investment</b>	<b>Year Ended December 31,</b>				
	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Balance, beginning of year	\$ 61,136	\$ 59,486	\$ 63,686	\$ 54,599	\$ 46,947
Transition adjustment for adoption of CECL accounting standard	12,562	—	—	—	—
Provision for credit losses	96,491	7,206	5,088	14,271	40,620
Recoveries of loans previously charged off:					
Commercial real estate	613	6	—	46	172
Commercial and industrial	1,834	2,829	4,273	1,833	1,931
Construction and land development	2	—	6	7	—
1-4 family residential	54	61	146	201	344
Consumer	392	37	64	79	123
Broker-dealer	—	—	—	—	—
Total recoveries	<u>2,895</u>	<u>2,933</u>	<u>4,489</u>	<u>2,166</u>	<u>2,570</u>
Loans charged off:					
Commercial real estate	4,517	1,160	800	764	1,362
Commercial and industrial	18,158	5,924	12,741	6,253	33,776
Construction and land development	2	—	—	13	—
1-4 family residential	748	907	143	112	196
Consumer	615	498	93	208	203
Broker-dealer	—	—	—	—	1
Total charge-offs	<u>24,040</u>	<u>8,489</u>	<u>13,777</u>	<u>7,350</u>	<u>35,538</u>
Net charge-offs	<u>(21,145)</u>	<u>(5,556)</u>	<u>(9,288)</u>	<u>(5,184)</u>	<u>(32,968)</u>
Balance, end of year	<u>\$ 149,044</u>	<u>\$ 61,136</u>	<u>\$ 59,486</u>	<u>\$ 63,686</u>	<u>\$ 54,599</u>
Allowance for credit losses as a percentage of gross loans held for investment	<u>1.94 %</u>	<u>0.83 %</u>	<u>0.86 %</u>	<u>0.99 %</u>	<u>0.90 %</u>

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 is presented in the tables below (dollars in thousands).

	December 31,									
	2020		2019		2018		2017		2016	
	Reserve	% of Gross Loans	Reserve	% of Gross Loans	Reserve	% of Gross Loans	Reserve	% of Gross Loans	Reserve	% of Gross Loans
Commercial real estate	\$ 109,629	40.74 %	\$ 31,595	40.65 %	\$ 27,100	42.42 %	\$ 29,142	42.82 %	\$ 22,675	42.61 %
Commercial and industrial	27,703	34.16 %	17,964	27.44 %	21,980	25.28 %	23,674	26.04 %	21,369	30.19 %
Construction and land development	6,677	10.77 %	4,878	12.74 %	6,061	13.46 %	7,844	14.91 %	7,002	12.90 %
1-4 family residential	3,946	8.19 %	6,386	10.72 %	3,956	9.80 %	2,362	6.65 %	2,974	5.39 %
Consumer	876	0.46 %	265	0.64 %	267	0.69 %	311	0.63 %	424	0.68 %
Broker-dealer	213	5.68 %	48	7.81 %	122	8.35 %	353	8.95 %	155	8.23 %
Total	<u>\$ 149,044</u>	<u>100.00 %</u>	<u>\$ 61,136</u>	<u>100.00 %</u>	<u>\$ 59,486</u>	<u>100.00 %</u>	<u>\$ 63,686</u>	<u>100.00 %</u>	<u>\$ 54,599</u>	<u>100.00 %</u>

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

	December 31, 2020	September 30, 2020	June 30, 2020	March 31, 2020	December 31, 2019
Commercial real estate	\$ 109,629	\$ 104,566	\$ 106,551	\$ 53,939	\$ 31,595
Commercial and industrial	27,703	38,178	31,863	38,550	17,964
Construction and land development	6,677	6,270	8,393	6,360	4,878
1-4 family residential	3,946	5,052	7,399	6,365	6,386
Consumer	876	1,002	1,429	1,203	265
Broker-dealer	213	146	748	322	48
	<u>\$ 149,044</u>	<u>\$ 155,214</u>	<u>\$ 156,383</u>	<u>\$ 106,739</u>	<u>\$ 61,136</u>

The increase in the allowance for credit losses for loans held for investment subsequent to December 31, 2019 in the table above was primarily attributable to the adoption of the new CECL standard as of January 1, 2020 and a deteriorating economic outlook associated with the impact of the market disruption caused by COVID-19 conditions. As previously noted, CECL requires that we reflect the expansion of the loss horizon to life of loan and take into account forecasts of expected future macroeconomic conditions in our determination of the allowance for credit losses.

#### *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).

	Year Ended December 31,		
	2020	2019	2018
Balance, beginning of year	\$ 2,075	\$ 2,366	\$ 1,932
Transition adjustment CECL accounting standard	3,837	—	—
Other noninterest expense	2,476	(291)	434
Balance, end of year	<u>\$ 8,388</u>	<u>\$ 2,075</u>	<u>\$ 2,366</u>

At December 31, 2020, the reserve for unfunded commitments was \$8.4 million, compared to \$2.1 million and \$2.4 million at December 31, 2019 and 2018, respectively. 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 2020, the increase in the reserve for unfunded commitments was primarily due to economic uncertainties associated with the impact of the market disruption caused by COVID-19 conditions.

#### *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 seven credit relationships totaling \$11.3 million of potential problem loans at December 31, 2020, compared with five credit relationships totaling \$16.8 million of potential problem loans at December 31, 2019 and seven credit relationships totaling \$17.8 million of potential problem loans at December 31, 2018.

#### *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 requirements for certain loan modifications to be categorized as a TDR. Starting in March, 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 entitled "Loan Portfolio" earlier in this Item 7, the Bank's actions during the third and fourth quarters of 2020 included approval of an additional \$75 million of new COVID-19 related loan modifications since June 30, 2020. The portfolio of active deferrals that have not reached the end of their deferral period was approximately \$240 million as of December 31, 2020, of which approximately \$90 million had received an additional deferral. COVID-19 related loan modifications of approximately \$714 million have returned to agreed-upon contractual terms and had made at least one required principal and/or interest payment since the end of their initial deferral period. Such loans represent elevated risk, 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).

	December 31,				
	2020	2019	2018	2017	2016
Loans accounted for on a non-accrual basis:					
Commercial real estate	\$ 11,133	\$ 7,308	\$ 5,324	\$ 19,724	\$ 13,351
Commercial and industrial	34,049	15,262	14,870	20,878	13,932
Construction and land development	507	1,316	3,278	611	755
1-4 family residential	32,263	12,204	10,437	4,358	244
Consumer	28	26	41	56	—
Broker-dealer	—	—	—	—	—
	<u>\$ 77,980</u>	<u>\$ 36,116</u>	<u>\$ 33,950</u>	<u>\$ 45,627</u>	<u>\$ 28,282</u>
Troubled debt restructurings included in accruing loans held for investment	1,954	2,173	1,339	1,433	1,699
Non-performing loans	<u>\$ 79,934</u>	<u>\$ 38,289</u>	<u>\$ 35,289</u>	<u>\$ 47,060</u>	<u>\$ 29,981</u>
Non-performing loans as a percentage of total loans <sup>(1)</sup>	<u>0.76 %</u>	<u>0.40 %</u>	<u>0.41 %</u>	<u>0.58 %</u>	<u>0.39 %</u>
Other real estate owned	<u>\$ 21,289</u>	<u>\$ 18,202</u>	<u>\$ 27,578</u>	<u>\$ 40,627</u>	<u>\$ 56,149</u>
Other repossessed assets	<u>\$ 101</u>	<u>\$ —</u>	<u>\$ 68</u>	<u>\$ 323</u>	<u>\$ 1,117</u>
Non-performing assets <sup>(1)</sup>	<u>\$ 101,324</u>	<u>\$ 56,491</u>	<u>\$ 62,935</u>	<u>\$ 88,010</u>	<u>\$ 87,247</u>
Non-performing assets as a percentage of total assets <sup>(1)</sup>	<u>0.60 %</u>	<u>0.37 %</u>	<u>0.46 %</u>	<u>0.65 %</u>	<u>0.68 %</u>
Loans past due 90 days or more and still accruing	<u>\$ 243,630</u>	<u>\$ 102,707</u>	<u>\$ 83,131</u>	<u>\$ 85,396</u>	<u>\$ 47,659</u>

(1) Noted balances and percentages during all prior periods reflect reclassifications to conform to current period presentation.

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 December 31, 2019, non-accrual loans included 23 commercial and industrial relationships with loans secured by accounts receivable, life insurance, oil and gas, livestock and equipment. Non-accrual loans at December 31, 2019 also included \$4.8 million of loans secured by residential real estate which were classified as loans held for sale. At December 31, 2018, non-accrual loans included 16 commercial and industrial relationships with loans secured by accounts receivable, life insurance, livestock, oil and gas, and equipment. Non-accrual loans at December 31, 2018 also included \$3.4 million of loans secured by residential real estate which were classified as loans held for sale.

At December 31, 2020, TDRs were comprised of \$2.0 million of loans that were considered to be performing and accruing, and of \$16.0 million of loans considered to be non-performing reported in non-accrual loans. At December 31, 2019, TDRs were comprised of \$2.2 million of loans that were considered to be performing and accruing, and \$11.9 million of loans considered to be non-performing reported in non-accrual loans. At December 31, 2018, TDRs were comprised of \$1.3 million related to loans that were considered to be performing and accruing, and of \$5.9 million of loans 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.

OREO increased from December 31, 2019 to December 31, 2020, primarily due to additions totaling \$13.9 million, partially offset by disposals of \$10.8 million. OREO as of December 31, 2019 decreased from December 31, 2018 primarily due to \$14.0 million of disposals and fair value decreases, partially offset by additions of totaling \$4.6 million. OREO as of December 31, 2018 decreased from December 31, 2017 due to \$16.7 million of disposals and fair value decreases, partially offset by additions totaling \$6.7 million. At both December 31, 2020 and 2019, OREO was primarily comprised of commercial properties.

Loans past due 90 days or more and still accruing at December 31, 2020, 2019 and 2018 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 December 31, 2020, \$198.8 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 December 31, 2020. As of December 31, 2020, \$142.1 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).

	Year Ended December 31,					
	2020		2019		2018	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
Noninterest-bearing demand deposits	\$ 3,304,475	0.00 %	\$ 2,635,924	0.00 %	\$ 2,504,599	0.00 %
Interest-bearing demand deposits	5,284,582	0.31 %	4,283,642	0.98 %	4,025,259	0.66 %
Savings deposits	231,996	0.07 %	186,235	0.19 %	201,328	0.11 %
Time deposits	1,880,543	1.11 %	1,446,614	2.02 %	1,341,886	1.42 %
	<u>\$ 10,701,596</u>	<u>0.35 %</u>	<u>\$ 8,552,415</u>	<u>0.84 %</u>	<u>\$ 8,073,072</u>	<u>0.57 %</u>

The maturity of consolidated interest-bearing time deposits of \$100,000 or more at December 31, 2020 is set forth in the table below (in thousands).

Months to maturity:	
3 months or less	\$ 386,037
3 months to 6 months	393,175
6 months to 12 months	536,333
Over 12 months	183,599
	<u>\$ 1,499,144</u>

The banking segment experienced an increase of \$384 million in interest-bearing time deposits of \$100,000 or more at December 31, 2020, compared to December 31, 2019. The increase during 2020, compared to 2019, was primarily due to an increase in the use of brokered certificates of deposit to strengthen the Bank's available liquidity position given the economic uncertainties associated with the impact of the market disruption caused by COVID-19 conditions. This is compared to an increase of \$96 million in interest-bearing time deposits of \$100,000 or more at December 31, 2019, compared to December 31, 2018. The increase during 2019, compared to 2018, was primarily due customers locking in higher rates before the federal funds interest rate started to decrease during 2019 and a more competitive deposit pricing environment. At December 31, 2020, there were \$1.5 billion in interest-bearing time deposits scheduled to mature within one year.

## Borrowings

Our borrowings associated with continuing operations are shown in the table below (dollars in thousands).

	December 31,					
	2020		2019		2018	
	Balance	Average Rate Paid	Balance	Average Rate Paid	Balance	Average Rate Paid
Short-term borrowings	\$ 695,798	1.46 %	\$ 1,424,010	2.41 %	\$ 1,065,807	2.15 %
Notes payable	381,987	4.54 %	256,269	4.70 %	201,372	4.72 %
Junior subordinated debentures	67,012	4.13 %	67,012	5.75 %	67,012	5.47 %
	<u>\$ 1,144,797</u>	<u>2.51 %</u>	<u>\$ 1,747,291</u>	<u>2.90 %</u>	<u>\$ 1,334,191</u>	<u>2.63 %</u>

Short-term borrowings has historically 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 \$728.2 million decrease in short-term borrowings at December 31, 2020, compared with December 31, 2019, included a decrease in borrowings in our banking and broker-dealer segments primarily associated with the increased utilization of available internal funds, a decrease in FHLB borrowings and a decrease in securities sold under agreements to repurchase by the Hilltop Broker-Dealers, partially offset by an increase in commercial paper used by the Hilltop Broker-Dealers to finance their activities. The \$358.2 million increase in short-term borrowings at December 31, 2019 compared with December 31, 2018 included a net increase of \$363.7 million in our banking segment primarily associated with increases in FHLB notes, partially offset by a net decrease of \$5.5 million in short-term bank loans, securities sold under agreements to repurchase and commercial paper used by the Hilltop Broker-Dealers to finance their activities.

Notes payable at December 31, 2020 of \$382.0 million was comprised of \$148.9 million related to Senior Notes, net of loan origination fees, Subordinated Notes, net of origination fees, of \$196.8 million and mortgage origination segment borrowings of \$36.2 million. Notes payable at December 31, 2019 of \$283.8 million was comprised of \$148.8 million related to Senior Notes, net of loan origination fees, FHLB borrowings with an original maturity greater than one year within our banking segment of \$28.8 million, and mortgage origination segment borrowings of \$78.7 million. Notes payable at December 31, 2018 of \$228.9 million was comprised of \$148.6 million related to Senior Notes, net of loan origination fees, FHLB borrowings with an original maturity greater than one year held within our banking segment of \$4.4 million, and mortgage origination segment borrowings of \$48.4 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 December 31, 2020, Hilltop had \$374.8 million in cash and cash equivalents, an increase of \$269.2 million from \$105.6 million at December 31, 2019. This increase in cash and cash equivalents was primarily due to the receipt of \$196.6 million in net proceeds associated with the Subordinated Notes offering, cash proceeds of \$154.1 million from the completed sale of NLC and \$207.2 million of dividends from subsidiaries, partially offset by \$32.5 million in cash dividends declared, \$208.7 million of stock repurchases, including through the tender offer completed in November 2020, and other general corporate expenses. Subject to regulatory restrictions, Hilltop has received, and may also continue to receive, dividends from its subsidiaries. If necessary or appropriate, we may also finance acquisitions with the proceeds from equity or debt issuances. We believe that Hilltop’s liquidity is sufficient for the foreseeable future, with current short-term liquidity needs including operating expenses, interest on debt obligations, dividend payments to stockholders and potential stock repurchases.

### ***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, including a significant decline in corporate debt and equity issuances and a deterioration in the mortgage servicing and commercial paper markets, we took a number of precautionary actions in March to enhance our financial flexibility by bolstering our cash position to ensure we have adequate cash readily available to meet both expected and unexpected funding needs without adversely affecting our daily operations.

The FOMC reduced the target range for short-term rates by 150 basis points to a range of 0% to 0.25% during March 2020 to support the economy and potentially reduce the impacts from the COVID-19 pandemic. As a result of these rate adjustments and the stressed economic outlook, mortgage rates fell to historically low levels, which resulted in significant growth in mortgage originations at both PrimeLending and Hilltop Securities through its partnerships with certain housing finance authorities. To strengthen the Bank’s available liquidity position, we raised brokered deposits that totaled \$1.4 billion at June 30, 2020, as well as swept an additional \$200 million of deposits from Hilltop Securities into the Bank, bringing the total funds swept from Hilltop Securities to approximately \$1.5 billion until June 2020 when the total funds swept was reduced back to \$1.3 billion at June 30, 2020. During the third and fourth quarters of 2020, given the continued strong cash and liquidity levels at the Bank, brokered deposits declined to \$731.0 million and \$1.0 billion as of December 31, 2020 and September 30, 2020, respectively, and the total funds swept from Hilltop Securities into the Bank was reduced further to approximately \$700 million and \$900 million as of December 31, 2020 and September 30, 2020, respectively.

Further, during March 2020, we substantially reduced the trading portfolio inventory limits at Hilltop Securities in an effort to protect capital, minimize losses and ensure target liquidity levels throughout the crisis. During March 2020, the capital markets experienced significant friction and in certain portions of the market, liquidity was not prevalent. In particular for us, the market for municipal securities, collateralized mortgage obligations, mortgage derivatives and GNMA mortgage pools experienced significant liquidity stress at points during the month. The Federal Reserve, in partnership with the Treasury of the United States, has stepped in to provide additional liquidity in each of these critical markets. We will continue to evaluate market conditions and determine the appropriateness of capital market inventory limits.

To meet demand for customer loan advances and satisfy our obligations to repay long-term 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 further or for an extended period.

#### *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.

#### *NLC Sale*

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 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. We also agreed to enter into an agreement at closing to refrain for a specified period from certain activities that compete with the business of NLC. As a result, NLC’s results and its assets and liabilities have been presented as discontinued operations in the consolidated financial statements, and we no longer have an insurance segment.

#### *Dividend Program and Declaration*

In October 2016, we announced that our board of directors authorized a dividend program under which we intend to pay quarterly dividends on our common stock, subject to quarterly declarations by our board of directors. During 2020, we declared and paid cash dividends of \$0.36 per common share, or \$32.5 million.

On January 28, 2021, our board of directors declared a quarterly cash dividend of \$0.12 per common share, payable on February 26, 2021 to all common stockholders of record as of the close of business on February 15, 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 are authorized to repurchase, in the aggregate, up to \$75.0 million of our outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation. Under the stock repurchase program authorized, we may repurchase shares in the open market or through privately negotiated transactions as permitted under Rule 10b-18 promulgated under the Exchange Act. The extent to which we repurchase our shares and the timing of such repurchases depends upon market conditions and other corporate considerations, as determined by Hilltop’s management team. Repurchased shares will be returned to our pool of authorized but unissued shares of common stock.

During 2020, we paid \$15.2 million to repurchase an aggregate of 720,901 shares of common stock at a weighted average price of \$21.13 per share. The purchases were funded from available cash balances.



### *Senior Notes due 2025*

On April 9, 2015, we completed an offering of \$150.0 million aggregate principal amount of our 5% senior notes due 2025 (“Senior Unregistered Notes”) in a private offering that was exempt from the registration requirements of the Securities Act. The Senior Unregistered Notes were offered within the United States only to qualified institutional buyers pursuant to Rule 144A under the Securities Act, and to persons outside of the United States under Regulation S under the Securities Act. The Senior Unregistered Notes were issued pursuant to an indenture, dated as of April 9, 2015 (the “indenture”), by and between Hilltop and U.S. Bank National Association, as trustee. The net proceeds from the offering, after deducting estimated fees and expenses and the initial purchasers’ discounts, were approximately \$148 million. We used the net proceeds of the offering to redeem all of our outstanding Series B Preferred Stock at an aggregate liquidation value of \$114.1 million, plus accrued but unpaid dividends of \$0.4 million, and Hilltop utilized the remainder for general corporate purposes.

In connection with the issuance of the Senior Unregistered Notes, on April 9, 2015, we entered into a registration rights agreement with the initial purchasers of the Senior Unregistered Notes. Under the terms of the registration rights agreement, we agreed to offer to exchange the Senior Unregistered Notes for notes registered under the Securities Act (the “Senior Registered Notes”). The terms of the Senior Registered Notes are substantially identical to the Senior Unregistered Notes for which they were exchanged (including principal amount, interest rate, maturity and redemption rights), except that the Senior Registered Notes generally are not subject to transfer restrictions. On May 22, 2015, and subject to the terms and conditions set forth in the Senior Registered Notes prospectus, we commenced an offer to exchange the outstanding Senior Unregistered Notes for Senior Registered Notes. Substantially all of the Senior Unregistered Notes were tendered for exchange, and on June 22, 2015, we fulfilled all of the requirements of the registration rights agreement for the Senior Unregistered Notes by issuing Senior Registered Notes in exchange for the tendered Senior Unregistered Notes. We refer to the Senior Registered Notes and the Senior Unregistered Notes that remain outstanding collectively as the “Senior Notes.”

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 December 31, 2020, \$150.0 million of our Senior Notes was outstanding.

The indenture contains covenants that limit our ability to, among other things and subject to certain significant exceptions: (i) dispose of or issue voting stock of certain of our bank subsidiaries or subsidiaries that own voting stock of our bank subsidiaries, (ii) incur or permit to exist any mortgage, pledge, encumbrance or lien or charge on the capital stock of certain of our bank subsidiaries or subsidiaries that own capital stock of our bank subsidiaries and (iii) sell all or substantially all of our assets or merge or consolidate with or into other companies. The indenture also provides for certain events of default, which, if any of them occurs, would permit or require the principal amount, premium, if any, and accrued and unpaid interest on the then outstanding Senior Notes to be declared immediately due and payable.

### *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. We intend to use the net proceeds of the offerings for general corporate purposes.

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 December 31, 2020, \$200 million of our Subordinated Notes was outstanding.

### *Junior Subordinated Debentures*

The Debentures have a stated term of 30 years with maturities ranging from July 2031 to February 2038 with interest payable quarterly. The rate on the Debentures, which resets quarterly, is three-month LIBOR plus an average spread of 3.22%. The total average interest rate at December 31, 2020 was 3.45%. The Debentures are callable at PCC's discretion with a minimum of a 45 to 60-day notice. At December 31, 2020, \$67.0 million of PCC's Debentures were outstanding.

### *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.

Under the comprehensive capital framework ("Basel III") for U.S. banking organizations, total capital consists of two tiers of capital, Tier 1 and Tier 2. Tier 1 capital is further composed of common equity Tier 1 capital and additional Tier 1 capital. Total capital is the sum of Tier 1 capital and Tier 2 capital. We perform reviews of the classification and calculation of risk-weighted assets to ensure accuracy and compliance with the Basel III regulatory capital requirements. 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.

Bank holding companies with less than \$15 billion in assets as of December 31, 2009 are allowed to include junior subordinated debentures in Tier 1 capital, subject to certain restrictions. However, because Hilltop has grown above \$15 billion in assets, if we make an acquisition in the future, the debentures issued to the Trusts may be phased out of Tier 1 and into Tier 2 capital. All of the debentures issued to the PCC Statutory Trusts I, II, III and IV (the "Trusts"), less the common stock of the Trusts, qualified as Tier 1 capital as of December 31, 2020, under guidance issued by the Board of Governors of the Federal Reserve System.

Actual capital amounts and ratios as of December 31, 2020 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 December 31, 2020, Hilltop had a total capital to risk weighted assets ratio of 22.34%, Tier 1 capital to risk weighted assets ratio of 19.57%, common equity Tier 1 capital to risk weighted assets ratio of 18.97% and a Tier 1 capital to average assets, or leverage, ratio of 12.64%. 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 December 31, 2020, PlainsCapital had a total capital to risk weighted assets ratio of 15.27%, Tier 1 capital to risk weighted assets ratio of 14.40%, common equity Tier 1 capital to risk weighted assets ratio of 14.40%, and a Tier 1 capital to average assets, or leverage, ratio of 10.44%. 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 24 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 this Annual Report.

### *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, to ensure we have adequate cash readily available 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 that totaled \$731 million at December 31, 2020, down from \$1.4 billion at June 30, 2020. Further, beginning in March 2020, an additional \$200 million of deposits was swept from Hilltop Securities into the Bank, bringing the total funds swept from Hilltop Securities to approximately \$1.5 billion until June 2020 when the total funds swept was reduced back to \$1.3 billion at June 30, 2020. During the third and fourth quarters of 2020, given the continued strong cash and liquidity levels at the Bank, the total funds swept from Hilltop Securities into the Bank was reduced further to approximately \$900 million as of September 30, 2020, and then approximately \$700 million as of December 31, 2020. 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).

	December 31,	
	2020	2019
FHLB capacity	\$ 4,410	\$ 3,207
Investment portfolio (available)	982	683
Fed deposits (excess daily requirements)	875	217
	<u>\$ 6,267</u>	<u>\$ 4,107</u>

As noted in the table above, the Bank’s available liquidity position and borrowing capacity at December 31, 2020 is 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 is uncertain, the Bank is targeting available liquidity of between approximately \$5 billion and \$6 billion during 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 experienced 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 9.58% of the Bank’s total deposits, and the Bank’s five largest depositors, excluding Hilltop and Hilltop Securities, collectively accounted for 4.40% of the Bank’s total deposits at December 31, 2020. 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 December 31, 2020, 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 December 31, 2020, Hilltop Securities had no borrowings under its credit arrangements or its credit facilities.

During the fourth quarter of 2019, Hilltop Securities initiated two commercial paper programs, in the ordinary course of its business, of which the net proceeds (after deducting related issuance expenses) from the sale will be used 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 discount to maturity will be based on an interest factor and the CP Notes are secured by a pledge of collateral owned by Hilltop Securities. As of December 31, 2020, the weighted average maturity of the CP Notes was 146 days at a rate of 1.23%, with a weighted average remaining life of 70 days. At December 31, 2020, the amount outstanding under these secured arrangements was \$277.6 million, which was collateralized by securities held for firm accounts valued at \$296.3 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 December 31, 2020. 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 outstanding at December 31, 2020.

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 December 31, 2020, 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 December 31, 2020, Ventures Management had outstanding borrowings of \$47.5 million, \$11.3 million of which was with the Bank.

## ***Contractual Obligations***

The following table presents information regarding our contractual obligations at December 31, 2020 (in thousands). Payments related to leases are based on actual payments specified in the underlying contracts, and the table below includes all leases that had commenced as of December 31, 2020. Payments related to short-term borrowings and long-term debt obligations include the estimated contractual interest payments under the respective agreements.

	<b>Payments Due by Period</b>				<b>Total</b>
	<b>1 year or Less</b>	<b>More than 1 Year but Less than 3 Years</b>	<b>3 Years or More but Less than 5 Years</b>	<b>5 Years or More</b>	
Short-term borrowings	\$ 700,264	\$ —	\$ —	\$ —	\$ 700,264
Long-term debt obligations	59,290	43,755	188,443	398,852	690,340
Finance lease obligations	1,212	2,521	2,049	1,411	7,193
Operating lease obligations	36,132	50,834	26,572	29,636	143,174
Total	<u>\$ 796,898</u>	<u>\$ 97,110</u>	<u>\$ 217,064</u>	<u>\$ 429,899</u>	<u>\$ 1,540,971</u>

In addition to the contractual obligations presented above, during 2018, Hilltop and the Bank entered into leases for a majority of the available corporate office space in Hilltop Plaza to serve as the headquarters for both companies as well as retail space for a PlainsCapital Bank branch. The two separate 129-month office and retail leases, which commenced in February 2020, have combined total base rent of approximately \$35 million with the first nine months of rent abated.

## ***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 \$1.9 billion at December 31, 2020 and outstanding financial and performance standby letters of credit of \$91.5 million at December 31, 2020.

### *Broker-Dealer Segment*

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

### *Critical Accounting Policies and Estimates*

Our accounting policies are fundamental to understanding our management's discussion and analysis of our results of operations and financial condition. Our significant accounting policies are presented in Note 1 to our consolidated financial statements, which are included in this Annual Report. 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. Actual amounts 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. The significant accounting policies, as summarized below, 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.

#### *Allowance for Credit Losses*

The allowance for credit losses for loans represents management's estimate of all expected credit losses over the expected contractual life of our existing loan 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.

We employ a disciplined process and methodology to establish our allowance for credit losses that has two basic components: first, an asset-specific component involving individual loans that do not share risk characteristics with other loans and the measurement of expected credit losses for such individual loans; and second, a pooled component for estimated expected credit losses for pools of loans that share similar risk characteristics.

The credit loss estimation process for both on and off-balance sheet exposures involves procedures to appropriately consider the unique characteristics of our loan portfolio segments, which are further disaggregated into loan classes, the level at which credit risk is monitored. When computing allowance levels, credit loss assumptions are estimated using models that analyze loans according to credit risk ratings, loss history, delinquency status and other credit trends and risk characteristics, including current conditions and reasonable and supportable forecasts about the future. 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. Future factors and forecasts may result in significant changes in the allowance and provision for (reversal of) credit losses in those future periods.

Credit quality is assessed and monitored by evaluating various attributes, such as credit risk ratings, historic loss experience, past due status and other credit trends and risk characteristics, including current conditions and reasonable and supportable forecasts about the future. The results of these continuous credit quality evaluations help form our underwriting criteria for new loans and also factor into the process for estimation of the allowance for credit losses. The allowance level is influenced by loan volumes, loan asset quality, delinquency status, historic loss experience and other conditions influencing loss expectations, such as reasonable and supportable forecasts of economic conditions. The allowance for credit losses will primarily reflect estimated losses for pools of loans that share similar risk characteristics, but will also consider individual loans that do not share risk characteristics with other loans.

In estimating the component of the allowance for credit losses for loans that share similar risk characteristics with other loans, such loans are segregated into loan classes. Loans are designated into loan classes based on loans pooled by product types and similar risk characteristics or areas of risk concentration. In determining the allowance for credit losses, we derive an estimated credit loss assumption from a model that categorizes loan pools based on loan type and internal risk rating or delinquency bucket.

When a loan moves to a substandard non-accrual risk rating grade, it is removed from the collective evaluation allowance methodology and is subject to individual evaluation. A problem asset report is prepared for each loan in excess of a predetermined threshold and the net realizable value of the loan is determined. This value is compared to the appropriate loan basis (depending on whether the loan is a PCD loan or a non-PCD loan) to determine the required allowance for credit loss reserve amount.

Estimating the timing and amounts of future loss cash flows is subject to significant management judgment as these loss cash flows rely upon estimates such as default rates, loss severities, collateral valuations, the amounts and timing of principal payments (including any expected prepayments) or other factors that are reflective of current or future expected conditions. These estimates, in turn, depend on the duration of current overall economic conditions, industry, borrower, or portfolio specific conditions, the expected outcome of bankruptcy or insolvency proceedings, as well as, in certain circumstances, other economic factors, including the level of current and future real estate prices. All of these estimates and assumptions require significant management judgment and certain assumptions that are highly subjective. Model imprecision also exists in the allowance for credit losses estimation process due to the inherent time lag of available industry information and differences between expected and actual outcomes.

The provision for (reversal of) credit losses recorded through earnings, and reduced by the charge-off of loan amounts, net of recoveries, is 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.

#### *Allowance for Loan Losses*

Prior to the adoption of the Current Expected Credit Losses (“CECL”) methodology on January 1, 2020, our allowance for loan losses was a valuation allowance for probable losses existing in the loan portfolio. Loans were charged to the allowance when the loss was confirmed or when a determination was made that a probable loss had been incurred on a specific loan. Recoveries were credited as a reduction to the allowance at the time of recovery. Throughout the respective year, management estimated the probable level of losses to determine whether the allowance for credit losses was appropriate to absorb losses existing in the portfolio. Based on these estimates, an amount was charged to or recovered from the provision for loan losses in order to adjust the allowance to a level determined to be appropriate to absorb losses. Management’s judgment regarding the appropriateness of the allowance for loan losses involved consideration of current economic conditions and their estimated effects on specific borrowers; an evaluation of the existing relationships among loans, potential loan losses and the present level of the allowance; results of examinations of the loan portfolio by regulatory agencies; and management’s internal review of the loan portfolio. In determining the ability to collect certain loans, management also considered the fair value of any underlying collateral. The amount ultimately realized may differ from the carrying value of these assets because of economic or other conditions beyond our control.

#### *Goodwill and Identifiable Intangible Assets*

Goodwill and other identifiable intangible assets are initially recorded at their estimated fair values at the date of acquisition. Goodwill and other intangible assets having an indefinite useful life are not amortized for financial statement purposes. In the event that facts and circumstances indicate that the goodwill or other identifiable intangible assets may be impaired, an interim impairment test would be required. Intangible assets with finite lives are amortized over their useful lives. We perform required annual impairment tests of our goodwill and other intangible assets as of October 1<sup>st</sup> for our reporting units.

The goodwill impairment test requires us to make judgments and assumptions. The test consists of estimating the fair value of each reporting unit based on valuation techniques, including a discounted cash flow model using revenue and profit forecasts and recent industry transaction and trading multiples of our peers, and comparing those estimated fair values with the carrying values of the assets and liabilities of each reporting unit, which includes the allocated goodwill. If

the estimated fair value is less than the carrying value, we will recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, any loss recognized will not exceed the total amount of goodwill allocated to that reporting unit.

This evaluation includes multiple assumptions, including estimated discounted cash flows and other estimates that may change over time. If future discounted cash flows become less than those projected by us, future impairment charges may become necessary that could have a materially adverse impact on our results of operations and financial condition in the period in which the write-off occurs.

#### *Mortgage Loan Indemnification Liability*

The mortgage origination segment may be responsible for errors or omissions relating to its representations and warranties that the mortgage loans sold meet certain requirements, including representations as to underwriting standards and the validity of certain borrower representations in connection with a mortgage loan. If determined to be at fault, the mortgage origination segment either repurchases the mortgage loans from the investors or reimburses the investors' losses (a "make-whole" payment). The mortgage origination segment has established an indemnification liability for such probable losses based upon, among other things, the level of current unresolved repurchase requests, the volume of estimated probable future repurchase requests, our ability to cure the defects identified in the repurchase requests, and the severity of an estimated loss upon repurchase. Although we consider this reserve to be appropriate, there can be no assurance that the reserve will prove to be appropriate over time to cover ultimate losses due to conditions outside of our control such as unanticipated adverse changes in the economy and historical loss patterns, discrete events adversely affecting specific borrowers or industries, or actions taken by institutions or investors. The impact of such matters will be considered in the reserving process when known.

#### *Mortgage Servicing Rights Asset*

The Company measures its residential mortgage servicing rights asset using the fair value method. Under the fair value method, the retained MSR assets are carried in the balance sheet at fair value and the changes in fair value are reported in earnings within other noninterest income in the period in which the change occurs. Retained MSR assets are measured at fair value as of the date of sale of the related mortgage loan. Subsequent fair value measurements are determined using a discounted cash flow model. In order to determine the fair value of the MSR asset, the present value of expected future cash flows is estimated. Assumptions used include market discount rates, anticipated prepayment speeds, delinquency and foreclosure rates, and ancillary fee income.

The model assumptions and the MSR asset fair value estimates are compared to observable trades of similar portfolios as well as to MSR asset broker valuations and industry surveys, as available. The expected life of the loan can vary from management's estimates due to prepayments by borrowers, especially when rates fall. Prepayments in excess of management's estimates would adversely impact the recorded value of the MSR asset. The value of the MSR asset is also dependent upon the discount rate used in the model, which is based on current market rates and is reviewed by management on an ongoing basis. An increase in the discount rate would result in a decrease in the value of the MSR asset.

#### *Acquisition Accounting*

We account for business combinations using the acquisition method, which requires an allocation of the purchase price of an acquired entity to the assets acquired and liabilities assumed, including identifiable intangibles, based on their estimated fair values at the date of acquisition. Management applies various valuation methodologies to these acquired assets and assumed liabilities which often involve a significant degree of judgment, as liquid markets often do not exist for certain loans, deposits, identifiable intangible assets and other assets and liabilities acquired or assumed. Our valuation methodologies employ significant estimates and assumptions to value such items, including, among others, projected cash flows, prepayment and default assumptions, discount rates, and realizable collateral values. Purchase date valuations, which are permitted to be revised for up to one year after the acquisition date, determine the amount of goodwill or bargain purchase gain recognized in connection with a business combination. Changes to provisional amounts identified during this measurement period are recognized in the reporting period in which the adjustment amounts are determined. Certain assumptions and estimates must be updated regularly in connection with the ongoing accounting for purchased loans. Valuation assumptions and estimates may also have to be revisited in connection with our periodic impairment assessments of goodwill, intangible assets and certain other long-lived assets. The use of different assumptions could



produce significantly different valuation results, which could have material positive or negative effects on the Company's results of operations.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

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.

At December 31, 2020, total debt obligations on our consolidated balance sheet, excluding short-term borrowings and unamortized debt issuance costs and premiums, were \$433 million, and included \$350 million in debt obligations subject to fixed interest rates, with the remainder of indebtedness subject to variable interest rates. If LIBOR and the prime rate were to increase by one eighth of one percent (0.125%), the increase in interest expense on the variable rate debt would not have a significant impact on our future consolidated earnings or cash flows.

##### *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).

	December 31, 2020					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	\$ 6,096,909	\$ 1,245,460	\$ 1,970,402	\$ 376,325	\$ 93,474	\$ 9,782,570
Securities	265,611	249,026	459,157	303,999	473,602	1,751,395
Federal funds sold and securities purchased under agreements to resell	386	—	—	—	—	386
Other interest sensitive assets	884,180	—	—	—	29,415	913,595
Total interest sensitive assets	<u>7,247,086</u>	<u>1,494,486</u>	<u>2,429,559</u>	<u>680,324</u>	<u>596,491</u>	<u>12,447,946</u>
<b>Interest sensitive liabilities:</b>						
Interest bearing checking	\$ 5,360,583	\$ —	\$ —	\$ —	\$ —	\$ 5,360,583
Savings	276,327	—	—	—	—	276,327
Time deposits	458,223	1,151,845	187,704	32,623	324	1,830,719
Notes payable and other borrowings	180,393	215	668	831	3,076	185,183
Total interest sensitive liabilities	<u>6,275,526</u>	<u>1,152,060</u>	<u>188,372</u>	<u>33,454</u>	<u>3,400</u>	<u>7,652,812</u>
Interest sensitivity gap	<u>\$ 971,560</u>	<u>\$ 342,426</u>	<u>\$ 2,241,187</u>	<u>\$ 646,870</u>	<u>\$ 593,091</u>	<u>\$ 4,795,134</u>
Cumulative interest sensitivity gap	<u>\$ 971,560</u>	<u>\$ 1,313,986</u>	<u>\$ 3,555,173</u>	<u>\$ 4,202,043</u>	<u>\$ 4,795,134</u>	
Percentage of cumulative gap to total interest sensitive assets	7.80 %	10.56 %	28.56 %	33.76 %	38.52 %	

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 December 31, 2020 (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	\$ 61,317	16.39 %	\$ 687,498	42.44 %
+200	\$ 27,191	7.27 %	\$ 496,741	30.66 %
+100	\$ 3,346	0.89 %	\$ 271,386	16.75 %
-50	\$ (3,266)	(0.87)%	\$ (212,535)	(13.12)%

The projected changes in net interest income and economic value of equity to changes in interest rates at December 31, 2020 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).

	December 31, 2020				Total
	1 Year or Less	> 1 Year to 5 Years	> 5 Years to 10 Years	> 10 Years	
<b><u>Trading securities, at fair value</u></b>					
Municipal obligations	\$ 26	\$ 5,703	\$ 27,131	\$ 138,713	\$ 171,573
U.S. government and government agency obligations	40,040	(8,029)	(24,609)	386,715	394,117
Corporate obligations	(5,179)	6,229	8,443	36,264	45,757
Total debt securities	<u>34,887</u>	<u>3,903</u>	<u>10,965</u>	<u>561,692</u>	<u>611,447</u>
Corporate equity securities	(3,004)	—	—	—	(3,004)
Other	4,970	—	—	—	4,970
	<u>\$ 36,853</u>	<u>\$ 3,903</u>	<u>\$ 10,965</u>	<u>\$ 561,692</u>	<u>\$ 613,413</u>

### **Weighted average yield**

Municipal obligations	0.00 %	0.68 %	1.17 %	2.91 %	2.56 %
U.S. government and government agency obligations	0.00 %	0.31 %	0.95 %	3.04 %	2.64 %
Corporate obligations	0.88 %	2.27 %	2.54 %	3.11 %	2.56 %

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 8. Financial Statements and Supplementary Data.**

Our financial statements required by this item are submitted as a separate section of this Annual Report. See “Financial Statements,” commencing on page F-1 hereof.

#### **Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

#### **Item 9A. Controls and Procedures.**

##### ***Conclusion Regarding the Effectiveness 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 December 31, 2020, the end of the period covered by this Annual Report.

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

## ***Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, as a process designed by, or under the supervision of, our Principal Executive Officer and Principal Financial Officer and effected by our board of directors, management and other personnel 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 and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorization of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2020. In making this assessment, management used the criteria set forth in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO. Based on our assessment, management concluded that, as of December 31, 2020, our internal control over financial reporting is effective.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, audited the effectiveness of our internal control over financial reporting as of December 31, 2020, and issued an unqualified opinion thereon as stated in their report, which appears on page F-2.

## ***Remediation of Material Weakness***

The Company and its Board of Directors are committed to maintaining a strong internal control environment. Following the identification of the material weakness described in our Annual Report on Form 10-K for the year ended December 31, 2019, related to certain aspects of the determination of the qualitative factors considered by management in the allowance for loan losses estimation process, we initiated remediation measures to address the material weakness. Management believes that it has completed its updates to the design and implementation of internal controls to remediate the material weakness and enhance the Company's internal control environment. As previously reported, the remediation plan was implemented during the fourth quarter of 2019 and included an enhanced analysis to support the qualitative factors considered in the estimation of the allowance for loan losses as of December 31, 2019. Management believes that such enhanced controls, including new controls implemented as a part of the adoption of CECL on January 1, 2020, have been designed to address the material weakness. We completed our remediation activities by testing the operating effectiveness of the enhanced and newly implemented controls and found them to be effective. Based on the implementation work and results of testing performed, we have concluded that the previously identified material weakness has been remediated as of December 31, 2020.

## ***Changes in Internal Control Over Financial Reporting***

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

## **Item 9B. Other Information.**

None.

### **PART III**

#### **Item 10. Directors, Executive Officers and Corporate Governance.**

The information called for by this Item is contained in our definitive Proxy Statement for our 2021 Annual Meeting of Stockholders, and is incorporated herein by reference.

#### **Item 11. Executive Compensation.**

The information called for by this Item is contained in our definitive Proxy Statement for our 2021 Annual Meeting of Stockholders, and is incorporated herein by reference.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information called for by this Item is contained in our definitive Proxy Statement for our 2021 Annual Meeting of Stockholders, and is incorporated herein by reference.

#### **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information called for by this Item is contained in our definitive Proxy Statement for our 2021 Annual Meeting of Stockholders, and is incorporated herein by reference.

#### **Item 14. Principal Accounting Fees and Services.**

The information called for by this Item is contained in our definitive Proxy Statement for our 2021 Annual Meeting of Stockholders, and is incorporated herein by reference.

## PART IV

### Item 15. Exhibits, Financial Statement Schedules.

(a) The following documents are filed herewith as part of this Form 10-K.

	<u>Page</u>
1. Financial Statements.	
Hilltop Holdings Inc.	
Report of Independent Registered Public Accounting Firm .....	F-2
Consolidated Balance Sheets .....	F-4
Consolidated Statements of Operations .....	F-5
Consolidated Statements of Comprehensive Income .....	F-6
Consolidated Statements of Stockholders' Equity .....	F-7
Consolidated Statements of Cash Flows .....	F-8
Notes to Consolidated Financial Statements .....	F-9

2. Financial Statement Schedules.

All financial statement schedules have been omitted because they are not required, not applicable or the information has been included in our consolidated financial statements.

3. Exhibits. See the Exhibit Index preceding the signature page hereto.

### Item 16. Form 10-K Summary.

None.

Exhibit Number	Description of Exhibit
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 therein by reference).
3.1	Articles of Amendment and Restatement of Affordable Residential Communities Inc., dated February 16, 2004, as amended or supplemented by: Articles Supplementary, dated February 16, 2004; Corporate Charter Certificate of Notice, dated June 6, 2005; Articles of Amendment, dated January 23, 2007; Articles of Amendment, dated July 31, 2007; Corporate Charter Certificate of Notice, dated September 23, 2008; Articles Supplementary, dated December 15, 2010; Articles Supplementary, dated as of November 29, 2012 relating to Subtitle 8 election; Articles Supplementary, dated November 29, 2012 relating to Non-Cumulative Perpetual Preferred Stock, Series B, of Hilltop Holdings Inc.; and Articles of Amendment and Restatement, dated March 31, 2014 (filed as Exhibit 3.1 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 (File No. 001-31987) and incorporated herein by reference).
3.2	Third Amended and Restated Bylaws of Hilltop Holdings Inc. (filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on January 31, 2018 (File No. 001-31987) and incorporated herein by reference).
3.2.1	First Amendment to Third Amended and Restated Bylaws of Hilltop Holdings Inc., adopted and effective April 25, 2019 (filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed May 1, 2019 (File No. 001-31987) and incorporated herein by reference).
4.1	Form of Certificate of Common Stock of Hilltop Holdings Inc. (filed as Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-31987) and incorporated herein by reference).
4.2	Corporate Charter Certificate of Notice, dated June 6, 2005 (filed as Exhibit 3.2 to the Registrant's Registration Statement on Form S-3 (File No. 333-125854) and incorporated herein by reference).
4.3.1	Amended and Restated Declaration of Trust, dated as of July 31, 2001, by and among U.S. Bank National Association (successor in interest to State Street Bank and Trust Company of Connecticut, National Association), as Institutional Trustee, PlainsCapital Corporation, and the Administrators party thereto from time to time (filed as Exhibit 4.2 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
4.3.2	First Amendment to Amended and Restated Declaration of Trust, dated as of August 7, 2006, by and between PlainsCapital Corporation and U.S. Bank National Association, as Institutional Trustee (filed as Exhibit 4.3 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
4.3.3	Indenture, dated as of July 31, 2001, by and between PlainsCapital Corporation and U.S. Bank National Association (successor in interest to State Street Bank and Trust Company of Connecticut, National Association), as Trustee (filed as Exhibit 4.4 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
4.3.4	First Supplemental Indenture, dated as of August 7, 2006, by and between PlainsCapital Corporation and U.S. Bank National Association, as Trustee (filed as Exhibit 4.5 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).



- 4.3.5 Second Supplemental Indenture, dated as of November 30, 2012, by and among U.S. Bank National Association, as Trustee, PlainsCapital Corporation (f/k/a Meadow Corporation) and PlainsCapital Corporation (filed as Exhibit 4.5.5 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 15, 2013 (File No. 001-31987) and incorporated herein by reference).
- 4.3.6 Amended and Restated Floating Rate Junior Subordinated Deferrable Interest Debenture of Plains Capital Corporation, dated as of August 7, 2006, by PlainsCapital Corporation in favor of U.S. Bank National Association, as Institutional Trustee for PCC Statutory Trust I (filed as Exhibit 4.6 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.3.7 Guarantee Agreement, dated as of July 31, 2001, by and between PlainsCapital and U.S. Bank National Association (successor in interest to State Street Bank and Trust Company of Connecticut, National Association), as Trustee (filed as Exhibit 4.7 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.3.8 First Amendment to Guarantee Agreement, dated as of August 7, 2006, by and between PlainsCapital Corporation and U.S. Bank National Association, as Guarantee Trustee (filed as Exhibit 4.8 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.4.1 Amended and Restated Declaration of Trust, dated as of March 26, 2003, by and among U.S. Bank National Association, as Institutional Trustee, PlainsCapital Corporation, and the Administrators party thereto from time to time (filed as Exhibit 4.9 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.4.2 Indenture, dated as of March 26, 2003, by and between PlainsCapital Corporation and U.S. Bank National Association, as Trustee (filed as Exhibit 4.10 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.4.3 First Supplemental Indenture, dated as of November 30, 2012, by and among U.S. Bank National Association, as Trustee, PlainsCapital Corporation (f/k/a Meadow Corporation) and PlainsCapital Corporation (filed as Exhibit 4.6.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 15, 2013 (File No. 001-31987) and incorporated herein by reference).
- 4.4.4 Floating Rate Junior Subordinated Deferrable Interest Debenture of Plains Capital Corporation, dated as of March 26, 2003, by PlainsCapital Corporation in favor of U.S. Bank National Association, as Institutional Trustee for PCC Statutory Trust II (filed as Exhibit 4.11 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.4.5 Guarantee Agreement, dated as of March 26, 2003, by and between PlainsCapital Corporation and U.S. Bank National Association, as Guarantee Trustee (filed as Exhibit 4.12 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.5.1 Amended and Restated Declaration of Trust, dated as of September 17, 2003, by and among U.S. Bank National Association, as Institutional Trustee, PlainsCapital Corporation, and the Administrators party thereto from time to time (filed as Exhibit 4.13 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.5.2 Indenture, dated as of September 17, 2003, by and between PlainsCapital Corporation and U.S. Bank National Association, as Trustee (filed as Exhibit 4.14 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.5.3 First Supplemental Indenture, dated as of November 30, 2012, by and among U.S. Bank National Association, as Trustee, PlainsCapital Corporation (f/k/a Meadow Corporation) and PlainsCapital Corporation. (filed as Exhibit 4.7.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 15, 2013 (File No. 001-31987) and incorporated herein by reference).

- 4.5.4 Floating Rate Junior Subordinated Deferrable Interest Debenture of Plains Capital Corporation, dated as of September 17, 2003, by PlainsCapital Corporation in favor of U.S. Bank National Association, as Institutional Trustee for PCC Statutory Trust III (filed as Exhibit 4.15 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.5.5 Guarantee Agreement, dated as of September 17, 2003, by and between PlainsCapital Corporation and U.S. Bank National Association, as Guarantee Trustee (filed as Exhibit 4.16 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.6.1 Amended and Restated Trust Agreement, dated as of February 22, 2008, by and among PlainsCapital Corporation, Wells Fargo Bank, N.A., as Property Trustee, Wells Fargo Delaware Trust Company, as Delaware Trustee, and the Administrators party thereto from time to time (filed as Exhibit 4.17 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.6.2 Junior Subordinated Indenture, dated as of February 22, 2008, by and between PlainsCapital Corporation and Wells Fargo Bank, N.A., as Trustee (filed as Exhibit 4.18 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.6.3 First Supplemental Indenture, dated as of November 30, 2012, by and between PlainsCapital Corporation (f/k/a Meadow Corporation) and Wells Fargo Bank, National Association, as Trustee. (filed as Exhibit 4.8.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 15, 2013 (File No. 001-31987) and incorporated herein by reference).
- 4.6.4 Plains Capital Corporation Floating Rate Junior Subordinated Note due 2038, dated as of February 22, 2008, by PlainsCapital Corporation in favor of Wells Fargo Bank, N.A., as Property Trustee of PCC Statutory Trust IV (filed as Exhibit 4.19 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.6.5 Guarantee Agreement, dated as of February 22, 2008, by and between PlainsCapital Corporation and Wells Fargo Bank, N.A., as Guarantee Trustee (filed as Exhibit 4.20 to the Registration Statement on Form 10 filed by PlainsCapital Corporation on April 17, 2009 (File No. 000-53629) and incorporated herein by reference).
- 4.7 Indenture, dated as of April 9, 2015, by and between Hilltop Holdings, Inc. and U.S. Bank National Association, as Trustee, including form of notes (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on April 9, 2015 (File No. 001-31987) and incorporated herein by reference).
- 4.8 Indenture, dated as of November 22, 2019, by and between Hilltop Securities Inc. and The Bank of New York Mellon, as indenture trustee (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on November 27, 2019 (File No. 001-31987) and incorporated herein by reference).
- 4.8.1 Indenture, dated as of December 6, 2019, by and between Hilltop Securities Inc. and The Bank of New York Mellon, as indenture trustee (filed as Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed on December 11, 2019 (File No. 001-31987) and incorporated herein by reference).
- 4.9.1 Indenture, dated as of May 11, 2020, between Hilltop Holdings Inc., as Issuer, and U.S. Bank National Association, as Trustee (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed May 13, 2020 (File No. 001-31987) and incorporated herein by reference).
- 4.9.2 First Supplemental Indenture, dated as of May 11, 2020, between Hilltop Holdings Inc., as Issuer, and U.S. Bank National Association, as Trustee (filed as Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed May 13, 2020 (File No. 001-31987) and incorporated herein by reference).

- 4.9.3 Second Supplemental Indenture, dated as of May 11, 2020, between Hilltop Holdings Inc., as Issuer, and U.S. Bank National Association, as Trustee (filed as Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed May 13, 2020 (File No. 001-31987) and incorporated herein by reference).
- 4.9.4 Form of 5.75% Fixed-to-Floating Rate Subordinated Notes due 2030 (filed as Exhibit 4.4 to the Registrant's Current Report on Form 8-K filed May 13, 2020 (File No. 001-31987) and incorporated herein by reference).
- 4.9.5 Form of 6.125% Fixed-to-Floating Rate Subordinated Notes due 2035 (filed as Exhibit 4.5 to the Registrant's Current Report on Form 8-K filed May 13, 2020 (File No. 001-31987) and incorporated herein by reference).
- 4.10\* Description of the Registrant's Securities.
- 10.1.1† Hilltop Holdings Inc. 2012 Equity Incentive Plan, effective September 20, 2012 (filed as Exhibit 10.18 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 15, 2013 (File No. 001-31987) and incorporated herein by reference).
- 10.1.2† Form of Restricted Stock Unit Award Agreement (Performance-Based Vesting) for awards beginning in 2018 (filed as Exhibit 10.1.8 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2017 filed on February 15, 2018 (File No. 001-31987) and incorporated herein by reference).
- 10.1.3† Form of Restricted Stock Unit Award Agreement (Time-Based Vesting for Section 16 Officers) for awards beginning in 2018 (filed as Exhibit 10.1.9 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2017 filed on February 15, 2018 (File No. 001-31987) and incorporated herein by reference).
- 10.1.4† Form of Restricted Stock Unit Award Agreement (Time-Based Vesting for Non-Section 16 Officers) for awards beginning in 2018 (filed as Exhibit 10.1.10 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2017 filed on February 15, 2018 (File No. 001-31987) and incorporated herein by reference).
- 10.1.5† Form of Restricted Stock Unit Award Agreement (Performance-Based Vesting) for awards beginning in 2019 (filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed on April 25, 2019 (File No. 001-31987) and incorporated herein by reference).
- 10.1.6† Form of Restricted Stock Unit Award Agreement (Time-Based Vesting for Section 16 Officers) for awards beginning in 2019 (filed as Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q filed on April 25, 2019 (File No. 001-31987) and incorporated herein by reference).
- 10.1.7† Form of Restricted Stock Unit Award Agreement (Time-Based Vesting for Non-Section 16 Officers) for awards beginning in 2019 (filed as Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q filed on April 25, 2019 (File No. 001-31987) and incorporated herein by reference).
- 10.1.8† Form of Restricted Stock Unit Award Agreement (Performance-Based Vesting) for awards beginning in 2020 (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2020 (File No. 001-31987) and incorporated herein by reference).
- 10.1.9† Form of Restricted Stock Unit Award Agreement (Time-Based Vesting for Section 16 Officers) for awards beginning in 2020 (filed as Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2020 (File No. 001-31987) and incorporated herein by reference).
- 10.1.10† Form of Restricted Stock Unit Award Agreement (Time-Based Vesting for Non-Section 16 Officers) for awards beginning in 2020 (filed as Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed on May 5, 2020 (File No. 001-31987) and incorporated herein by reference).
- 10.2.1† Hilltop Holdings Inc. 2020 Equity Incentive Plan (filed as Exhibit 99.1 to the Registrant's Registration Statement on Form S-8 filed July 24, 2020 (File No. 333-240090) and incorporated herein by reference).

- 10.2.2† Form of Restricted Stock Unit Award Agreement (Performance-Based) for awards beginning in 2020 (filed as Exhibit 99.3 to the Registrant’s Registration Statement on Form S-8 filed July 24, 2020 (File No. 333-240090) and incorporated herein by reference).
- 10.2.3† Form of Restricted Stock Unit Award Agreement (Time-Based Vesting for Section 16 Officers) for awards beginning in 2020 (filed as Exhibit 99.4 to the Registrant’s Registration Statement on Form S-8 filed July 24, 2020 (File No. 333-240090) and incorporated herein by reference).
- 10.2.4† Form of Restricted Stock Unit Award Agreement (Time-Based Vesting for Non-Section 16 Officers) for awards beginning in 2020 (filed as Exhibit 99.5 to the Registrant’s Registration Statement on Form S-8 filed July 24, 2020 (File No. 333-240090) and incorporated herein by reference).
- 10.3† Hilltop Holdings Inc. Employee Stock Purchase Plan (filed as Exhibit 99.2 to the Registrant’s Registration Statement on Form S-8 filed July 24, 2020 (File No. 333-240090) and incorporated herein by reference).
- 10.4† Hilltop Holdings Inc. Annual Incentive Plan, effective September 20, 2012 (filed as Exhibit 10.19 to the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 15, 2013 (File No. 001-31987) and incorporated herein by reference).
- 10.5.1† Employment Agreement, dated as of December 4, 2014, by and between Todd Salmans and Hilltop Holdings Inc. (filed as Exhibit 10.8 to the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2014 (File No. 001-31987) and incorporated herein by reference).
- 10.5.2† First Amendment to Employment Agreement, dated as of November 8, 2017, by and between Todd Salmans and Hilltop Holdings Inc. (filed as Exhibit 10.1 to the Registrant’s Current Report on Form 8-K filed on November 13, 2017 (File No. 001-31987) and incorporated herein by reference).
- 10.5.3† Retention Agreement by and between Hilltop Holdings Inc. and Todd Salmans, dated as of October 25, 2019, but effective January 1, 2020 (filed as Exhibit 10.1 to the Registrant’s Current Report on Form 8-K filed October 30, 2019 (File No. 001-31987) and incorporated herein by reference).
- 10.6† Compensation arrangement of Jeremy B. Ford (filed as Exhibit 10.5 to the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2019 filed on February 27, 2020 (File No. 001-31987) and incorporated herein by reference).
- 10.7.1† Employment Agreement, dated as of September 1, 2016, by and between William Furr and Hilltop Holdings Inc. (filed as Exhibit 10.1 to the Registrant’s Current Report on Form 8-K/A (Amendment No. 1) filed on September 7, 2016 (File No. 001-31987) and incorporated herein by reference).
- 10.7.2† First Amendment to Employment Agreement by and between Hilltop Holdings Inc. and William B. Furr, dated as of August 30, 2019 (filed as Exhibit 10.7.2 to the Registrant’s Current Report on Form 8-K filed September 6, 2019 (File No. 001-31987) and incorporated herein by reference).
- 10.8† Employment Agreement, dated as of November 20, 2018, by and between Hilltop Holdings Inc. and Martin B. Winges (filed as Exhibit 10.1 to Registrant’s Current Report on Form 8-K filed on December 12, 2018 (File No. 001-31987) and incorporated herein by reference).
- 10.9† Retention Agreement, dated as of February 19, 2019, by and between Hill A. Feinberg and Hilltop Holdings Inc. (filed as Exhibit 10.2 to the Registrant’s Current Report on Form 8-K filed on February 22, 2019 (File No. 001-31987) and incorporated herein by reference).
- 10.10† Employment Agreement by and between Hilltop Holdings Inc. and Steve Thompson, dated as of October 25, 2019, but effective January 1, 2020 (filed as Exhibit 10.2 to the Registrant’s Current Report on Form 8-K filed October 30, 2019 (File No. 001-31987) and incorporated herein by reference).

- 10.11† Limited Liability Company Agreement of HTH Diamond Hillcrest Land LLC, dated as of July 31, 2018 (filed as Exhibit 10.1 to the Registrant’s Current Report on Form 8-K filed on August 6, 2018 (File No. 001-31987) and incorporated herein by reference).
- 10.12† Ground Lease Agreement by and among HTH Diamond Hillcrest Land LLC, as Ground Lessor, and SPC Park Plaza Partners LLC, HTH Hillcrest Project LLC and Diamond Hillcrest LLC, as Ground Lessees, dated as of July 31, 2018 (filed as Exhibit 10.2 to the Registrant’s Current Report on Form 8-K filed on August 6, 2018 (File No. 001-31987) and incorporated herein by reference).
- 10.13† Hilltop Plaza Co-Owners Agreement, by and among Diamond Hillcrest, LLC, HTH Hillcrest Project LLC and SPC Park Plaza Partners LLC, dated as of July 31, 2018 (filed as Exhibit 10.3 to the Registrant’s Current Report on Form 8-K filed on August 6, 2018 (File No. 001-31987) and incorporated herein by reference).
- 10.14† Office Lease between SPC Park Plaza Partners, LLC, Diamond Hillcrest, LLC, and HTH Hillcrest Project LLC, as Co-Owners, and Hilltop Holdings Inc., as Tenant, dated July 31, 2018 (filed as Exhibit 10.4 to the Registrant’s Current Report on Form 8-K filed on August 6, 2018 (File No. 001-31987) and incorporated herein by reference).
- 10.15† Retail Lease between SPC Park Plaza Partners, LLC, Diamond Hillcrest, LLC, and HTH Hillcrest Project LLC, as Co-Owners, and PlainsCapital Bank, as Tenant, dated July 31, 2018 (filed as Exhibit 10.5 to the Registrant’s Current Report on Form 8-K filed on August 6, 2018 (File No. 001-31987) and incorporated herein by reference).
- 21.1\* List of subsidiaries of the Registrant.
- 23.1\* Consent of PricewaterhouseCoopers LLP.
- 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 Data File (formatted as Inline XBRL and contained in Exhibit 101).

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\* Filed herewith.

† Exhibit is a management contract or compensatory plan or arrangement.

# 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 Section 13 or 15(d) 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.

Date: February 16, 2021

### HILLTOP HOLDINGS INC.

By: /s/ William B. Furr

William B. Furr

Chief Financial Officer

(Principal Financial Officer and duly authorized officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Capacity in which Signed</u>	<u>Date</u>
<u>/s/ Jeremy B. Ford</u> Jeremy B. Ford	President, Chief Executive Officer and Director (Principal Executive Officer)	February 16, 2021
<u>/s/ William B. Furr</u> William B. Furr	Chief Financial Officer (Principal Financial Officer)	February 16, 2021
<u>/s/ Keith E. Bornemann</u> Keith E. Bornemann	Executive Vice President, Chief Accounting Officer (Principal Accounting Officer)	February 16, 2021
<u>Charlotte Jones Anderson</u>	Director	
<u>/s/ Rhodes Bobbitt</u> Rhodes Bobbitt	Director	February 16, 2021
<u>/s/ Tracy A. Bolt</u> Tracy A. Bolt	Director and Audit Committee Member	February 16, 2021
<u>/s/ J. Taylor Crandall</u> J. Taylor Crandall	Director	February 16, 2021
<u>/s/ Charles R. Cummings</u> Charles R. Cummings	Director and Chairman of Audit Committee	February 16, 2021
<u>/s/ Hill A. Feinberg</u> Hill A. Feinberg	Director	February 16, 2021
<u>/s/ Gerald J. Ford</u> Gerald J. Ford	Chairman of the Board	February 16, 2021
<u>/s/ J. Markham Green</u> J. Markham Green	Director and Audit Committee Member	February 16, 2021
<u>William T. Hill, Jr.</u>	Director	
<u>/s/ Lee Lewis</u> Lee Lewis	Director	February 16, 2021
<u>Andrew J. Littlefair</u>	Director	
<u>/s/ W. Robert Nichols, III</u> W. Robert Nichols, III	Director	February 16, 2021
<u>Thomas C. Nichols</u>	Director	
<u>Kenneth D. Russell</u>	Director	
<u>A. Haag Sherman</u>	Director	
<u>/s/ Jonathan S. Sobel</u> Jonathan S. Sobel	Director	February 16, 2021
<u>/s/ Robert Taylor, Jr.</u> Robert Taylor, Jr.	Director	February 16, 2021
<u>/s/ Carl B. Webb</u> Carl B. Webb	Director	February 16, 2021

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Hilltop Holdings Inc.

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## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Hilltop Holdings Inc.

### Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Hilltop Holdings Inc. and its subsidiaries (the "Company") as of December 31, 2020 and 2019, and the related consolidated statements of operations, of comprehensive income, of stockholders' equity and of cash flows for each of the three years in the period ended December 31, 2020, including the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2020 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

#### *Change in Accounting Principle*

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for credit losses in 2020.

### Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that (i) relate to accounts or disclosures that are material to the consolidated financial statements and (ii) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not

alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

#### *Allowance for Credit Losses for Loans Held for Investment – Collectively Evaluated*

As described in Notes 1 and 8 to the consolidated financial statements, the Company's allowance for credit losses for loans held for investment was \$149 million as of December 31, 2020. Management's allowance for credit losses for collectively evaluated loans is an estimate of expected losses over the lifetime of a loan within the Company's existing loans held for investment portfolio and is based on historical experience, current conditions and reasonable and supportable forecasts. The credit loss estimation process considers the characteristics of the Company's loan portfolio segments, which are further disaggregated into loan classes, the level at which credit risk is monitored. The allowance for credit losses for collectively evaluated loans is calculated using statistical credit factors, including probabilities of default ("PD") and loss given default ("LGD"), to the amortized cost of pools of loan exposures with similar risk characteristics over its contractual life, adjusted for prepayments, to arrive at an estimate of expected credit losses. As described by management, 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. Management utilizes a single macroeconomic baseline scenario published by a third party that reflects the U.S. economic outlook. This baseline scenario utilizes multiple economic variables in forecasting the economic outlook. Significant variables that impact the modeled losses across the Company's loan portfolios are the U.S. Real Gross Domestic Product (GDP) growth rates and unemployment rate assumptions. Management also considers adjustments for certain conditions in the Company's allowance for credit losses estimate qualitatively where they have not been measured directly in management's collective assessments.

The principal considerations for our determination that performing procedures relating to the allowance for credit losses for collectively evaluated loans held for investment is a critical audit matter are (i) the significant judgment by management in estimating the allowance for credit losses, which in turn led to a high degree of auditor judgment, subjectivity, and effort in performing procedures and evaluating audit evidence relating to management's determination of the impact of GDP growth rate and unemployment rate forecasts within the macroeconomic baseline scenario, as well as qualitative adjustments to the allowance for credit losses; and (ii) the audit effort involved the use of professionals with specialized skill and knowledge.

Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included testing the effectiveness of controls relating to the allowance for credit losses for collectively evaluated loans held for investment, which included controls over evaluation and selection of the variables used in the macroeconomic baseline scenario as well as qualitative adjustments. These procedures also included, among others, the involvement of professionals with specialized skill and knowledge to assist in testing management's process for estimating the allowance for credit losses, which included (i) evaluating the appropriateness of the methodology and models, (ii) testing the completeness and accuracy of certain data used in the estimate, (iii) evaluating the reasonableness of management's determination of the impact of GDP growth rate and unemployment rate forecasts within the macroeconomic baseline scenario and (iv) evaluating the reasonableness of qualitative adjustments to the allowance for credit losses.

#### *Valuation of Mortgage Servicing Rights*

As described in Notes 1 and 12 to the consolidated financial statements, the Company measures its residential mortgage servicing rights asset at fair value, which totaled \$144 million as of December 31, 2020. Management estimates the fair value of residential mortgage servicing rights by valuing the projected net servicing cash flows, which are then discounted to estimate fair value using a discounted cash flow model. The significant unobservable inputs related to the valuation of residential mortgage servicing rights are the discount rate and the constant prepayment rate assumptions. As disclosed by management, the model assumptions and the mortgage servicing rights fair value estimates are compared to observable trades of similar portfolios as well as to broker valuations and industry surveys, as available.

The principal considerations for our determination that performing procedures relating to the valuation of mortgage servicing rights is a critical audit matter are (i) the significant judgment by management in estimating the fair value of residential mortgage servicing rights, which in turn led to a high degree of auditor judgment, subjectivity and effort in performing procedures and evaluating audit evidence relating to management's estimate of the fair value of mortgage servicing rights and the constant prepayment rate and discount rate assumptions used in the estimate, and (ii) the audit effort involved the use of professionals with specialized skill and knowledge.

Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included testing the effectiveness of controls relating to the valuation of mortgage servicing rights, which included controls over the constant prepayment rate and discount rate assumptions. These procedures also included, among others, the involvement of professionals with specialized skill and knowledge to assist in testing management's process for estimating the valuation of mortgage servicing rights, which included (i) evaluating the appropriateness of the methodology, (ii) testing the completeness and accuracy of certain data used in the estimate, (iii) evaluating the reasonableness of the constant prepayment rate and discount rate assumptions used in the estimate and (iv) evaluating the reasonableness of the fair value of mortgage servicing rights, which included comparison to observable trades of similar portfolios and industry surveys.

/s/ PricewaterhouseCoopers LLP  
Dallas, Texas  
February 16, 2021

We have served as the Company's auditor since 1998.

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

	December 31,	
	2020	2019
<b>Assets</b>		
Cash and due from banks	\$ 1,062,560	\$ 433,626
Federal funds sold	386	394
Assets segregated for regulatory purposes	290,357	157,436
Securities purchased under agreements to resell	80,319	59,031
Securities:		
Trading, at fair value	694,255	689,576
Available for sale, at fair value, net (amortized cost of \$1,435,919 and 899,817, respectively)	1,462,205	911,493
Held to maturity, at amortized cost, net (fair value of \$326,671 and \$388,930, respectively)	311,944	386,326
Equity, at fair value	140	166
	<u>2,468,544</u>	<u>1,987,561</u>
Loans held for sale	2,788,386	2,106,361
Loans held for investment, net of unearned income	7,693,141	7,381,400
Allowance for credit losses	(149,044)	(61,136)
Loans held for investment, net	<u>7,544,097</u>	<u>7,320,264</u>
Broker-dealer and clearing organization receivables	1,404,727	1,780,280
Premises and equipment, net	211,595	210,375
Operating lease right-of-use assets	105,757	114,320
Mortgage servicing rights	143,742	55,504
Other assets	555,983	404,754
Goodwill	267,447	267,447
Other intangible assets, net	20,364	26,666
Assets of discontinued operations	—	248,429
Total assets	<u>\$ 16,944,264</u>	<u>\$ 15,172,448</u>
<b>Liabilities and Stockholders' Equity</b>		
Deposits:		
Noninterest-bearing	\$ 3,612,384	\$ 2,769,556
Interest-bearing	7,629,935	6,262,658
Total deposits	<u>11,242,319</u>	<u>9,032,214</u>
Broker-dealer and clearing organization payables	1,368,373	1,605,518
Short-term borrowings	695,798	1,424,010
Securities sold, not yet purchased, at fair value	79,789	43,817
Notes payable	381,987	256,269
Operating lease liabilities	125,450	125,619
Junior subordinated debentures	67,012	67,012
Other liabilities	632,889	348,519
Liabilities of discontinued operations	—	140,674
Total liabilities	<u>14,593,617</u>	<u>13,043,652</u>
Commitments and contingencies (see Notes 21 and 22)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, \$0.01 par value, 125,000,000 shares authorized; 82,184,893 and 90,640,944 shares issued and outstanding at December 31, 2020 and 2019, respectively	822	906
Additional paid-in capital	1,317,929	1,445,233
Accumulated other comprehensive income	17,763	11,419
Retained earnings	986,792	644,860
Deferred compensation employee stock trust, net	771	776
Employee stock trust (6,930 and 7,794 shares, at cost, at December 31, 2020 and 2019, respectively)	(138)	(155)
Total Hilltop stockholders' equity	<u>2,323,939</u>	<u>2,103,039</u>
Noncontrolling interests	26,708	25,757
Total stockholders' equity	<u>2,350,647</u>	<u>2,128,796</u>
Total liabilities and stockholders' equity	<u>\$ 16,944,264</u>	<u>\$ 15,172,448</u>

*See accompanying notes.*

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

	Year Ended December 31,		
	2020	2019	2018
Interest income:			
Loans, including fees	\$ 433,311	\$ 460,471	\$ 436,725
Securities borrowed	51,360	69,582	66,914
Securities:			
Taxable	48,273	58,493	46,665
Tax-exempt	6,698	6,159	6,834
Other	6,853	15,991	17,485
Total interest income	<u>546,495</u>	<u>610,696</u>	<u>574,623</u>
Interest expense:			
Deposits	47,040	71,509	46,002
Securities loaned	42,816	60,086	56,733
Short-term borrowings	11,611	26,778	25,816
Notes payable	15,897	8,948	8,483
Junior subordinated debentures	2,772	3,851	3,663
Other	2,193	545	627
Total interest expense	<u>122,329</u>	<u>171,717</u>	<u>141,324</u>
Net interest income	424,166	438,979	433,299
Provision for credit losses	96,491	7,206	5,088
Net interest income after provision for credit losses	<u>327,675</u>	<u>431,773</u>	<u>428,211</u>
Noninterest income:			
Net gains from sale of loans and other mortgage production income	1,001,059	504,935	445,116
Mortgage loan origination fees	171,769	130,003	103,563
Securities commissions and fees	142,720	137,742	150,989
Investment and securities advisory fees and commissions	131,327	103,787	90,066
Other	243,605	186,350	90,396
Total noninterest income	<u>1,690,480</u>	<u>1,062,817</u>	<u>880,130</u>
Noninterest expense:			
Employees' compensation and benefits	1,059,645	844,602	757,214
Occupancy and equipment, net	99,416	113,336	113,923
Professional services	69,984	60,565	69,799
Other	224,758	193,386	212,392
Total noninterest expense	<u>1,453,803</u>	<u>1,211,889</u>	<u>1,153,328</u>
Income from continuing operations before income taxes	564,352	282,701	155,013
Income tax expense	133,071	63,714	34,227
Income from continuing operations	431,281	218,987	120,786
Income from discontinued operations, net of income taxes	38,396	13,990	4,941
Net income	469,677	232,977	125,727
Less: Net income attributable to noncontrolling interest	21,841	7,686	4,286
Income attributable to Hilltop	<u>\$ 447,836</u>	<u>\$ 225,291</u>	<u>\$ 121,441</u>
Earnings per common share:			
Basic:			
Earnings from continuing operations	\$ 4.59	\$ 2.29	\$ 1.23
Earnings from discontinued operations	0.43	0.15	0.05
	<u>\$ 5.02</u>	<u>\$ 2.44</u>	<u>\$ 1.28</u>
Diluted:			
Earnings from continuing operations	\$ 4.58	\$ 2.29	\$ 1.23
Earnings from discontinued operations	0.43	0.15	0.05
	<u>\$ 5.01</u>	<u>\$ 2.44</u>	<u>\$ 1.28</u>
Weighted average share information:			
Basic	89,280	92,345	94,969
Diluted	<u>89,304</u>	<u>92,394</u>	<u>95,067</u>

*See accompanying notes.*

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

	Year Ended December 31,		
	2020	2019	2018
Net income	\$ 469,677	\$ 232,977	\$ 125,727
Other comprehensive income:			
Change in fair value of cash flow and fair value hedges, net of tax of \$(820), \$111 and \$0, respectively	(2,950)	417	—
Net unrealized gains (losses) on securities available for sale, net of tax of \$2,756, \$6,276 and \$(1,558), respectively	9,111	21,599	(5,632)
Reclassification adjustment for gains (losses) included in net income, net of tax of \$55, \$(573) and \$0, respectively	183	(1,970)	—
Comprehensive income	476,021	253,023	120,095
Less: comprehensive income attributable to noncontrolling interest	21,841	7,686	4,286
Comprehensive income applicable to Hilltop	<u>\$ 454,180</u>	<u>\$ 245,337</u>	<u>\$ 115,809</u>

*See accompanying notes.*

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

	Common Stock		Additional Paid-in Capital		Accumulated Other Comprehensive Income (Loss)		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
Balance, December 31, 2017	95,982	\$ 960	\$ 1,526,369	\$ 384,545	\$ 121,441	848	12	\$ (247)	\$ 1,912,081	\$ 2,726	\$ 1,914,807	\$ 4,286	\$ 1,918,093			
Net income	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(5,632)	—	—	—	(5,632)	—	(5,632)	—	—	—	—	—
Stock-based compensation expense	—	—	8,454	—	—	—	—	—	8,454	—	8,454	—	—	—	—	—
Common stock issued to board members	30	—	654	—	—	—	—	—	654	—	654	—	—	—	—	—
Issuance of common stock related to share-based awards, net	327	3	(1,850)	—	—	—	—	—	(1,847)	—	(1,847)	—	—	—	—	(1,847)
Dividends on common stock (\$0.28 per share)	(2,729)	(27)	(43,811)	(15,152)	—	—	—	—	(58,990)	—	(58,990)	—	—	—	—	(58,990)
Deferred compensation plan	—	—	—	—	(26,698)	—	—	—	(26,698)	—	(26,698)	—	—	—	—	(26,698)
Adoption of accounting standards	—	—	—	—	—	—	(23)	—	7	—	7	—	—	—	—	7
Net cash contributed from noncontrolling interest	—	—	—	2,601	(2,601)	—	—	—	—	—	—	—	—	—	—	—
Balance, December 31, 2018	93,610	\$ 936	\$ 1,489,816	\$ 466,737	\$ 121,441	825	11	\$ (217)	\$ 1,949,470	\$ 17,411	\$ 1,966,881	\$ 24,423	\$ 1,991,304			
Net income	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	20,046	—	—	—	20,046	—	20,046	—	—	—	—	—
Stock-based compensation expense	—	—	11,243	—	—	—	—	—	11,243	—	11,243	—	—	—	—	—
Common stock issued to board members	27	—	573	—	—	—	—	—	573	—	573	—	—	—	—	—
Issuance of common stock related to share-based awards, net	394	4	(1,982)	—	—	—	—	—	(1,978)	—	(1,978)	—	—	—	—	(1,978)
Dividends on common stock (\$0.32 per share)	(3,390)	(34)	(54,417)	(18,934)	—	—	—	—	(73,385)	—	(73,385)	—	—	—	—	(73,385)
Deferred compensation plan	—	—	—	—	(29,627)	—	—	—	(29,627)	—	(29,627)	—	—	—	—	(29,627)
Adoption of accounting standards	—	—	—	—	—	—	(49)	—	13	—	13	—	—	—	—	13
Net cash contributed to noncontrolling interest	—	—	—	1,393	—	—	—	—	1,393	—	1,393	—	—	—	—	1,393
Balance, December 31, 2019	90,641	\$ 906	\$ 1,445,233	\$ 644,860	\$ 447,836	776	8	\$ (155)	\$ 2,103,039	\$ (6,352)	\$ 2,096,687	\$ 25,757	\$ 2,122,444			
Net income	—	—	—	—	6,344	—	—	—	6,344	—	6,344	—	—	—	—	—
Stock-based compensation expense	—	—	—	—	—	—	—	—	14,089	—	14,089	—	—	—	—	—
Common stock issued to board members	31	—	586	—	—	—	—	—	586	—	586	—	—	—	—	—
Issuance of common stock related to share-based awards, net	293	3	(1,091)	—	—	—	—	—	(1,088)	—	(1,088)	—	—	—	—	(1,088)
Repurchases of common stock	(8,780)	(87)	(140,888)	(67,689)	—	—	—	—	(208,664)	—	(208,664)	—	—	—	—	(208,664)
Dividends on common stock (\$0.36 per share)	—	—	—	—	—	—	(5)	—	(32,524)	—	(32,524)	—	—	—	—	(32,524)
Deferred compensation plan	—	—	—	—	—	—	—	—	17	—	17	—	—	—	—	17
Adoption of accounting standards (Note 2)	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Net cash distributed to noncontrolling interest	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Balance, December 31, 2020	82,185	\$ 822	\$ 1,317,929	\$ 986,792	\$ 17,763	771	7	\$ (138)	\$ 2,323,939	\$ (20,890)	\$ 2,303,049	\$ 26,708	\$ 2,329,757			

See accompanying notes.

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

	<b>Year Ended December 31,</b>		
	<b>2020</b>	<b>2019</b>	<b>2018</b>
<b>Operating Activities</b>			
Net income	\$ 469,677	\$ 232,977	\$ 125,727
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for credit losses	96,491	7,206	5,088
Depreciation, amortization and accretion, net	21,930	(1,483)	(5,272)
Deferred income taxes	16,583	(4,063)	13,009
Other, net	11,849	15,445	8,972
Net change in securities purchased under agreements to resell	(21,288)	2,580	124,926
Net change in trading securities	(4,679)	55,890	(14,781)
Net change in broker-dealer and clearing organization receivables	515,073	(338,158)	23,618
Net change in other assets	(78,997)	61,688	33,321
Net change in broker-dealer and clearing organization payables	(152,158)	206,170	(7,054)
Net change in other liabilities	249,313	78,245	(78,708)
Net change in securities sold, not yet purchased	35,972	(37,850)	(151,154)
Proceeds from sale of mortgage servicing rights asset	35,142	—	9,303
Change in valuation of mortgage servicing rights asset	37,926	24,353	4,337
Net gains from sales of loans	(1,001,059)	(504,935)	(445,116)
Loans originated for sale	(26,766,999)	(16,644,259)	(14,287,551)
Proceeds from loans sold	26,848,663	16,413,647	15,037,339
Net cash provided by (used in) operating activities for continuing operations	313,439	(432,547)	396,004
Net cash used in operating activities for discontinued operations	(33,003)	(476)	(6,464)
Net cash provided by (used in) operating activities	280,436	(433,023)	389,540
<b>Investing Activities</b>			
Proceeds from maturities and principal reductions of securities held to maturity	81,140	73,924	43,699
Proceeds from sales, maturities and principal reductions of securities available for sale	433,828	296,812	215,368
Purchases of securities held to maturity	(7,553)	(109,622)	(39,259)
Purchases of securities available for sale	(975,289)	(415,763)	(306,005)
Net change in loans held for investment	(457,540)	(423,890)	(110,615)
Purchases of premises and equipment and other assets	(37,746)	(42,287)	(67,726)
Proceeds from sales of premises and equipment and other real estate owned	21,512	14,309	25,847
Net cash received from (paid to) Federal Home Loan Bank and Federal Reserve Bank stock	22,808	(17,092)	3,198
Net cash paid for acquisition	—	—	(63,245)
Other, net	—	904	(49)
Net cash used in investing activities for continuing operations	(918,840)	(622,705)	(298,787)
Net cash provided by investing activities for discontinued operations	1,941	18,413	9,120
Net cash received from disposal of discontinued operations	89,233	—	—
Net cash used in investing activities	(827,666)	(604,292)	(289,667)
<b>Financing Activities</b>			
Net change in deposits	2,125,118	600,481	196,060
Net change in short-term borrowings	(729,110)	358,203	(140,617)
Proceeds from notes payable	1,451,249	1,055,772	664,045
Payments on notes payable	(1,325,711)	(1,000,960)	(643,921)
Payments to repurchase common stock	(208,664)	(73,385)	(58,990)
Dividends paid on common stock	(32,524)	(29,627)	(26,698)
Net cash distributed to (from) noncontrolling interest	(20,890)	(6,352)	17,411
Other, net	(1,724)	(2,494)	(2,657)
Net cash provided by financing activities	1,257,744	901,638	4,633
Net change in cash, cash equivalents and restricted cash	710,514	(135,677)	104,506
Cash, cash equivalents and restricted cash, beginning of year	642,789	778,466	673,960
Cash, cash equivalents and restricted cash, end of year	\$ 1,353,303	\$ 642,789	\$ 778,466
<b>Reconciliation of Cash, Cash Equivalents and Restricted Cash to Consolidated Balance Sheets</b>			
Cash and due from banks	\$ 1,062,560	\$ 433,626	\$ 598,999
Cash and due from banks, included within assets of discontinued operations	—	51,333	45,074
Federal funds sold	386	394	400
Assets segregated for regulatory purposes	290,357	157,436	133,993
Total cash, cash equivalents and restricted cash	\$ 1,353,303	\$ 642,789	\$ 778,466
<b>Supplemental Disclosures of Cash Flow Information</b>			
Cash paid for interest	\$ 124,934	\$ 168,535	\$ 143,201
Cash paid for income taxes, net of refunds	\$ 123,553	\$ 56,901	\$ 8,378
<b>Supplemental Schedule of Non-Cash Activities</b>			
Derecognition of construction in progress related to build-to-suit lease obligations	\$ —	\$ —	\$ 27,802
Conversion of loans to other real estate owned	\$ 13,865	\$ 4,669	\$ 6,899
Additions to mortgage servicing rights	\$ 162,914	\$ 13,755	\$ 25,028

*See accompanying notes.*

**Hilltop Holdings Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

**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 and its assets and liabilities have been presented as discontinued operations in the consolidated financial statements. For further details, see Note 3 to the consolidated financial statements.

As a result of the above noted sale of NLC, 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 continue to adversely impact the global economy and have contributed to significant volatility in banking and other financial activity in the areas in which the Company operates. The effects of COVID-19 and the governmental and societal response to the virus have negatively impacted financial markets and overall economic conditions on an unprecedented scale, resulting in the shuttering of businesses across the country and significant job loss. Many of these businesses reopened but may be operating at limited capacity. 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 audited 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”). Other than changes related to the implementation of the current expected credit losses (“CECL”) standard, as further described in Note 2 to the consolidated financial statements, the Company has applied its critical accounting policies and estimation methods consistently in all periods presented in these consolidated financial statements. Actual amounts 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”).



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

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., formerly Hilltop Securities 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 Securities and Exchange Commission (“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 and are collectively referred to as the “Hilltop Plaza Entities.”

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

Certain reclassifications have been made to the prior period consolidated financial statements to conform with the current period presentation, including reclassifications due to the adoption of new accounting pronouncements and reclassifications due to the presentation of NLC’s results and its assets and liabilities as discontinued operations. 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.

### **Use of Estimates**

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 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.

### **Acquisition Accounting**

Acquisitions are accounted for under the acquisition method of accounting. Purchased assets, including identifiable intangible assets, and assumed liabilities are recorded at their respective acquisition date fair values. If the fair value of net assets purchased exceeds the consideration given, a bargain purchase gain is recognized. If the consideration given exceeds the fair value of the net assets received, goodwill is recognized.

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

**Securities Purchased Under Agreements to Resell**

Securities purchased under agreements to resell (reverse repurchase agreements or reverse repos) are treated as collateralized financings and are carried at the amounts at which the securities will subsequently be resold as specified in the agreements. The Company is in possession of collateral with a fair value equal to or in excess of the contract amounts.

**Securities**

Management classifies securities at the time of purchase and reassesses such designation at each balance sheet date. Securities held for resale to facilitate principal transactions with customers are classified as trading and are carried at fair value, with changes in fair value reflected in the consolidated statements of operations. The Company reports interest income on trading securities as interest income on securities and other changes in fair value as other noninterest income.

Debt securities held but not intended to be held to maturity or on a long-term basis are classified as available for sale. Securities included in this category are those that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates, prepayment risk or other factors related to interest rate and prepayment risk. Debt securities available for sale are carried at fair value. Unrealized holding gains and losses on debt securities available for sale, net of taxes, are reported in other comprehensive income (loss) until realized. Premiums and discounts are recognized in interest income using the effective interest method and reflect any optionality that may be embedded in the security.

Equity securities are carried at fair value, with changes in fair value reflected in the consolidated statements of operations. Equity securities that do not have readily determinable fair values are initially recorded at cost and subsequently remeasured when there is (i) an observable transaction involving the same investment, (ii) an observable transaction involving a similar investment from the same issuer or (iii) an impairment. These remeasurements are reflected in the consolidated statements of operations.

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

Available for sale debt securities in unrealized loss positions are evaluated for impairment related to credit losses at least quarterly. For available for sale debt securities, a decline in fair value due to credit loss results in recording an allowance for credit losses to the extent the fair value is less than the amortized cost basis. Declines in fair value that have not been recorded through an allowance for credit losses, such as declines due to changes in market interest rates, are recorded through other comprehensive income, net of applicable taxes.

Allowances for credit losses may result from credit deterioration of the issuer or the collateral underlying the security. In performing an assessment of whether any decline in fair value is due to a credit loss, all relevant information is considered at the individual security level. In assessing whether a credit loss exists, the Company compares the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis for the security, a credit loss exists and an allowance for credit losses is recorded, limited to the amount by which the fair value is less than the amortized cost basis.

Under the new credit loss guidance adopted on January 1, 2020, the previous other-than-temporary-impairment (“OTTI”) model was replaced. Under the OTTI model, credit losses were recognized as a reduction to the cost basis of the investment with recovery of an impairment loss recognized prospectively over time as interest income, and reversals of impairment were not allowed. Effective January 1, 2020, if the Company intends to sell a debt security, or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the debt security is written down to its fair value and the write down is charged against the allowance for credit losses, with any incremental impairment reported in earnings. Reversals of the allowance for credit losses are permitted and should not exceed the allowance amount initially recognized.

For debt securities held to maturity, estimated expected credit losses are calculated in a manner like that used for loans held for investment. That is, the historical lifetime probability of default and severity of loss in the event of default is derived or obtained from external sources and adjusted for the expected effects of reasonable and supportable forecasts over the expected lives of the securities on those historical credit losses. With respect to certain classes of debt securities, primarily U.S. Treasuries, the Company considers the history of credit losses, current conditions and reasonable and

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

supportable forecasts, which may indicate that the expectation that nonpayment of the amortized cost basis is or continues to be zero, even if the U.S. government were to technically default. Therefore, for those securities, the Company does not record expected credit losses.

**Loans Held for Sale**

Loans held for sale consist primarily of single-family residential mortgages funded through PrimeLending. These loans are generally on the consolidated balance sheet between 30 and 45 days. Substantially all mortgage loans originated by PrimeLending are sold to various investors in the secondary market, historically with the majority with servicing released. Mortgage loans held for sale are carried at fair value in accordance with the provisions of the Fair Value Option Subsections of the ASC (the “Fair Value Option”). Changes in the fair value of the loans held for sale are recognized in earnings and fees and costs associated with origination are recognized as incurred. The specific identification method is used to determine realized gains and losses on sales of loans, which are reported as net gains (losses) in noninterest income. Loans sold are subject to certain indemnification provisions with investors, including the repurchase of loans sold and repayment of certain sales proceeds to investors under certain conditions. In addition, certain mortgage loans guaranteed by U.S. Government agencies and sold into Government National Mortgage Association (“GNMA”) pools may, under certain conditions specified in the government programs, become subject to repurchase by PrimeLending. When such loans subject to repurchase no longer qualify for sale accounting, they are reported as loans held for sale in the consolidated balance sheets.

**Loans Held for Investment**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal reduced by unearned income, net unamortized deferred fees and an allowance for credit losses. Unearned income on installment loans and interest on other loans is recognized using the effective interest method. Net fees received for providing loan commitments and letters of credit that result in loans are deferred and amortized to interest income over the life of the related loan, beginning with the initial borrowing. Net fees on commitments and letters of credit that are not expected to be funded are amortized to noninterest income over the commitment period. Income on direct financing leases is recognized on a basis that achieves a constant periodic rate of return on the outstanding investment.

The accrual of interest on credit deteriorated loans is discontinued when, in management’s opinion, there is a clear indication that the borrower’s cash flow may not be sufficient to meet principal and interest payments, which is generally when a loan is 90 days past due unless the asset is both well secured and in the process of collection. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is charged against income. Once placed on non-accrual status, interest income is recognized on a cash basis. Additionally, accretion of purchased discount on non-accrual loans is suspended.

The Company follows applicable regulatory guidance when measuring past due status. The Company uses the actual days elapsed since the payment due date of the loan to determine delinquency. In response to the ongoing 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 modifications generally meet the criteria of the CARES Act, and therefore, the Company does not account for such loan modifications as TDRs, nor are loans granted payment deferrals related to COVID-19 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.

Management defines loans acquired in a business combination as acquired loans. Acquired loans are recorded at estimated fair value on their purchase date with no carryover of the related allowance for credit losses. Acquired loans are segregated between those considered to be credit deteriorated and those without credit deterioration at acquisition. To make this determination, management considers such factors as past due status, non-accrual status and credit risk ratings. For acquired performing loans, a lifetime allowance for credit losses is estimated as of the date of acquisition and is recorded through provision for (reversal of) credit losses. The difference between the purchase price and loan receivable is amortized over the remaining life of the loan.

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

All formerly designated purchased credit impaired (“PCI”) loans became purchased credit deteriorated (“PCD”) loans effective January 1, 2020. PCD loans are loans that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination. For PCD loans, any non-credit discount or premium related to an acquired pool of PCD loans is allocated to each individual asset within the pool. On the acquisition date, the initial allowance for credit losses measured on a pooled basis is allocated to each individual asset within the pool to allocate any non-credit discount or premium. Credit losses are measured based on unpaid principal balance. A lifetime allowance for credit losses is estimated as of the date of acquisition. The initial allowance for credit losses is added to the purchase price and is considered to be part of the PCD loan amortized cost basis.

**Allowance for Credit Losses for Loans Held for Investment**

Credit quality within the loans held for investment portfolio is continuously monitored by management and is reflected within the allowance for credit losses for loans. The allowance for credit losses, or reserve, is an estimate of expected losses over the lifetime of a loan within the Company’s existing loans held for investment portfolio. The allowance for credit losses for loans held for investment is adjusted by a provision for (reversal of) credit losses, which is reported in earnings, and reduced by the charge-off of loan amounts, net of recoveries.

The credit loss estimation process involves procedures to appropriately consider the unique characteristics of the Company’s loan portfolio segments, which are further disaggregated into loan classes, the level at which credit risk is monitored. The allowance for credit losses for loans not evaluated for specific reserves is calculated using statistical credit factors, including probabilities of default (“PD”) and loss given default (“LGD”), to the amortized cost of pools of loan exposures with similar risk characteristics over its contractual life, adjusted for prepayments, to arrive at an estimate of expected credit losses. Economic forecasts are applied over the period management believes it can estimate reasonable and supportable forecasts. Reasonable and supportable forecast periods and reversion assumptions to historical data are credit model specific. The Company typically forecasts economic variables over a one to four year horizon. Prepayments are estimated by loan type using historical information and adjusted for current and future conditions.

Commercial loans that exceed a minimum size scope are underwritten and graded using credit models that leverage national industry default data to score the loans. At the conclusion of the process of underwriting or re-grading a borrower, each borrower (for commercial and industrial loans) or property (for commercial real estate loans) is assigned a PD grade threshold. The valuation methodology of risk rating internal grades is based on the merits of the financial ratios of the borrower or the property. In addition, an LGD grade is determined by the credit models utilizing collateral information provided. A master rating scale effectively “pools” the loans by credit scores and assigns a standard one year PD percentage and an LGD percentage equally for all loans that have a given score. For borrowers or loans that do not meet the minimum balance threshold, an internal scorecard is utilized to approximate the grades derived from the credit models and is mapped to the master rating scale. The resulting numerical PD grade is the credit quality indicator for commercial loans. The grades on borrowers or properties that are scored in the credit models are determined at origination and updated at least annually. The grades on the internal scorecards are updated annually if they meet a minimum threshold, or if new circumstances (favorable or unfavorable) warrant a re-scoring.

When computing allowance levels, credit loss assumptions are estimated using models that analyze loans according to credit risk ratings, historic loss experience, past due status and other credit trends and risk characteristics, including current conditions and reasonable and supportable forecasts about the future. Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Future factors and forecasts may result in significant changes in the allowance and provision (reversal) for credit losses in those future periods. The allowance for credit losses will primarily reflect estimated losses for pools of loans that share similar risk characteristics, but will also consider individual loans that do not share risk characteristics with other loans.

*Loans that Share Risk Characteristics with Other Loans*

In estimating the component of the allowance for credit losses for loans that share similar risk characteristics with other loans, such loans are segregated into loan classes. Loans are designated into loan classes based on loans pooled by product types and similar risk characteristics or areas of risk concentration. In determining the allowance for credit losses, the Company derives an estimated credit loss assumption from a model that categorizes loan pools based on loan type and internal risk rating or past due category as follows.

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

*Commercial and Industrial and Commercial Real Estate Loans.* The Company assesses the credit quality of the borrower and assigns an internal risk rating by loan type for the commercial and industrial and commercial real estate portfolios. Internal risk ratings are assigned at origination or acquisition, and if necessary, adjusted for changes in credit quality over the life of the exposure. In assessing the internal PD risk rating of the loan or related unfunded commitments, we separately evaluate owner and non-owner occupied real estate. The borrower's financial statements may be used to evaluate amounts and sources of repayments, debt service coverage, debt capacity, and quality of earnings. Other non-financial metrics are also evaluated including the geographies and industries within which it operates, its management strength, and its reputation and historical experience. The internal LGD risk rating also considers assessment of collateral quality and current loan to value, collateral type and loan seniority, covenant strength and performance, as well as any individual, corporate, or government guarantees.

These factors are based on an evaluation of historical and current information and sometimes involve subjective assessment and interpretation. Specific considerations for construction are considered in the internal PD and LGD risk ratings including property type, development phase and complexity, as well as lease-up and stabilization projections. The PD and LGD factors are further sensitized in the models for future expectations over the loan's contractual life, adjusted for prepayments.

*1-4 Family Residential Loans.* The 1-4 family residential loan portfolio is segmented into pools of residential real estate loans with similar credit risk characteristics. For 1-4 family residential loans, the Company utilizes separate credit models designed for these types of loans to estimate the PD and LGD grades for the allowance for credit losses calculation. The models calculate expected losses and prepayments using borrower information at origination, including FICO score, loan type, collateral type, lien position, geography, origination year, and loan to value. Past due status post-origination is also a key input in the models. Current and future changes in economic conditions, including unemployment rates, home prices, index rates, and mortgage rates, are also considered. New originations and loan purchases are scored using the FICO score at origination. FICO score bands are assigned following prevalent industry standards and are used as the credit quality indicator for these types of loans. Substandard non-accrual loans are treated as a separate category in the credit scoring grid as the probability of default is 100% and the FICO score is no longer a relevant predictor.

*Consumer Loans.* The consumer loan portfolio is segmented into pools of consumer installment loans or revolving lines of credit with similar credit characteristics. The models calculate expected losses using borrower information at origination, including FICO score, origination year, geography, and collateral type.

*Broker-Dealer Loans.* The broker-dealer loan portfolio is evaluated on an individual basis using the collateral maintenance practical expedient. The collateral maintenance practical expedient allows the broker-dealer to compare the fair value of the collateral of each loan as of the reporting date to loan value. The underlying collateral of the loans to customers and correspondents is marked to market daily and any required additional collateral is collected. The allowance represents the amount of unsecured loan balances at the end of the period.

#### *Qualitative Factors*

Estimating the timing and amounts of future loss cash flows is subject to significant management judgment as these loss cash flows rely upon estimates such as default rates, loss severities, collateral valuations, the amounts and timing of principal payments (including any expected prepayments) or other factors that are reflective of current or future expected conditions. These estimates, in turn, depend on the duration of current overall economic conditions, industry, borrower, or portfolio specific conditions, the expected outcome of bankruptcy or insolvency proceedings, as well as, in certain circumstances, other economic factors, including the level of current and future real estate prices. All of these estimates and assumptions require significant management judgment and certain assumptions that are highly subjective. Model imprecision also exists in the allowance for credit losses estimation process due to the inherent time lag of available industry information and differences between expected and actual outcomes.

Management considers adjustments for these conditions in its allowance for credit loss estimates qualitatively where they may not be measured directly in its individual or collective assessments, including but not limited to:

- an adjustment to historical loss data to measure credit risk even if that risk is remote and does not meet the scope of assets with zero expected losses;

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

- the environmental factors and the areas in which credit is concentrated, such as the regulatory, environmental, or technological environment, the geographical area or key industries, or in the national or regional economic and business conditions where the borrower has exposure;
- the nature and volume of the company's financial assets;
- the borrower's financial condition, credit rating, credit score, asset quality, or business prospects;
- the borrower's ability to make scheduled interest or principal payments;
- the remaining payment terms of the financial assets and the remaining time to maturity and the timing and extent of prepayments on the financial assets;
- the volume and severity of past due or adversely classified financial assets;
- the value of underlying collateral in which the collateral-dependent practical expedient has not been utilized;
- any updates to credit lending policies and procedures, including lending strategies, underwriting standards, collection and recovery practices, not reflected in the models; and
- the quality of the internal credit review system.

*Loans that Do Not Share Risk Characteristics with Other Loans*

When a loan is assigned a substandard non-accrual risk rating grade, the loan subsequently is evaluated on an individual basis and no longer evaluated on a collective basis. The net realizable value of the loan is compared to the appropriate loan basis (i.e. PCD loan versus non-PCD loan) to determine any allowance for credit losses. Loans that are below a predetermined threshold, with the exception of 1-4 family residential loans, are fully reserved. The Company generally considers non-accrual loans to be collateral-dependent. The practical expedient to measure credit losses using the fair value of the collateral has been exercised.

For commercial real estate loans, the fair value of collateral is primarily based on appraisals. For owner occupied real estate loans, underlying properties are occupied by the borrower in its business, and evaluations are based on business operations used to service the debt. For non-owner occupied real estate loans, underlying properties are income-producing and evaluations are based on tenant revenues. For income producing construction and land development loans, appraisals reflect the assumption that properties are completed.

For 1-4 family residential loans that are graded substandard non-accrual, an assessment of value is made using the most recent appraisal on file. If the appraisal on file is older than two years, the latest property tax assessment is used as a screening value to determine if a reserve might be required. If the assessed value is less than the appraised value, this value is discounted for selling costs and is used to measure the reserve required. If the appraisal is less than two years old, the value is discounted for selling costs and compared to the appropriate basis in the loan.

Consumer loans are charged off when they reach 90 days delinquency as a general rule. There are limited cases where the loan is not charged off due to special circumstances and is subject to the collateral review process.

**Allowance for Loan Losses for Loans Held for Investment**

Prior to the adoption of the new CECL standard as described in Note 2 to the consolidated financial statements, the Company's allowance for loan losses was a reserve established through a provision for loan losses charged to or recovered from expense, which represents management's best estimate of probable losses inherent in the existing portfolio of loans at the balance sheet date. The allowance for loan losses included allowance allocations calculated in accordance with the regulatory Interagency Policy Statement on the Allowance for Loan and Lease Losses and the Receivables and Contingencies Topics of the ASC. The level of the allowance reflected management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions, and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilized its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond its control, including the performance of the loan portfolio, the economy and changes in interest rates.

The Bank's allowance for loan losses consisted of three elements: (i) specific valuation allowances established for probable losses on individually impaired loans; (ii) general historical valuation allowances calculated based on historical

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

loan loss experience for homogenous loans with similar collateral; and (iii) valuation allowances to adjust general reserves based on current economic conditions and other qualitative risk factors, including projected loss emergence period, both internal and external to the Bank.

Changes in the volume and severity of past due, non-accrual and classified loans, as well as changes in the nature, volume and terms of loans in the portfolio are key indicators of changes that could indicate a necessary adjustment to the historical loss factors. Classified loans are defined as loans having a well-defined weakness or weaknesses related to the borrower's financial capacity or to pledged collateral that may jeopardize the repayment of the debt. They are characterized by the possibility that the Bank may sustain some loss if the deficiencies giving rise to the substandard classification are not corrected. The magnitude of the impact of these factors on the qualitative assessment of the allowance for loan loss changes from quarter to quarter. Periodically, management conducted an analysis to estimate the loss emergence period for each loan portfolio segment based on historical charge-offs, loan type and loan payment history and considered available industry peer bank data. Model output by loan category was reviewed to evaluate the reasonableness of the reserve levels in comparison to the estimated loss emergence period applied to historical loss experience.

In connection with business combinations, the Bank acquired loans both with and without evidence of credit quality deterioration since origination. PCI loans were accounted for in pools as well as on an individual loan basis. Cash flows expected to be collected were recast quarterly for each loan or pool. These evaluations required the continued use and updating of key assumptions and estimates such as default rates, loss severity given default and prepayment speed assumptions (similar to those used for the initial fair value estimate). Management judgment was applied in developing these assumptions. If expected cash flows for a loan or pool decreased, an increase in the allowance for loan losses was made through a charge to the provision for loan losses. If expected cash flows for a loan or pool increased, any previously established allowance for loan losses was reversed and any remaining difference increased the accretable yield. This increase in accretable yield was taken into income over the remaining life of the loan.

Loans without evidence of credit impairment at acquisition were subsequently evaluated for any required allowance at each reporting date. An allowance for loan losses was calculated using a methodology similar to that described above for originated loans. The allowance as determined for each loan collateral type was compared to the remaining fair value discount for that loan collateral type. If greater, the excess was recognized as an addition to the allowance through a provision for loan losses. If less than the discount, no additional allowance was recorded. Charge-offs and losses first reduced any remaining fair value discount for the loan and once the discount was depleted, losses were applied against the allowance established for that loan.

#### **Off-Balance Sheet Credit Exposures, Including Unfunded Loan Commitments**

The Company maintains a separate allowance for credit losses from off-balance sheet credit exposures, including unfunded loan commitments, which is included in other liabilities within the consolidated balance sheets. The Company 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.

#### **Broker-Dealer and Clearing Organization Transactions**

Amounts recorded in broker-dealer and clearing organization receivables and payables include securities lending activities, as well as amounts related to securities transactions for either customers of the Hilltop Broker-Dealers or for the accounts of the Hilltop Broker-Dealers. Securities borrowed and securities loaned transactions are generally reported as collateralized financings. Securities borrowed transactions require the Hilltop Broker-Dealers to deposit cash, letters of credit, or other collateral with the lender. With respect to securities loaned, the Hilltop Broker-Dealers receive collateral in the form of cash or other assets in an amount generally in excess of the market value of securities loaned. The Hilltop Broker-Dealers monitor the market value of securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as necessary. Interest income and interest expense associated with collateralized financings is included in the accompanying consolidated statements of operations.

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

**Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation and amortization computed principally on the straight-line method over the estimated useful lives of the assets, which range between 3 and 25 years. Gains or losses on disposals of premises and equipment are included in results of operations.

**Leases**

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

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

**Other Real Estate Owned**

Real estate acquired through foreclosure (“OREO”) is included in other assets within the consolidated balance sheets and is carried at management’s estimate of fair value, less estimated cost to sell. Any excess of recorded investment over fair value, less cost to sell, is charged against the allowance for credit losses when property is initially transferred to OREO. Subsequent to the initial transfer to OREO, downward valuation adjustments are charged against earnings. Valuation adjustments, revenue and expenses from operations of the properties and resulting gains or losses on sale are included within the consolidated statements of operations in other noninterest income or expense, as appropriate.

**Debt Issuance Costs**

The Company capitalizes debt issuance costs associated with financing of debt. These costs are amortized using the effective interest method over the repayment term of the debt. Unamortized debt issuance costs are presented in the consolidated balance sheets as a direct reduction from the associated debt liability. Debt issuance costs of \$0.3 million, \$0.2 million and \$0.2 million during 2020, 2019 and 2018, respectively, were amortized and included in interest expense within the consolidated statements of operations. In May 2020 and April 2015, debt issuance costs of \$3.2 million and \$1.9 million, respectively, were capitalized in connection with Hilltop’s issuance of the Subordinated Notes due 2030 and 2035 (defined hereafter) and the 5% senior notes due 2025 (defined hereafter), respectively.

**Goodwill**

Goodwill, which represents the excess of cost over the fair value of the net assets acquired, is allocated to reporting units and tested for impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the carrying amount should be assessed. The Company performs required annual impairment tests of its goodwill as of October 1<sup>st</sup> for each of its reporting units, which is one level below an operating segment. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired



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

or internally generated, are available to support the value of the goodwill. The goodwill impairment test requires the Company to make judgments in determining what assumptions to use in the calculation. The process consists of estimating the fair value of each reporting unit based on valuation techniques, including a discounted cash flow model using revenue and profit forecasts and recent industry transaction and trading multiples of peers, and comparing those estimated fair values with the carrying values of the assets and liabilities of the reporting unit, which includes the allocated goodwill. If the estimated fair value is less than the carrying value, the Company is required to recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, any loss recognized will not exceed the total amount of goodwill allocated to that reporting unit.

### **Intangibles and Other Long-Lived Assets**

Intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. The Company's intangible assets primarily consist of core deposits, trade names and customer relationships. Intangible assets with definite useful lives are generally amortized on the straight-line method over their estimated lives, although certain intangibles, including core deposits, and customer relationships, are amortized on an accelerated basis. Amortization of intangible assets is recorded in other noninterest expense within the consolidated statements of operations. Intangible assets with indefinite useful lives are tested for impairment on an annual basis as of October 1<sup>st</sup>, or more often if events or circumstances indicate there may be impairment, and not amortized until their lives are determined to be definite. Intangible assets with definite useful lives, premises and equipment, operating lease ROU assets, and other long-lived assets are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. Impaired assets are recorded at fair value.

### **Mortgage Servicing Rights**

The Company determines its portfolio segment of residential mortgage servicing assets based on the asset type being serviced along with the methods used to manage the risk inherent in the servicing assets, which includes the market inputs used to value the servicing assets. The Company measures its servicing assets at fair value and reports changes in fair value through earnings.

The retained mortgage servicing rights ("MSR") asset is measured at fair value as of the date of sale of the related mortgage loan. Subsequent fair value measurements of the MSR asset are determined by valuing the projected net servicing cash flows, which are then discounted to estimate fair value using a discounted cash flow model. Assumptions used include market discount rates, anticipated prepayment speeds, delinquency and foreclosure rates, and ancillary fee income.

The model assumptions and the MSR asset fair value estimates are compared to observable trades of similar portfolios as well as to MSR asset broker valuations and industry surveys, as available. The expected life of the loan can vary from management's estimates due to prepayments by borrowers. The value of the MSR asset is also dependent upon the discount rate used in the model, which is based on current market rates that are reviewed by management on an ongoing basis.

### **Derivative Financial Instruments**

The Company enters into various derivative financial instruments to manage interest rate risk or to hedge specified assets and liabilities. The Company's derivative financial instruments also include interest rate lock commitments ("IRLCs") executed with its customers that allow those customers to obtain a mortgage loan on a future date at an agreed-upon interest rate. The IRLCs, forward commitments, interest rate swaps, U.S. Treasury bond futures and options and Eurodollar futures meet the definition of a derivative under the provisions of the Derivatives and Hedging Topic of the ASC.

Derivatives are recorded at fair value in the consolidated balance sheets. To qualify for hedge accounting, derivatives must be highly effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the derivative contract. If derivative instruments are designated as hedges of fair values, the change in the fair value of both the derivative instrument and the hedged item are included in current earnings. Changes in the fair

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

value of derivatives designated as hedges of cash flows are recorded in other comprehensive income (loss). Actual cash receipts and/or payments and related accruals on derivatives related to hedges are recorded as adjustments to the line item where the hedged item's effect on earnings is recorded.

**Revenue from Contracts with Customers**

Certain activities primarily within the Company's broker-dealer and banking segments are subject to the provisions of ASC 606, *Revenue from Contracts with Customers*. The Company's broker-dealer segment has four primary lines of business: (i) public finance services, (ii) structured finance, (iii) fixed income services and (iv) wealth management, which includes retail, clearing services and securities lending groups. Revenue from contracts with customers subject to the guidance in ASC 606 from the broker-dealer segment is included within the securities commissions and fees and investment and securities advisory fees and commissions line items within the consolidated statements of operations. Commissions and fees revenue is generally recognized at a point in time upon the delivery of contracted services based on a predefined contractual amount or on the trade date for trade execution services based on prevailing market prices and internal and regulatory guidelines.

The Company's banking segment has three primary lines of business: (i) business banking, (ii) personal banking and (iii) wealth and investment management. Revenue from contracts with customers subject to the guidance in ASC 606 from the banking segment (certain retail and trust fees) is included within the other noninterest income line item within the consolidated statements of operations. Retail and trust fees are generally recognized at the time the related transaction occurs or when services are completed. Fees are based on the dollar amount of the transaction or are otherwise predefined in contracts associated with each customer account depending on the type of account and services provided.

**Loss Contingencies**

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

**Stock-Based Compensation**

Stock-based compensation expense for all share-based awards granted is based on the grant date fair value estimated in accordance with the provisions of the Stock Compensation Topic of the ASC. The Company recognizes these compensation costs for only those awards expected to vest over the service period of the award.

**Income Taxes**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recorded for the estimated future tax effects of the temporary difference between the tax basis and book basis of assets and liabilities reported in the accompanying consolidated balance sheets. The provision for income tax expense or benefit differs from the amounts of income taxes currently payable because certain items of income and expense included in the consolidated financial statements are recognized in different time periods by taxing authorities. Interest and penalties incurred related to tax matters are charged to other interest expense or other noninterest expense, respectively. The revaluation of deferred tax assets as a result of enacted tax rate changes, such as those found in the Tax Cuts and Jobs Act of 2017 ("Tax Legislation"), is recognized within income tax expense in continuing operations in the period of enactment.

Benefits from uncertain tax positions are recognized in the consolidated financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority having full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of cumulative benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold are recognized in the reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold are derecognized in the reporting period in which that threshold is no longer met. If the Company were to prevail on all uncertain tax positions, the effect would be a benefit to the Company's effective tax rate. Due to uncertainties in any tax audit outcome, estimates of the ultimate settlement of unrecognized tax positions may change and the actual tax benefits may differ significantly from the estimate.

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

Deferred tax assets, including net operating loss and tax credit carry forwards, are reduced by a valuation allowance when, in the opinion of management, it is more-likely-than-not that any portion of these tax attributes will not be realized. Periodic reviews of the carrying amount of deferred tax assets are made when it is more likely than not that all or a portion of a deferred tax asset will not be realized.

**Cash, Cash Equivalents and Restricted Cash**

For the purpose of presentation in the consolidated statements of cash flows, cash, cash equivalents and restricted cash are defined as the amounts included in the consolidated balance sheet captions “Cash and due from banks”, “Federal funds sold” and “Assets segregated for regulatory purposes.” Cash equivalents have original maturities of three months or less.

**Repurchases of Common Stock**

In accordance with Maryland law, the Company uses the par value method of accounting for its stock repurchases, whereby the par value of the shares is deducted from common stock. The excess of the cost of shares acquired over the par value is allocated to additional paid-in capital based on an estimated average sales price per issued share with the excess amounts charged to retained earnings.

**Basic and Diluted Net Income Per Share**

Nonvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of earnings per share pursuant to the two-class method prescribed by the Earnings Per Share Topic of the ASC. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings.

Net earnings, less any preferred dividends accumulated for the period (whether or not declared), is allocated between the common stock and participating securities pursuant to the two-class method. Basic earnings per common share is computed by dividing net earnings available to common stockholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares. The Company calculated basic earnings per common share using the treasury method instead of the two-class method because there were no instruments which qualified as participating securities during 2020, 2019 or 2018.

Diluted earnings per common share is computed in a similar manner, except that first the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares, excluding the participating securities, were issued using the treasury stock method. During 2020, 2019 and 2018, restricted stock units (“RSUs”) were the only potentially dilutive non-participating instruments issued by Hilltop. Next, the Company determines and includes in the diluted earnings per common share calculation the more dilutive effect of the participating securities using the treasury stock method or the two-class method. Undistributed losses are not allocated to the nonvested share-based payment awards (the participating securities) under the two-class method as the holders are not contractually obligated to share in the losses of the Company.

**2. Recently Issued Accounting Standards**

*Accounting Standards Adopted During 2020*

In March 2020, FASB issued ASU 2020-03 which included various clarifications and improvements related to financial instruments. The following topics are addressed: fair value option disclosures, applicability of portfolio exception to non-financial items, disclosures for depository and lending institutions, cross-reference to line-of-credit or revolving debt arrangements, cross-reference to net asset value practical expedient, the contractual term of a net investment in a lease for measuring expected credit losses, and recording of an allowance for credit losses when control of financial assets sold is regained. All items had various effective dates, which for the Company ranged from January 1, 2020 to the date of issuance. The adoption of ASU 2020-03 did not have a material impact on the Company’s consolidated financial statements.

In December 2019, FASB issued ASU 2019-12 which simplifies the accounting for income taxes by removing certain exceptions to the general principles in the ASC and is intended to improve consistency by clarifying and amending

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

existing guidance. The amendments are effective for annual periods beginning after December 15, 2020. As permitted within the amendment, the Company elected to early adopt and prospectively apply the provisions of this amendment as of January 1, 2020. The removal of the exceptions did not result in a material change in the Company's current or deferred income tax provisions and did not have a material impact on the Company's consolidated financial statements.

In August 2018, FASB issued ASU 2018-15 which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include internal-use software licenses). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this update. The amendment also includes presentation and disclosure provisions regarding capitalized implementation costs. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019. The Company adopted the provisions of this amendment as of January 1, 2020. The impact of this amendment is limited to presentation and disclosure changes that did not have an impact on the Company's consolidated financial statements.

In August 2018, FASB issued ASU 2018-13 which includes various removals, modifications and additions to existing guidance regarding fair value disclosures. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019. The Company adopted the provisions of these amendments as of January 1, 2020. The impact of these amendments is limited to presentation and disclosure changes that did not have an impact on the Company's consolidated financial statements.

In June 2016, FASB issued ASU 2016-13 which sets forth a current expected credit loss model that requires entities to measure all credit losses expected over the life of an exposure (or pool of exposures) for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. The FASB has issued various updates, improvements and technical corrections to the standard since the issuance of ASU 2016-13. The new standard, which is codified in ASC 326, *Financial Instruments – Credit Losses*, replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. For available for sale securities, the standard modifies the current OTTI model by requiring entities to record an allowance for credit losses rather than reducing the carrying amount of securities. Additionally, the new standard eliminated the former accounting model for PCI loans, but requires an allowance to be recognized for PCD assets. The new standard also requires enhanced disclosures to help financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. The Company's implementation efforts included, among other activities, the development, testing and validation of credit forecasting models and a new credit scoring system for significant loan portfolio segments, reassessment of risk rating grades and matrix, as well as development of the policies, systems and controls required to fully implement CECL. The new standard is effective for the Company for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2019, with a cumulative-effect adjustment to retained earnings at the date of adoption. On January 1, 2020, the Company adopted the new CECL standard and recorded entries that resulted in an aggregate allowance for credit losses of \$83.6 million within the consolidated balance sheets. The transition adjustment resulted in a net of tax, decrease of \$5.7 million to opening retained earnings at January 1, 2020. The decrease to retained earnings included an initial estimate of lifetime expected credit losses for PCD loans and was recognized through a balance sheet gross-up. While not material, the impact of the adoption of CECL also affected the Company's regulatory capital, performance and other asset quality ratios. 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 March 2020, FASB issued ASU 2020-04, which is intended to provide temporary optional expedients and exceptions to the GAAP guidance on contract modifications and hedge accounting to ease the financial reporting burdens related to the expected market transition from the London Interbank Offered Rate (LIBOR) and other interbank offered rates to alternative reference rates. This guidance is effective beginning on March 12, 2020, and the Company may elect to apply the amendments prospectively through December 31, 2022. Further, in January 2021, FASB issued ASU 2021-01, which clarifies that all derivative instruments affected by changes to the interest rates used for discounting, margining or contract price alignment are in the scope of ASU 2020-04 and therefore qualify for the available temporary optional expedients and exceptions. As such, entities that employ derivatives that are the designated hedged item in a hedge relationship where perfect effectiveness is assumed can continue to apply hedge accounting without de-designating the

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

hedging relationship to the extent such derivatives are impacted by the discounting transition. The Company adopted the provisions of ASU 2020-04, as well as retrospectively applied the amendments of ASU 2021-01, as of December 31, 2020. The adoption of these amendments did not have a material impact on the Company's consolidated financial statements.

*Accounting Standards Issued But Not Yet Adopted*

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 ASU 2020-01 as of January 1, 2021. The impact of this guidance is not expected to have a material impact on the Company's 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 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 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 pending sale of NLC met the criteria to be presented as discontinued operations. Therefore, NLC's results and its assets and liabilities have been presented as discontinued operations in the consolidated financial statements. All related notes to consolidated financial statements for discontinued operations have been included in this note. The following table details the carrying amounts of assets and liabilities of NLC reflected in the consolidated balance sheet under the caption "Assets of discontinued operations" and "Liabilities of discontinued operations", respectively, at December 31, 2019.

<b>Assets</b>	
Cash and due from banks	\$ 51,333
Securities:	
Available for sale, at fair value	86,899
Equity, at fair value	19,841
	<u>106,740</u>
Premises and equipment, net	9,607
Operating lease right-of-use assets	2,739
Other assets	50,533
Goodwill	23,988
Other intangible assets, net	3,489
Total assets of discontinued operations	<u>\$ 248,429</u>
<b>Liabilities</b>	
Notes payable	\$ 27,500
Operating lease liabilities	2,783
Other liabilities	110,391
Total liabilities of discontinued operations	<u>\$ 140,674</u>

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

The following table presents the results of discontinued operations for NLC for the periods indicated.

	Year Ended December 31,		
	2020	2019	2018
Interest income:			
Securities:			
Taxable	\$ 1,752	\$ 3,611	\$ 4,310
Other	71	522	495
Total interest income	<u>1,823</u>	<u>4,133</u>	<u>4,805</u>
Interest expense:			
Notes payable	775	1,806	1,780
Noninterest income:			
Net insurance premiums earned	65,077	132,284	136,751
Other	3,051	10,915	5,909
Total noninterest income	<u>68,128</u>	<u>143,199</u>	<u>142,660</u>
Noninterest expense:			
Employees' compensation and benefits	6,002	11,663	11,474
Occupancy and equipment, net	464	991	1,284
Professional services	18,201	35,528	35,953
Loss and loss adjustment expenses	38,419	68,940	79,347
Other	3,987	10,796	11,863
Total noninterest expense	<u>67,073</u>	<u>127,918</u>	<u>139,921</u>
Income from discontinued operations before income taxes	2,103	17,608	5,764
Gain on disposal of discontinued operations	36,811	—	—
Income tax expense	518	3,618	823
Income from discontinued operations, net of income taxes	<u>\$ 38,396</u>	<u>\$ 13,990</u>	<u>\$ 4,941</u>

*Securities*

The available for sale securities held by NLC at December 31, 2019 reflected in the consolidated balance sheets under the caption "Assets of discontinued operations" were primarily comprised of U.S. Treasury, residential mortgage-backed and corporate debt securities with aggregate unrealized gross gains of \$2.5 million and measured using Level 2 inputs on a recurring basis. NLC's available for sale portfolio had nominal unrealized gross losses at December 31, 2019.

NLC had unrealized net gains of \$1.1 million during 2020 from the equity securities held at December 31, 2019, measured using Level 1 inputs on a recurring basis. NLC recognized net gains of \$1.9 million during 2019 due to changes in the fair value of equity securities still held at the balance sheet date.

*Reinsurance Activity*

Net insurance premiums earned, losses and LAE, and policy acquisition and other underwriting expenses are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE and unearned insurance premiums ceded to them are included in other assets within the consolidated balance sheets. Reinsurance assumed from other companies, including assumed premiums written and earned, and losses and LAE, is accounted for in the same manner as direct insurance written.

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

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

	Year Ended December 31,					
	2020		2019		2018	
	Written	Earned	Written	Earned	Written	Earned
Premiums from direct business	\$ 63,811	\$ 61,384	\$ 125,157	\$ 126,434	\$ 129,611	\$ 133,112
Reinsurance assumed	6,396	6,452	13,148	13,041	12,917	12,516
Reinsurance ceded	(2,759)	(2,759)	(7,191)	(7,191)	(8,749)	(8,877)
Net premiums	<u>\$ 67,448</u>	<u>\$ 65,077</u>	<u>\$ 131,114</u>	<u>\$ 132,284</u>	<u>\$ 133,779</u>	<u>\$ 136,751</u>

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

	Year Ended December 31,		
	2020	2019	2018
	Losses and LAE incurred	\$ 38,225	\$ 68,130
Reinsurance recoverables	194	810	2,883
Net loss and LAE incurred	<u>\$ 38,419</u>	<u>\$ 68,940</u>	<u>\$ 79,347</u>

Costs of acquiring insurance primarily consist of commissions, premium taxes and underwriting expenses, and are deferred and amortized over the terms of the policies or reinsurance treaties to which they relate. Proceeds from reinsurance transactions that represent recovery of acquisition costs reduce applicable unamortized acquisition costs in such a manner that net acquisition costs are capitalized and charged to expense in proportion to net revenue recognized. A premium deficiency and a corresponding charge to income is recognized if the sum of the expected loss and LAE, unamortized policy acquisition costs, and maintenance costs exceed related unearned insurance premiums and anticipated investment income. At December 31, 2019, there was no premium deficiency.

Policy acquisition expenses, primarily commissions, premium taxes and underwriting expenses related to the successful issuance of a new or renewal policy incurred by NLC are deferred and charged against income ratably over the terms of the related policies. A summary of the activity in deferred policy acquisition costs included within discontinued operations for all periods is as follows (in thousands).

	Year Ended December 31,		
	2020	2019	2018
	Balance, beginning of year	\$ 15,672	\$ 16,633
Acquisition expenses capitalized	17,642	32,245	34,328
Amortization charged to income	(16,967)	(33,206)	(34,683)
Balance, end of year	<u>\$ 16,347</u>	<u>\$ 15,672</u>	<u>\$ 16,633</u>

*Insurance Losses and Loss Adjustment Expenses*

At December 31, 2019, our gross reserve for unpaid losses and LAE reflected in the consolidated balance sheet under the caption "Liabilities of discontinued operations" was \$15.3 million, including estimated recoveries from reinsurance of \$1.0 million. The liability for insurance losses and LAE represents estimates of the ultimate unpaid cost of all losses incurred, including losses for claims that have not yet been reported, less a reduction for reinsurance recoverables related to those liabilities. Separately for each insurance subsidiary and each line of business, our actuaries estimate the liability for unpaid losses and LAE by first estimating ultimate losses and LAE amounts for each year, prior to recognizing the impact of reinsurance. The amount of liabilities for reported claims was based primarily on a claim-by-claim evaluation of coverage, liability, injury severity or scope of property damage, and any other information considered relevant to estimating exposure presented by the claim.

The methods that our actuaries utilized to estimate ultimate loss and LAE amounts were the paid and reported loss development method and the paid and reported Bornhuetter-Ferguson method. Significant periods of time can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer and the insurer's payment of that loss. NLC's liabilities for unpaid losses represent the best estimate at a given point in time of what it expects to pay claimants,

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

based on facts, circumstances and historical trends then known. Estimating the liability for unpaid losses and LAE is inherently judgmental and is influenced by factors that are subject to significant variation. Liabilities for LAE are intended to cover the ultimate cost of settling claims, including investigation and defense of lawsuits resulting from such claims.

**4. Acquisition**

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

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

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

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

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

During 2018, pre-tax transaction- and integration-related expenses of \$8.2 million associated with the BORO Acquisition are included in noninterest expense within the consolidated statement of operations. Such expenses were for professional services and other incremental employee costs associated with the integration of BORO’s operations.



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

## **5. Fair Value Measurements**

### *Fair Value Measurements and Disclosures*

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

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

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

### *Fair Value Option*

The Company has elected to measure substantially all of PrimeLending’s mortgage loans held for sale and the retained 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 December 31, 2020 and 2019, the aggregate fair value of PrimeLending’s mortgage loans held for sale accounted for under the Fair Value Option was \$2.52 billion and \$1.94 billion, respectively, and the unpaid principal balance of those loans was \$2.41 billion and \$1.88 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.

**Trading Securities** — Trading securities are reported at fair value primarily using either Level 1 or Level 2 inputs in the same manner as discussed below for available for sale securities.

**Available For Sale Securities** — Most securities available for sale are reported at fair value using Level 2 inputs. The Company obtains fair value measurements from independent pricing services. As the Company is responsible for the determination of fair value, control processes are designed to ensure that the fair values received from independent pricing services are reasonable and the valuation techniques and assumptions used appear reasonable and consistent with prevailing market conditions. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the financial instruments’ terms and conditions, among other things.

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

**Equity Securities** - For public common and preferred equity stocks, the determination of fair value uses Level 1 inputs based on observable market transactions.

**Loans Held for Sale** — Mortgage loans held for sale are reported at fair value, as discussed above, using Level 2 inputs that consist of commitments on hand from investors or prevailing market prices. These instruments are held for relatively short periods, typically no more than 30 days. As a result, changes in instrument-specific credit risk are not a significant component of the change in fair value. The fair value of certain loans held for sale that cannot be sold through normal sale channels or are non-performing is measured using Level 3, or unobservable, inputs. The fair value of such loans is generally based upon estimates of expected cash flows using unobservable inputs, including listing prices of comparable assets, uncorroborated expert opinions, and/or management’s knowledge of underlying collateral.

**Derivatives** — Derivatives, which are included in other assets and liabilities within the Company’s consolidated balance sheets, are reported at fair value using either Level 2 or Level 3 inputs. The Bank uses dealer quotes to value interest rate swaps, forward purchase commitments and forward sale commitments executed for both hedging and non-hedging purposes. PrimeLending and the Hilltop Broker-Dealers use dealer quotes to value forward purchase commitments and forward sale commitments, respectively, executed for both hedging and non-hedging purposes. PrimeLending also issues IRLCs to its customers and the Hilltop Broker-Dealers issue forward purchase commitments to its clients that are valued based on the change in the fair value of the underlying mortgage loan from inception of the IRLC or purchase commitment to the balance sheet date, adjusted for projected loan closing rates. PrimeLending determines the value of the underlying mortgage loan as discussed in “Loans Held for Sale”, above. The Hilltop Broker-Dealers determine the value of the underlying mortgage loan from prices of comparable securities used to value forward sale commitments. Additionally, PrimeLending also uses dealer quotes to value Eurodollar futures and U.S. Treasury bond futures and options used to hedge interest rate risk, and the Hilltop Broker-Dealers use dealer quotes to value Eurodollar futures and U.S. Treasury bond futures and options used to hedge changes in the fair value of securities.

**MSR Asset** — 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 rates and discount rates, the most significant unobservable inputs, are discussed further in Note 12 to the consolidated financial statements. The increase in the weighted average discount rate used to value the MSR asset at December 31, 2020, compared to December 31, 2019, addresses the effect of the reduction in third-party servicing outlets beginning in the second quarter of 2020 resulting from the impact of the Coronavirus Aid Relief, and Economic Security Act (“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.

**Securities Sold, Not Yet Purchased** — Securities sold, not yet purchased are reported at fair value primarily using either Level 1 or Level 2 inputs in the same manner as discussed above for trading and available for sale securities.

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

December 31, 2020	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
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

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

<u>December 31, 2019</u>	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Fair Value</u>
Trading securities	\$ —	\$ 689,576	\$ —	\$ 689,576
Available for sale securities	—	911,493	—	911,493
Equity securities	166	—	—	166
Loans held for sale	—	1,868,518	67,195	1,935,713
Derivative assets	—	33,129	—	33,129
MSR asset	—	—	55,504	55,504
Securities sold, not yet purchased	29,080	14,737	—	43,817
Derivative liabilities	—	17,140	—	17,140

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

	<u>Balance at Beginning of Year</u>	<u>Purchases/ Additions</u>	<u>Sales/ Reductions</u>	<u>Transfers into Level 3</u>	<u>Total Gains or Losses (Realized or Unrealized)</u>		<u>Balance at End of Year</u>
					<u>Included in Net Income</u>	<u>Included in Other Comprehensive Income (Loss)</u>	
<b><u>Year ended December 31, 2020</u></b>							
Loans held for sale	\$ 67,195	\$ 61,410	\$ (57,682)	\$ 10,323	\$ (9,430)	\$ —	\$ 71,816
MSR asset	55,504	162,914	(36,750)	—	(37,926)	—	143,742
Total	<u>\$ 122,699</u>	<u>\$ 224,324</u>	<u>\$ (94,432)</u>	<u>\$ 10,323</u>	<u>\$ (47,356)</u>	<u>\$ —</u>	<u>\$ 215,558</u>
<b><u>Year ended December 31, 2019</u></b>							
Loans held for sale	\$ 50,464	\$ 60,475	\$ (34,849)	\$ 1,136	\$ (10,031)	\$ —	\$ 67,195
MSR asset	66,102	13,755	—	—	(24,353)	—	55,504
Total	<u>\$ 116,566</u>	<u>\$ 74,230</u>	<u>\$ (34,849)</u>	<u>\$ 1,136</u>	<u>\$ (34,384)</u>	<u>\$ —</u>	<u>\$ 122,699</u>
<b><u>Year ended December 31, 2018</u></b>							
Loans held for sale	\$ 36,972	\$ 61,573	\$ (41,801)	\$ —	\$ (6,280)	\$ —	\$ 50,464
MSR asset	54,714	25,028	(9,303)	—	(4,337)	—	66,102
Total	<u>\$ 91,686</u>	<u>\$ 86,601</u>	<u>\$ (51,104)</u>	<u>\$ —</u>	<u>\$ (10,617)</u>	<u>\$ —</u>	<u>\$ 116,566</u>

All net realized and unrealized gains (losses) in the table above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at December 31, 2020.

For Level 3 financial instruments measured at fair value on a recurring basis at December 31, 2020 and 2019, the significant unobservable inputs used in the fair value measurements were as follows.

<u>Financial instrument</u>	<u>Valuation Technique</u>	<u>Unobservable Inputs</u>	<u>Range (Weighted-Average)</u>	
			<u>December 31,</u>	
			<u>2020</u>	<u>2019</u>
Loans held for sale	Market comparable	Projected price	91 - 94 % ( 94 %)	92 - 96 % ( 95 %)
MSR asset	Discounted cash flows	Constant prepayment rate	12.15 %	13.16 %
		Discount rate	14.60 %	11.14 %

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

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

	<u>Year Ended December 31, 2020</u>			<u>Year Ended December 31, 2019</u>			<u>Year Ended December 31, 2018</u>		
	<u>Net Gains (Losses)</u>	<u>Other Noninterest Income</u>	<u>Total Changes in Fair Value</u>	<u>Net Gains (Losses)</u>	<u>Other Noninterest Income</u>	<u>Total Changes in Fair Value</u>	<u>Net Gains (Losses)</u>	<u>Other Noninterest Income</u>	<u>Total Changes in Fair Value</u>
Loans held for sale	\$ 52,296	\$ —	\$ 52,296	\$ 12,775	\$ —	\$ 12,775	\$ (8,063)	\$ —	\$ (8,063)
MSR asset	(37,926)	—	(37,926)	(24,353)	—	(24,353)	(4,337)	—	(4,337)

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

The Company determines the fair value of OREO on a non-recurring basis. In particular, the fair value of properties are determined at their respective acquisition date fair values. In addition, facts and circumstances may dictate a fair value measurement when there is evidence of impairment. The Company determines fair value primarily using independent appraisals of OREO properties. The resulting fair value measurements are classified as Level 2 inputs. At December 31, 2020 and 2019, the estimated fair value of OREO was \$21.3 million and \$18.2 million, respectively, and the underlying fair value measurements utilized Level 2 inputs. The amounts are included in other assets within the consolidated balance sheets. During the reported periods, all fair value measurements for OREO subsequent to initial recognition utilized Level 2 inputs. The Company recorded total losses of \$4.4 million, \$1.4 million and \$2.8 million during 2020, 2019 and 2018, respectively, which represent a change in fair value subsequent to initial recognition of the asset.

The Fair Value of Financial Instruments Subsection of the ASC requires disclosure of the fair value of financial assets and liabilities, including the financial assets and liabilities previously discussed. The methods for determining estimated fair value for financial assets and liabilities measured at fair value on a recurring or non-recurring basis are discussed above. For other financial assets and liabilities, the Company utilizes quoted market prices, if available, to estimate the fair value of financial instruments. Because no quoted market prices exist for a significant portion of the Company's financial instruments, the fair value of such instruments has been derived based on management's assumptions with respect to future economic conditions, the amount and timing of future cash flows, and estimated discount rates. Different assumptions could significantly affect these estimates. Accordingly, the estimates provided herein do not necessarily indicate amounts which could be realized in a current transaction. Further, as it is management's intent to hold a significant portion of its financial instruments to maturity, it is not probable that the fair values shown below will be realized in a current transaction.

Because of the wide range of permissible valuation techniques and the numerous estimates which must be made, it may be difficult to make reasonable comparisons of the Company's fair value information to that of other financial institutions. The aggregate estimated fair value amount should in no way be construed as representative of the underlying value of Hilltop and its subsidiaries. The following methods and assumptions are typically used in estimating the fair value disclosures for financial instruments:

**Cash and Cash Equivalents** — For cash and due from banks and federal funds sold, the carrying amount is a reasonable estimate of fair value.

**Assets Segregated for Regulatory Purposes** — Assets segregated for regulatory purposes may consist of cash and securities with carrying amounts that approximate fair value.

**Securities Purchased Under Agreements to Resell** — Securities purchased under agreements to resell are carried at the amounts at which the securities will subsequently be resold as specified in the agreements. The carrying amounts approximate fair value due to their short-term nature.

**Held to Maturity Securities** — For securities held to maturity, estimated fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

**Loans Held for Sale** — Loans held for sale includes mortgage loans held for sale that are guaranteed by U.S. government agencies that are subject to repurchase, or have been repurchased, by PrimeLending and certain mortgage loans originated by PrimeLending on behalf of the Bank. Such loans are reported at fair value, as discussed above, using Level 2 inputs that consist of commitments on hand from investors or prevailing market prices.

**Loans Held for Investment** — The estimated fair values of loans held for investment are measured using an exit price method.

**Broker-Dealer and Clearing Organization Receivables and Payables** — The carrying amount approximates their fair value.

**Deposits** — The estimated fair value of demand deposits, savings accounts and NOW accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently

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

offered for deposits of similar remaining maturities. The carrying amount for variable-rate certificates of deposit approximates their fair values.

**Short-Term Borrowings** — The carrying amounts of federal funds purchased, borrowings under repurchase agreements, Federal Home Loan Bank (“FHLB”) and other short-term borrowings approximate their fair values.

**Debt** — The fair values are estimated using discounted cash flow analysis based on current incremental borrowing rates for similar types of borrowing arrangements.

**Other Assets and Liabilities** — Other assets and liabilities primarily consists of cash surrender value of life insurance policies and accrued interest receivable and payable with carrying amounts that approximate their fair values using Level 2 inputs. The fair value of certain other receivables and investments is based on Level 3 inputs.

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).

<b>December 31, 2020</b>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>			<b>Total</b>
		<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>	
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

<b>December 31, 2019</b>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>			<b>Total</b>
		<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>	
Financial assets:					
Cash and cash equivalents	\$ 434,020	\$ 434,020	\$ —	\$ —	\$ 434,020
Assets segregated for regulatory purposes	157,436	157,436	—	—	157,436
Securities purchased under agreements to resell	59,031	—	59,031	—	59,031
Held to maturity securities	386,326	—	388,930	—	388,930
Loans held for sale	170,648	—	170,648	—	170,648
Loans held for investment, net	7,320,264	—	576,527	6,990,706	7,567,233
Broker-dealer and clearing organization receivables	1,780,280	—	1,780,280	—	1,780,280
Other assets	71,040	—	69,580	1,460	71,040
Financial liabilities:					
Deposits	9,032,214	—	9,032,496	—	9,032,496
Broker-dealer and clearing organization payables	1,605,518	—	1,605,518	—	1,605,518
Short-term borrowings	1,424,010	—	1,424,010	—	1,424,010
Debt	323,281	—	323,281	—	323,281
Other liabilities	8,340	—	8,340	—	8,340

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

The Company held equity investments other than securities of \$63.6 million and \$36.6 million at December 31, 2020 and 2019, respectively, which are included within other assets in the consolidated balance sheets. Of the \$63.6 million of such equity investments held at December 31, 2020, \$22.8 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 (in thousands).

	Year Ended December 31,	
	2020	2019
Balance, beginning of year	\$ 19,771	\$ 20,376
Additional investments	500	—
Upward adjustments	4,188	403
Impairments and downward adjustments	(1,615)	(1,008)
Dispositions	—	—
Balance, end of year	<u>\$ 22,844</u>	<u>\$ 19,771</u>

## 6. Securities

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

	December 31,	
	2020	2019
U.S. Treasury securities	\$ 40,491	\$ —
U.S. government agencies:		
Bonds	40	24,680
Residential mortgage-backed securities	336,081	331,601
Commercial mortgage-backed securities	876	2,145
Collateralized mortgage obligations	69,172	191,154
Corporate debt securities	62,481	36,973
States and political subdivisions	171,573	93,117
Unit investment trusts	—	3,468
Private-label securitized product	8,571	2,992
Other	4,970	3,446
Totals	<u>\$ 694,255</u>	<u>\$ 689,576</u>

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 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 \$79.8 million and \$43.8 million at December 31, 2020 and 2019, respectively.

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

December 31, 2020	Available for Sale			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
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>

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

<u>December 31, 2019</u>	Available for Sale			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agencies:				
Bonds	\$ 84,590	\$ 1,049	\$ (64)	\$ 85,575
Residential mortgage-backed securities	430,514	6,662	(147)	437,029
Commercial mortgage-backed securities	11,488	543	—	12,031
Collateralized mortgage obligations	333,256	3,175	(815)	335,616
States and political subdivisions	39,969	1,273	—	41,242
Totals	\$ 899,817	\$ 12,702	\$ (1,026)	\$ 911,493

<u>December 31, 2020</u>	Held to Maturity			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
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	\$ 311,944	\$ 14,727	\$ —	\$ 326,671

<u>December 31, 2019</u>	Held to Maturity			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agencies:				
Bonds	\$ 24,020	\$ 10	\$ (35)	\$ 23,995
Residential mortgage-backed securities	17,776	295	—	18,071
Commercial mortgage-backed securities	161,624	2,810	(655)	163,779
Collateralized mortgage obligations	113,894	226	(904)	113,216
States and political subdivisions	69,012	1,013	(156)	69,869
Totals	\$ 386,326	\$ 4,354	\$ (1,750)	\$ 388,930

Additionally, the Company had unrealized net gains of \$0.1 million at both December 31, 2020 and 2019 from equity securities with fair values of \$0.1 million and \$0.2 million at December 31, 2020 and 2019, respectively. The Company recognized nominal net gains and losses during 2020 and 2019 due to changes in the fair value of equity securities still held at the balance sheet date. During 2020 and 2019, net gains and losses recognized from equity securities sold were nominal.

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

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

	December 31, 2020			December 31, 2019		
	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	8	\$ 60,298	\$ 325	2	\$ 24,937	\$ 64
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	8	60,298	325	2	24,937	64
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	15	86,287	429	37	36,187	87
Unrealized loss for twelve months or longer	—	—	—	2	13,683	58
	15	86,287	429	39	49,870	145
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	10	105,386	1,176	1	9,967	2
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	10	105,386	1,176	1	9,967	2
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	10	101,990	324	15	94,545	446
Unrealized loss for twelve months or longer	5	13,611	46	13	46,217	369
	15	115,601	370	28	140,762	815
States and political subdivisions:						
Unrealized loss for less than twelve months	—	—	—	—	—	—
Unrealized loss for twelve months or longer	—	—	—	1	487	—
	—	—	—	1	487	—
Total available for sale:						
Unrealized loss for less than twelve months	43	353,961	2,254	55	165,636	599
Unrealized loss for twelve months or longer	5	13,611	46	16	60,387	427
	48	\$ 367,572	\$ 2,300	71	\$ 226,023	\$ 1,026

	December 31, 2020			December 31, 2019		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
<b>Held to Maturity</b>						
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	—	\$ —	\$ —	2	\$ 9,665	\$ 35
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	2	9,665	35
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	—	—	—	8	44,610	656
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	8	44,610	656
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	—	—	—	4	23,904	287
Unrealized loss for twelve months or longer	—	—	—	8	59,560	617
	—	—	—	12	83,464	904
States and political subdivisions:						
Unrealized loss for less than twelve months	2	578	—	38	15,996	124
Unrealized loss for twelve months or longer	—	—	—	4	1,099	31
	2	578	—	42	17,095	155
Total held to maturity:						
Unrealized loss for less than twelve months	2	578	—	52	94,175	1,102
Unrealized loss for twelve months or longer	—	—	—	12	60,659	648
	2	\$ 578	\$ —	64	\$ 154,834	\$ 1,750



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

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 December 31, 2020 are shown by contractual maturity below (in thousands).

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 4,999	\$ 5,072	\$ 645	\$ 646
Due after one year through five years	61,182	62,636	1,225	1,273
Due after five years through ten years	17,537	18,179	8,205	8,525
Due after ten years	43,047	44,261	60,570	62,979
	126,765	130,148	70,645	73,423
Residential mortgage-backed securities	624,863	641,611	13,547	14,255
Collateralized mortgage obligations	559,362	565,908	74,932	76,968
Commercial mortgage-backed securities	124,929	124,538	152,820	162,025
	\$ 1,435,919	\$ 1,462,205	\$ 311,944	\$ 326,671

During 2020, 2019 and 2018, the Company recognized net gains from its trading portfolio of \$122.0 million, \$20.5 million and \$6.2 million, respectively. In addition, the Hilltop Broker-Dealers realized net gains from structured product trading activities of \$77.1 million, \$132.7 million and \$41.9 million during 2020, 2019 and 2018, respectively. During 2020 and 2019, the Company had other realized gains on securities of \$0.2 million and other realized losses on securities of \$2.5 million, respectively, while other net realized gains on securities during 2018 were nominal. All such net gains and losses are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of \$712.3 million and \$576.0 million (with a fair value of \$733.8 million and \$583.6 million, respectively) at December 31, 2020 and 2019, 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 Company's available for sale and held to maturity securities portfolios at December 31, 2020 and 2019.

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

## **7. 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.

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

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

	<u>December 31,</u>	
	<u>2020</u>	<u>2019</u>
Commercial real estate	\$ 3,133,903	\$ 3,000,523
Commercial and industrial <sup>(1)</sup>	2,627,774	2,025,720
Construction and land development	828,852	940,564
1-4 family residential	629,938	791,020
Consumer	35,667	47,046
Broker-dealer <sup>(2)</sup>	437,007	576,527
	<u>7,693,141</u>	<u>7,381,400</u>
Allowance for credit losses	(149,044)	(61,136)
Total loans held for investment, net of allowance	<u>\$ 7,544,097</u>	<u>\$ 7,320,264</u>

(1) Included loans totaling \$486.7 million at December 31, 2020 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).

	<u>Non-accrual Loans</u>			<u>December 31,</u> <u>2019</u>	<u>Interest Income</u> <u>Recognized (1)</u> <u>Year Ended</u> <u>December 31, 2020</u>
	<u>December 31, 2020</u>				
	<u>With</u> <u>Allowance</u>	<u>With No</u> <u>Allowance</u>	<u>Total</u>		
Commercial real estate:					
Non-owner occupied	\$ 1,213	\$ 445	\$ 1,658	\$ 3,813	\$ 1,364
Owner occupied	3,473	6,002	9,475	3,495	295
Commercial and industrial	10,821	23,228	34,049	15,262	2,362
Construction and land development	102	405	507	1,316	110
1-4 family residential	4,726	16,651	21,377	7,382	1,568
Consumer	28	—	28	26	122
Broker-dealer	—	—	—	—	—
	<u>\$ 20,363</u>	<u>\$ 46,731</u>	<u>\$ 67,094</u>	<u>\$ 31,294</u>	<u>\$ 5,821</u>

(1) Interest income recognized on non-accrual loans during 2019 and 2018 was \$1.6 million and \$1.4 million, respectively.

At December 31, 2020 and 2019, \$10.9 million and \$4.8 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 increased from December 31, 2019 to December 31, 2020, by \$35.8 million. A number of loans previously accounted for in accruing pools under ASC 310-30 were reclassified to non-accrual in the CECL transition. The increase in commercial real estate loans in non-accrual status at December 31, 2020 of \$3.8 million was primarily related to the addition of loans totaling \$8.4 million, of which \$6.8 million were previously accruing at December 31, 2019, partially offset by the resolution of loans totaling \$4.5 million. Commercial real estate loans in non-accrual status carried a reserve of \$1.1 million at December 31, 2020. The increase in commercial and industrial loans in non-accrual status since December 31, 2019 was primarily due to a small number of relationships that included loans totaling \$18.9 million and a CECL transition gross-up adjustment of \$4.3 million related to a single loan. Commercial and industrial loans in non-accrual status carried a reserve of \$7.9 million at December 31, 2020. The increase in 1-4 family residential loans in non-accrual status at December 31, 2020, compared to December 31, 2019, was primarily related to the addition of \$17.1 million of loans in non-accrual status, of which \$15.0 million were previously accruing at December 31, 2019, partially offset by both the return to accruing classification and resolution of loans totaling \$3.2 million. 1-4 family residential loans in non-accrual status carried a reserve of \$0.7 million at December 31, 2020.

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

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 \$968 million in COVID-19 related loan modifications as of June 30, 2020. During the third and fourth quarters of 2020, the Bank continued to support its impacted banking clients through the approval of COVID-19 related loan modifications, which resulted in an additional \$75 million of new COVID-19 related loan modifications since June 30, 2020. The portfolio of active deferrals that have not reached the end of their deferral period was approximately \$240 million as of December 31, 2020, of which approximately \$90 million had received an additional deferral. COVID-19 related loan modifications of approximately \$714 million have returned to agreed-upon contractual terms and had made at least one required principal and/or interest payment since the end of their initial deferral period. Such loans represent elevated risk, therefore management continues to monitor these loans. The extent to which these measures will impact the Bank is 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.

Information regarding TDRs granted during 2020 and 2019 that do not qualify for the CARES Act exemption is shown in the following table (dollars in thousands). There were no TDRs granted during 2018.

	Year Ended December 31, 2020			Year Ended December 31, 2019		
	Number of Loans	Balance at Extension	Balance at End of Period	Number of Loans	Balance at Extension	Balance at End of Period
Commercial real estate:						
Non-owner occupied	—	\$ —	\$ —	—	\$ —	\$ —
Owner occupied	—	—	—	—	—	—
Commercial and industrial	3	9,464	4,116	4	9,618	8,566
Construction and land development	—	—	—	—	—	—
1-4 family residential	5	438	438	—	—	—
Consumer	—	—	—	—	—	—
Broker-dealer	—	—	—	—	—	—
	<u>8</u>	<u>\$ 9,902</u>	<u>\$ 4,554</u>	<u>4</u>	<u>\$ 9,618</u>	<u>\$ 8,566</u>

All of the loan modifications included in the table above involved payment term extensions. The Bank did not grant principal reductions on any restructured loans during 2020, 2019 or 2018.

At December 31, 2020 and 2019, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs. There were no TDRs granted during the twelve months preceding December 31, 2020, 2019 or 2018 for which a payment was at least 30 days past due.

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

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

<u>December 31, 2020</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	\$ 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>

<u>December 31, 2019</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	\$ 4,062	\$ —	\$ 2,790	\$ 6,852	\$ 1,702,500	\$ 1,709,352	\$ —
Owner occupied	1,813	880	3,265	5,958	1,285,213	1,291,171	—
Commercial and industrial	5,967	1,735	3,395	11,097	2,014,623	2,025,720	3
Construction and land development	7,580	1,827	—	9,407	931,157	940,564	—
1-4 family residential	12,058	3,442	6,520	22,020	769,000	791,020	—
Consumer	455	34	—	489	46,557	47,046	—
Broker-dealer	—	—	—	—	576,527	576,527	—
	<u>\$ 31,935</u>	<u>\$ 7,918</u>	<u>\$ 15,970</u>	<u>\$ 55,823</u>	<u>\$ 7,325,577</u>	<u>\$ 7,381,400</u>	<u>\$ 3</u>

In addition to the loans shown in the tables above, PrimeLending had \$243.6 million and \$102.7 million of loans included in loans held for sale (with an aggregate unpaid principal balance of \$245.5 million and \$104.0 million, respectively) that were 90 days past due and accruing interest at December 31, 2020 and 2019, 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 ongoing 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 December 31, 2020, PrimeLending had \$198.8 million of loans subject to repurchase under a forbearance agreement.

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 (v) general economic conditions in state and local markets. The Company defines classified loans as loans with a risk rating of substandard, doubtful or loss.

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

A description of the risk rating internal grades for commercial loans to is presented in the following table.

<b>Risk Rating</b>	<b>Internal Grade</b>	<b>Risk Rating Description</b>
Pass low risk	1 - 3	Represents loans to very high credit quality commercial borrowers of investment or near investment grade. These borrowers have significant capital strength, moderate leverage, stable earnings and growth, and readily available financing alternatives. Commercial borrowers entirely cash secured are also included in this category.
Pass normal risk	4 - 7	Represents loans to commercial borrowers of solid credit quality with moderate risk. Borrowers in these grades are differentiated from higher grades on the basis of size (capital and/or revenue), leverage, asset quality and the stability of the industry or market area.
Pass high risk	8 - 10	Represents "pass grade" loans to commercial borrowers of higher, but acceptable credit quality and risk. Such borrowers are differentiated from Pass Normal Risk in terms of size, secondary sources of repayment or they are of lesser stature in other key credit metrics.
Watch	11	Represents loans on management's "watch list" and is intended to be utilized on a temporary basis for pass grade commercial borrowers where a significant risk-modifying action is anticipated in the near term.
Special mention	12	Represents loans with potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in a deterioration of the repayment prospects for the loans and weaken the Company's credit position at some future date.
Substandard accrual	13	Represents loans for which the accrual of interest has not been stopped, but are inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.
Substandard non-accrual	14	Represents loans for which the accrual of interest has been stopped and includes loans where interest is more than 90 days past due and not fully secured and loans where a specific valuation allowance may be necessary.
Doubtful	15	Represents loans that are placed on non-accrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty.
Loss	16	Represents loans that are to be charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. Rating is not intended to imply that the loan or some portion of it will never be paid, nor does it in any way imply that there has been a forgiveness of debt.

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

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).

December 31, 2020	Amortized Cost Basis by Origination Year						2015 and		Total
	2020	2019	2018	2017	2016	Prior	Revolving		
<b>Commercial real estate: non-owner occupied</b>									
Internal Grade 1-3 (Pass low risk)	\$ 21,135	\$ 22,913	\$ 3,171	\$ 2,735	\$ 12,896	\$ 15,263	\$ 1	\$ 78,114	
Internal Grade 4-7 (Pass normal risk)	245,833	138,836	83,951	88,119	108,371	64,200	47,920	777,230	
Internal Grade 8-11 (Pass high risk and watch)	227,440	133,246	122,022	99,473	108,536	64,031	488	755,236	
Internal Grade 12 (Special mention)	—	—	—	—	—	—	—	—	
Internal Grade 13 (Substandard accrual)	34,020	16,139	29,166	29,810	33,353	33,467	118	176,073	
Internal Grade 14 (Substandard non-accrual)	—	—	—	—	—	1,658	—	1,658	
<b>Commercial real estate: owner occupied</b>									
Internal Grade 1-3 (Pass low risk)	\$ 60,809	\$ 21,011	\$ 12,712	\$ 44,163	\$ 21,567	\$ 37,688	\$ 1	\$ 197,951	
Internal Grade 4-7 (Pass normal risk)	164,939	169,582	131,821	56,801	53,811	75,372	39,868	692,194	
Internal Grade 8-11 (Pass high risk and watch)	118,328	80,375	49,601	23,588	23,330	30,249	1,291	326,762	
Internal Grade 12 (Special mention)	365	—	3,691	—	—	527	—	4,583	
Internal Grade 13 (Substandard accrual)	8,372	5,620	69,617	10,315	8,663	12,040	—	114,627	
Internal Grade 14 (Substandard non-accrual)	506	1,259	441	5,345	1,045	879	—	9,475	
<b>Commercial and industrial</b>									
Internal Grade 1-3 (Pass low risk)	\$ 30,754	\$ 27,144	\$ 7,149	\$ 5,486	\$ 3,587	\$ 335	\$ 21,651	\$ 96,106	
Internal Grade 4-7 (Pass normal risk)	179,394	54,423	53,908	29,778	24,179	10,945	395,320	747,947	
Internal Grade 8-11 (Pass high risk and watch)	95,835	62,411	20,162	13,459	13,885	2,144	197,273	405,169	
Internal Grade 12 (Special mention)	757	14	3,723	—	152	—	2,093	6,739	
Internal Grade 13 (Substandard accrual)	9,863	3,689	13,788	5,531	5,759	253	19,360	58,243	
Internal Grade 14 (Substandard non-accrual)	25,107	5,084	2,021	315	16	98	1,408	34,049	
<b>Construction and land development</b>									
Internal Grade 1-3 (Pass low risk)	\$ 15,764	\$ 2,710	\$ 4,176	\$ 264	\$ 4,129	\$ 331	\$ 624	\$ 27,998	
Internal Grade 4-7 (Pass normal risk)	202,624	103,864	63,135	3,210	2,596	3,142	28,387	406,958	
Internal Grade 8-11 (Pass high risk and watch)	194,432	97,206	47,102	9,659	3,552	544	7,951	360,446	
Internal Grade 12 (Special mention)	—	—	—	—	—	—	—	—	
Internal Grade 13 (Substandard accrual)	8,684	29	—	5,385	—	65	—	14,163	
Internal Grade 14 (Substandard non-accrual)	—	405	—	—	—	102	—	507	
<b>Construction and land development - individuals</b>									
FICO less than 620	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
FICO between 620 and 720	557	—	1,253	—	—	—	—	1,810	
FICO greater than 720	13,207	—	2,539	—	—	—	—	15,746	
Substandard non-accrual	—	—	—	—	—	—	—	—	
Other (1)	1,224	—	—	—	—	—	—	1,224	
<b>1-4 family residential</b>									
FICO less than 620	\$ 1,109	\$ 819	\$ 3,674	\$ 56	\$ 883	\$ 32,077	\$ 318	\$ 38,936	
FICO between 620 and 720	17,269	18,461	9,545	8,714	8,171	41,625	1,289	105,074	
FICO greater than 720	125,094	80,688	65,975	37,943	29,171	70,815	5,313	414,999	
Substandard non-accrual	—	—	—	96	714	20,567	—	21,377	
Other (1)	27,407	10,085	5,998	1,899	920	2,529	714	49,552	
<b>Consumer</b>									
FICO less than 620	\$ 955	\$ 1,235	\$ 106	\$ 128	\$ 43	\$ 22	\$ 334	\$ 2,823	
FICO between 620 and 720	5,194	2,627	478	536	118	79	2,157	11,189	
FICO greater than 720	6,849	1,674	2,952	292	60	34	3,054	14,915	
Substandard non-accrual	—	—	—	27	—	1	—	28	
Other (1)	5,050	1,141	129	43	36	—	313	6,712	
Total loans with credit quality measures	\$ 1,848,876	\$ 1,062,690	\$ 814,006	\$ 483,170	\$ 469,543	\$ 521,082	\$ 777,246	\$ 5,976,613	
Commercial and industrial (mortgage warehouse lending)								\$ 792,806	
Commercial and industrial (Paycheck Protection Program loans)								\$ 486,715	
Broker-Dealer (margin loans and correspondent receivables)								\$ 437,007	
<b>Total loans held for investment</b>								<b>\$ 7,693,141</b>	

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

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

## **8. 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 declines 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 December 31, 2020. In addition, as of December 31, 2020, 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 CECL. 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 December 31, 2020. While the Company believes it has an appropriate allowance for the existing loan portfolio at December 31, 2020, 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.

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 December 31, 2020, the Company utilized a single macroeconomic baseline scenario published by a third party in December 2020 that was updated to reflect the U.S. economic outlook due to COVID-19 conditions. This baseline scenario utilizes multiple economic variables in forecasting the economic outlook. 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 has resulted in a weak labor market and weak overall economic conditions that will affect borrowers across our lending portfolios and significant judgment is required to estimate the severity and duration of the current economic downturn, as well as its potential impact on borrower defaults and loss severity. In particular, macroeconomic conditions and forecasts regarding the duration and severity of the economic downturn are rapidly changing and remain highly uncertain as the resurgence of COVID-19 cases evolves 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 government stimulus, customer relief and enhanced unemployment benefits should help mitigate in the short term, but the extent and duration of government stimulus as well as performance of recently implemented payment deferral programs remains uncertain.

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.

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

During 2020, the significant build in the allowance included provision for credit losses on individually evaluated loans of \$20.2 million, while the provision for credit losses on expected losses of collectively evaluated loans accounted for \$76.1 million of the total provision primarily due to the identified changes in the Bank's loan portfolio composition and credit quality and 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 change to the reserve due to the impact of COVID-19 reflects economic uncertainty which, along with the expectation of continued higher unemployment and lower GDP, has increased the probability of default and loss given default rates used in our estimate of the lifetime expected credit losses for our loan portfolio.

The change in the allowance for credit losses during 2020 was primarily attributable to the Bank and also reflected other factors including, but not limited to, loan growth, loan mix, and changes in risk rating grades, macroeconomic factor assumptions and qualitative factors. The change in the allowance during 2020 was also impacted by net charge-offs of \$21.1 million, primarily associated with loans specifically reserved for during the first quarter of 2020.

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

<b>Year Ended December 31, 2020</b>	<b>Balance, Beginning of Year</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 Year</b>
Commercial real estate	\$ 31,595	\$ 8,073	\$ 73,865	\$ (4,517)	\$ 613	\$ 109,629
Commercial and industrial	17,964	3,193	22,870	(18,158)	1,834	27,703
Construction and land development	4,878	577	1,222	(2)	2	6,677
1-4 family residential	6,386	(29)	(1,717)	(748)	54	3,946
Consumer	265	748	86	(615)	392	876
Broker-dealer	48	—	165	—	—	213
Total	<u>\$ 61,136</u>	<u>\$ 12,562</u>	<u>\$ 96,491</u>	<u>\$ (24,040)</u>	<u>\$ 2,895</u>	<u>\$ 149,044</u>

<b>Year Ended December 31, 2019</b>	<b>Balance, Beginning of Year</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 Year</b>
Commercial real estate	\$ 27,100	\$ —	\$ 5,649	\$ (1,160)	\$ 6	\$ 31,595
Commercial and industrial	21,980	—	(921)	(5,924)	2,829	17,964
Construction and land development	6,061	—	(1,183)	—	—	4,878
1-4 family residential	3,956	—	3,276	(907)	61	6,386
Consumer	267	—	459	(498)	37	265
Broker-dealer	122	—	(74)	—	—	48
Total	<u>\$ 59,486</u>	<u>\$ —</u>	<u>\$ 7,206</u>	<u>\$ (8,489)</u>	<u>\$ 2,933</u>	<u>\$ 61,136</u>

<b>Year Ended December 31, 2018</b>	<b>Balance, Beginning of Year</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 Year</b>
Commercial real estate	\$ 27,232	\$ —	\$ 668	\$ (800)	\$ —	\$ 27,100
Commercial and industrial	23,698	—	6,750	(12,741)	4,273	21,980
Construction and land development	7,847	—	(1,792)	—	6	6,061
1-4 family residential	4,245	—	(292)	(143)	146	3,956
Consumer	311	—	(15)	(93)	64	267
Broker-dealer	353	—	(231)	—	—	122
Total	<u>\$ 63,686</u>	<u>\$ —</u>	<u>\$ 5,088</u>	<u>\$ (13,777)</u>	<u>\$ 4,489</u>	<u>\$ 59,486</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 PD grade and LGD 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



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

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).

	Year Ended December 31,		
	2020	2019	2018
Balance, beginning of year	\$ 2,075	\$ 2,366	\$ 1,932
Transition adjustment CECL accounting standard	3,837	—	—
Other noninterest expense	2,476	(291)	434
Balance, end of year	\$ 8,388	\$ 2,075	\$ 2,366

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 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.

**9. Cash and Due from Banks**

Cash and due from banks consisted of the following (in thousands).

	December 31,	
	2020	2019
Cash on hand	\$ 45,207	\$ 39,590
Clearings and collection items	82,396	129,055
Deposits at Federal Reserve Bank	874,998	232,019
Deposits at Federal Home Loan Bank	1,607	1,458
Deposits in FDIC-insured institutions	58,352	31,504
	\$ 1,062,560	\$ 433,626

The amounts above include interest-bearing deposits of \$878.0 million and \$235.4 million at December 31, 2020 and 2019, respectively. Cash on hand and deposits at the Federal Reserve Bank satisfy regulatory reserve requirements at December 31, 2020 and December 31, 2019.

**10. Premises and Equipment**

The components of premises and equipment are summarized as follows (in thousands).

	December 31,	
	2020	2019
Land and premises	\$ 125,701	\$ 130,312
Furniture and equipment	257,810	265,602
	383,511	395,914
Less accumulated depreciation and amortization	(171,916)	(185,539)
	\$ 211,595	\$ 210,375

The amounts shown above include gross assets recorded under finance leases of \$7.8 million, with accumulated amortization of \$4.8 million and \$4.2 million at December 31, 2020 and 2019, respectively.

Occupancy expense was reduced by rental income of \$1.7 million, \$2.7 million and \$1.4 million during 2020, 2019 and 2018, respectively. Depreciation and amortization expense on premises and equipment, which includes amortization of finance leases, amounted to \$27.9 million, \$27.3 million and \$30.8 million during 2020, 2019 and 2018, respectively.

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

**11. Goodwill and Other Intangible Assets**

At December 31, 2020, the carrying amount of goodwill of \$267.4 million was comprised of \$39.6 million recorded in connection with the BORO Acquisition and \$227.8 million recorded in connection with the completion of the merger with PCC (the “PlainsCapital Merger”).

Other intangible assets were \$20.4 million and \$26.7 million at December 31, 2020 and 2019, respectively.

The Company performed required annual impairment tests of its goodwill and other intangible assets having an indefinite useful life as of October 1<sup>st</sup> for each of its reporting units. At October 1, 2020, the Company determined that the estimated fair value of each of its reporting units exceeded its carrying value. The Company estimated the fair values of its reporting units based on both a market and income approach using historical, normalized actual and forecasted results. Based on this evaluation, at December 31, 2020, the Company concluded that the goodwill and other identifiable intangible assets were fully realizable.

The Company’s evaluation includes multiple assumptions, including estimated discounted cash flows and other estimates that may change over time. If future discounted cash flows become less than those projected by the Company, future impairment charges may become necessary that could have a materially adverse impact on the Company’s results of operations and financial condition. As quoted market prices in active stock markets are relevant evidence of fair value, a significant decline in the Company’s common stock trading price may indicate an impairment of goodwill.

Additionally, given the potential impacts as a result of COVID-19, actual results may differ materially from the Company’s current estimates as the scope of COVID-19 evolves or if the duration of business disruptions is longer than currently anticipated. While certain valuation assumptions and judgments may change to account for pandemic-related circumstances, the Company does not anticipate significant changes in methodology used to determine the fair value of its goodwill, intangible assets and other long-lived assets. The Company 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.

The carrying value of intangible assets subject to amortization was as follows (in thousands).

<u>December 31, 2020</u>	<u>Estimated Useful Life (Years)</u>	<u>Gross Intangible Assets</u>	<u>Accumulated Amortization</u>	<u>Net Intangible Assets</u>
Core deposits	4 - 12	\$ 48,930	\$ (40,997)	\$ 7,933
Trademarks and trade names	20	16,500	(7,563)	8,937
Noncompete agreements	4	4,310	(4,310)	—
Customer contracts and relationships	12 - 14	15,300	(11,806)	3,494
		<u>\$ 85,040</u>	<u>\$ (64,676)</u>	<u>\$ 20,364</u>
<u>December 31, 2019</u>	<u>Estimated Useful Life (Years)</u>	<u>Gross Intangible Assets</u>	<u>Accumulated Amortization</u>	<u>Net Intangible Assets</u>
Core deposits	4 - 12	\$ 48,930	\$ (36,576)	\$ 12,354
Trademarks and trade names	20	16,500	(6,812)	9,688
Noncompete agreements	4	4,310	(4,310)	—
Customer contracts and relationships	12 - 14	15,300	(10,676)	4,624
		<u>\$ 85,040</u>	<u>\$ (58,374)</u>	<u>\$ 26,666</u>

Amortization expense related to intangible assets during 2020, 2019 and 2018 was \$6.3 million, \$7.5 million and \$8.0 million, respectively.

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

The estimated aggregate future amortization expense for intangible assets at December 31, 2020 is as follows (in thousands).

2021	\$ 5,080
2022	3,967
2023	2,860
2024	1,826
2025	1,028
Thereafter	5,603
	<u>\$ 20,364</u>

**12. 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).

	Year Ended December 31,		
	2020	2019	2018
Balance, beginning of year	\$ 55,504	\$ 66,102	\$ 54,714
Additions	162,914	13,755	25,028
Sales	(36,750)	—	(9,303)
Changes in fair value:			
Due to changes in model inputs or assumptions <sup>(1)</sup>	(27,261)	(16,054)	159
Due to customer payoffs	(10,665)	(8,299)	(4,496)
Balance, end of year	<u>\$ 143,742</u>	<u>\$ 55,504</u>	<u>\$ 66,102</u>

  

	December 31,	
	2020	2019
Mortgage loans serviced for others <sup>(2)</sup>	\$ 14,643,623	\$ 4,948,441
MSR asset as a percentage of serviced mortgage loans	0.98 %	1.12 %

- (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.
- (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.

	December 31,	
	2020	2019
Weighted average constant prepayment rate	12.15 %	13.16 %
Weighted average discount rate	14.60 %	11.14 %
Weighted average life (in years)	6.3	6.0

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).

	December 31,	
	2020	2019
Constant prepayment rate:		
Impact of 10% adverse change	\$ (5,639)	\$ (3,072)
Impact of 20% adverse change	(11,164)	(5,943)
Discount rate:		
Impact of 10% adverse change	(6,435)	(2,094)
Impact of 20% adverse change	(12,287)	(4,028)

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 changes in assumptions generally cannot be extrapolated because the relationship

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

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 \$35.4 million, \$25.3 million and \$23.3 million during 2020, 2019 and 2018, respectively, were included in other noninterest income within the consolidated statements of operations.

**13. Deposits**

Deposits are summarized as follows (in thousands).

	<u>December 31,</u>	
	<u>2020</u>	<u>2019</u>
Noninterest-bearing demand	\$ 3,612,384	\$ 2,769,556
Interest-bearing:		
Demand accounts	2,399,341	1,881,614
Brokered - demand	282,426	—
Money market	2,716,878	2,641,116
Brokered - money market	124,243	5,000
Savings	276,327	199,076
Time	1,506,435	1,505,375
Brokered - time	324,285	30,477
	<u>\$ 11,242,319</u>	<u>\$ 9,032,214</u>

At December 31, 2020, deposits include \$1.1 billion of time deposit accounts that meet or exceed the FDIC insurance limit of \$250,000. Scheduled maturities of interest-bearing time deposits at December 31, 2020 are as follows (in thousands).

2021	\$ 1,600,039
2022	148,404
2023	49,026
2024	22,091
2025 and thereafter	11,160
	<u>\$ 1,830,720</u>

**14. Short-term Borrowings**

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

	<u>December 31,</u>	
	<u>2020</u>	<u>2019</u>
Federal funds purchased	\$ 180,325	\$ 81,625
Securities sold under agreements to repurchase	237,856	612,125
Federal Home Loan Bank	—	600,000
Short-term bank loans	—	111,000
Commercial paper	277,617	19,260
	<u>\$ 695,798</u>	<u>\$ 1,424,010</u>

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.

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

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

	Year Ended December 31,		
	2020	2019	2018
Average balance during the year	\$ 509,577	\$ 605,858	\$ 701,622
Average interest rate during the year	0.89 %	2.48 %	1.96 %
Maximum month-end balance during the year	\$ 714,507	\$ 693,750	\$ 849,568

  

	December 31,	
	2020	2019
Average interest rate at end of year	0.25 %	1.97 %
Securities underlying the agreements at end of year:		
Carrying value	\$ 237,913	\$ 612,515
Estimated fair value	\$ 262,554	\$ 661,023

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. At December 31, 2020, the Bank had available collateral of \$4.4 billion, substantially all of which was blanket collateral. Other information regarding FHLB short-term borrowings is shown in the following tables (dollars in thousands).

	Year Ended December 31,		
	2020	2019	2018
Average balance during the year	\$ 38,634	\$ 329,356	\$ 214,110
Average interest rate during the year	1.63 %	2.16 %	2.09 %
Maximum month-end balance during the year	\$ 150,000	\$ 700,000	\$ 675,000

  

	December 31,	
	2020	2019
Average interest rate at end of year	— %	1.56 %

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 short-term bank loan borrowings at December 31, 2020 and 2019 was 0.00% and 2.52%, respectively.

During 2019, Hilltop Securities initiated two commercial paper programs in the ordinary course of its business of which the net proceeds (after deducting related issuance expenses) from the sale will be used 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 December 31, 2020, the weighted average maturity of the CP Notes was 146 days at a rate of 1.23%, with a weighted average remaining life of 70 days. At December 31, 2020, the amount outstanding under these secured arrangements was \$277.6 million, which was collateralized by securities held for firm accounts valued at \$296.3 million.

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

**15. Notes Payable**

Notes payable consisted of the following (in thousands).

	December 31,	
	2020	2019
Senior Notes due April 2025, net of discount of \$1,063 and \$1,232, respectively	\$ 148,937	\$ 148,768
Subordinated Notes due May 2030, net of discount of \$793	49,207	—
Subordinated Notes due May 2035, net of discount of \$2,392	147,608	—
FHLB notes, including premium of \$0 and \$146, respectively	—	28,848
Ventures Management lines of credit	36,235	78,653
	\$ 381,987	\$ 256,269

*Senior Notes*

On April 9, 2015, Hilltop completed an offering of \$150.0 million aggregate principal amount of its 5% senior notes due 2025 (“Senior Unregistered Notes”) in a private offering that was exempt from the registration requirements of the Securities Act of 1933, as amended (the “Securities Act”). The Senior Unregistered Notes were offered within the United States only to qualified institutional buyers pursuant to Rule 144A under the Securities Act, and to persons outside of the United States under Regulation S under the Securities Act. The Senior Unregistered Notes were issued pursuant to an indenture, dated as of April 9, 2015, by and between Hilltop and U.S. Bank National Association, as trustee. The net proceeds from the offering, after deducting estimated fees and expenses and the initial purchasers’ discounts, were approximately \$148 million. Hilltop used the net proceeds of the offering to redeem all of Hilltop’s outstanding Non-Cumulative Perpetual Preferred Stock, Series B at an aggregate liquidation value of \$114.1 million, plus accrued but unpaid dividends of \$0.4 million, and Hilltop utilized the remainder for general corporate purposes. Unamortized debt issuance costs presented as a reduction from the Senior Notes are discussed further in Note 1 to the consolidated financial statements.

In connection with the issuance of the Senior Unregistered Notes, on April 9, 2015, the Company entered into a registration rights agreement with the initial purchasers of the Senior Unregistered Notes. Under the terms of the registration rights agreement, the Company agreed to offer to exchange the Senior Unregistered Notes for notes registered under the Securities Act (the “Senior Registered Notes”). The terms of the Senior Registered Notes are substantially identical to the Senior Unregistered Notes for which they were exchanged (including principal amount, interest rate, maturity and redemption rights), except that the Senior Registered Notes generally are not subject to transfer restrictions. On May 22, 2015 and subject to the terms and conditions set forth in the Senior Registered Notes prospectus, the Company commenced an offer to exchange the Senior Unregistered Notes for Senior Registered Notes. Substantially all of the Senior Unregistered Notes were tendered in the exchange offer, and on June 22, 2015, the Company fulfilled its requirements under the registration rights agreement for the Senior Unregistered Notes by issuing Senior Registered Notes in exchange for the tendered Senior Unregistered Notes. The Senior Registered Notes and the Senior Unregistered Notes that remain outstanding are collectively referred to as the “Senior Notes.”

The Senior Notes bear interest at a rate of 5% per year, payable semi-annually in arrears in cash on April 15 and October 15 of each year. The Senior Notes will mature on April 15, 2025, unless Hilltop redeems 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 its 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.

The indenture contains covenants that limit the Company’s ability to, among other things and subject to certain significant exceptions: (i) dispose of or issue voting stock of certain of the Company’s bank subsidiaries or subsidiaries that own voting stock of the Company’s bank subsidiaries, (ii) incur or permit to exist any mortgage, pledge, encumbrance or lien or charge on the capital stock of certain of the Company’s bank subsidiaries or subsidiaries that own capital stock of the Company’s bank subsidiaries and (iii) sell all or substantially all of the Company’s assets or merge or consolidate with or into other companies. The indenture also provides for certain events of default, which, if any of them occurs, would permit or require the principal amount, premium, if any, and accrued and unpaid interest on the then outstanding Senior Notes to be declared immediately due and payable.

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

*Subordinated Notes*

On May 7, 2020, Hilltop 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”) (collectively, 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.

The 2030 Subordinated Notes and the 2035 Subordinated Notes will mature on May 15, 2030 and May 15, 2035, respectively. Hilltop may redeem the Subordinated Notes, in whole or in part, from time to time, subject to obtaining regulatory 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, in each case 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 the 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 Secured Overnight Financing Rate (“SOFR rate”), plus 5.68%, payable quarterly in arrears. The 2035 Subordinated Notes bear interest at the 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.

*Federal Home Loan Bank notes*

The FHLB notes, as well as other borrowings from the FHLB, are collateralized by FHLB stock, a blanket lien on commercial and real estate loans, as well as by the amount of securities that are in safekeeping at the FHLB.

*Ventures Management Lines of Credit*

At December 31, 2020, Ventures Management’s ABAs had combined available lines of credit totaling \$170.0 million, \$80.0 million of which was with a single unaffiliated bank and \$90.0 million of which was with the Bank. At December 31, 2020, Ventures Management had outstanding borrowings of \$47.5 million, \$11.3 million of which was with the Bank with stated interest rates of the greater of a calculated index rate on mortgage notes or 3.13% to 3.75%. The weighted average interest rate of these lines of credit at December 31, 2020 was 3.27%. The Ventures Management lines of credit are collateralized by mortgage notes, and the loan agreements relating to the lines of credit contain various financial and other covenants which must be maintained until all indebtedness to the financial institution is repaid.

*Scheduled Maturities*

Scheduled maturities for notes payable outstanding at December 31, 2020 are as follows (in thousands).

2021	\$ 36,235
2022	—
2023	—
2024	—
2025	150,000
Thereafter	200,000
	<u>\$ 386,235</u>

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

**16. Leases**

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

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

	<u>Year Ended December 31,</u>	
	<u>2020</u>	<u>2019</u>
Finance leases:		
Premises and equipment	\$ 7,780	\$ 7,780
Accumulated depreciation	(4,768)	(4,178)
Premises and equipment, net	<u>\$ 3,012</u>	<u>\$ 3,602</u>

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

	<u>Year Ended December 31,</u>	
	<u>2020</u>	<u>2019</u>
Operating lease cost	\$ 41,903	\$ 44,331
Less operating lease and sublease income	(1,676)	(2,657)
Net operating lease cost	<u>\$ 40,227</u>	<u>\$ 41,674</u>
Finance lease cost:		
Amortization of ROU assets	\$ 590	\$ 590
Interest on lease liabilities	561	596
Total finance lease cost	<u>\$ 1,151</u>	<u>\$ 1,186</u>

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

	<u>Year Ended December 31,</u>	
	<u>2020</u>	<u>2019</u>
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ 31,850	\$ 37,527
Operating cash flows from finance leases	561	587
Financing cash flows from finance leases	636	603
Right-of-use assets obtained in exchange for new lease obligations:		
Operating leases	\$ 11,723	\$ 27,055
Finance leases	—	—

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

<u>Lease Classification</u>	<u>December 31, 2020</u>		<u>December 31, 2019</u>	
	<u>Weighted Average Remaining Lease Term (Years)</u>	<u>Weighted Average Discount Rate</u>	<u>Weighted Average Remaining Lease Term (Years)</u>	<u>Weighted Average Discount Rate</u>
Operating	5.5	4.67 %	5.9	5.29 %
Finance	5.6	4.81 %	6.5	4.79 %



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

Maturities of lease liabilities at December 31, 2020, under lease agreements that had commenced as of or subsequent to January 1, 2019, are presented below (in thousands).

	<u>Operating Leases</u>	<u>Finance Leases</u>
2021	\$ 36,132	\$ 1,212
2022	28,189	1,241
2023	22,645	1,280
2024	15,395	1,163
2025	11,177	886
Thereafter	29,636	1,411
Total minimum lease payments	143,174	7,193
Less amount representing interest	(17,724)	(2,334)
Lease liabilities	<u>\$ 125,450</u>	<u>\$ 4,859</u>

As of December 31, 2020, the Company had additional operating leases that have not yet commenced with aggregate future minimum lease payments of approximately \$22.9 million. These leases are expected to commence between January 2021 and October 2021 with lease terms ranging from two to eleven years.

**17. Junior Subordinated Debentures and Trust Preferred Securities**

PCC has four statutory Trusts, three of which were formed under the laws of the state of Connecticut and one of which, PCC Statutory Trust IV, was formed under the laws of the state of Delaware. The Trusts were created for the sole purpose of issuing and selling preferred securities and common securities, using the resulting proceeds to acquire junior subordinated debentures issued by PCC (the “Debentures”). Accordingly, the Debentures are the sole assets of the Trusts, and payments under the Debentures are the sole revenue of the Trusts. All of the common securities are owned by PCC; however, PCC is not the primary beneficiary of the Trusts. Accordingly, the Trusts are not included in the Company’s consolidated financial statements.

The Trusts have issued \$65,000,000 of floating rate preferred securities and \$2,012,000 of common securities and have invested the proceeds from the securities in floating rate Debentures of PCC.

Information regarding the PCC Debentures is shown in the following table (in thousands).

<u>Investor</u>	<u>Issue Date</u>	<u>Amount</u>
PCC Statutory Trust I	July 31, 2001	\$ 18,042
PCC Statutory Trust II	March 26, 2003	\$ 18,042
PCC Statutory Trust III	September 17, 2003	\$ 15,464
PCC Statutory Trust IV	February 22, 2008	\$ 15,464

The stated term of the Debentures is 30 years with interest payable quarterly. The rate on the Debentures, which resets quarterly, is 3-month LIBOR plus an average spread of 3.22%. The total average interest rate at December 31, 2020 was 3.45%. The term, rate and other features of the preferred securities are the same as the Debentures. PCC’s obligations under the Debentures and related documents, taken together, constitute a full and unconditional guarantee of the Trust’s obligations under the preferred securities.

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

**18. Income Taxes**

The significant components of the income tax provision are as follows (in thousands).

	<u>Year Ended December 31,</u>		
	<u>2020</u>	<u>2019</u>	<u>2018</u>
Current:			
Federal	\$ 97,338	\$ 58,562	\$ 18,977
State	19,150	9,215	2,241
	<u>116,488</u>	<u>67,777</u>	<u>21,218</u>
Deferred:			
Federal	\$ 13,325	\$ (2,690)	\$ 11,153
State	3,258	(1,373)	1,856
	<u>16,583</u>	<u>(4,063)</u>	<u>13,009</u>
	<u>\$ 133,071</u>	<u>\$ 63,714</u>	<u>\$ 34,227</u>

The income tax provision differs from the amount that would be computed by applying the statutory Federal income tax rate to income before income taxes as a result of the following (in thousands). The applicable corporate federal income tax rates were 21% for all periods presented.

	<u>Year Ended December 31,</u>		
	<u>2020</u>	<u>2019</u>	<u>2018</u>
Computed tax at federal statutory rate	\$ 118,629	\$ 59,392	\$ 32,572
Tax effect of:			
Nondeductible expenses	2,304	2,681	1,373
State income taxes	17,702	6,195	3,236
Tax-exempt income, net	(1,706)	(1,727)	(1,432)
Minority interest	(4,587)	(1,614)	(900)
Other	729	(1,213)	(622)
	<u>\$ 133,071</u>	<u>\$ 63,714</u>	<u>\$ 34,227</u>

The components of the tax effects of temporary differences that give rise to the net deferred tax asset included in other assets within the consolidated balance sheets are as follows (in thousands).

	<u>December 31,</u>	
	<u>2020</u>	<u>2019</u>
Deferred tax assets:		
Net operating and built-in loss carryforward	\$ 5,736	\$ 7,823
Purchase accounting adjustment - loans	11,814	15,850
Allowance for credit losses	35,542	14,796
Compensation and benefits	22,513	17,723
Legal and other reserves	7,097	1,272
Foreclosed property	1,913	5,456
Operating lease liabilities	29,348	29,125
Other	9,717	6,475
	<u>123,680</u>	<u>98,520</u>
Deferred tax liabilities:		
Premises and equipment	20,076	10,079
Intangible assets	4,518	6,098
Derivatives	17,688	4,342
Loan servicing	34,868	13,278
Operating lease ROU assets	24,755	26,498
Other	8,015	5,251
	<u>109,920</u>	<u>65,546</u>
Net deferred tax asset	<u>\$ 13,760</u>	<u>\$ 32,974</u>

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

The Company's effective tax rate was 23.6%, 22.5% and 22.1% during 2020, 2019 and 2018, respectively. The increase in the effective tax rate during 2020 was primarily attributable to the percentage of income at subsidiaries with higher state effective tax rates, while the effective tax rates for 2019 and 2018 approximated statutory rates and included the effect of investments in tax-exempt instruments, offset by nondeductible expenses.

At December 31, 2020 and 2019, the Company had net operating loss carryforwards for Federal income tax purposes of \$2.7 million and \$12.2 million, respectively (or \$0.6 million and \$2.4 million, respectively, on a tax effected basis at applicable rates for respective tax years). The net operating loss carryforwards are subject to an annual Section 382 limitation on their usage. These net operating loss carryforwards expire starting in 2034. The Company expects to realize its current deferred tax asset for these net operating loss carryforwards through the implementation of certain tax planning strategies, core earnings, and reversal of timing differences. At December 31, 2020, the Company also had a recognized built-in loss ("RBIL") carryover of \$20.5 million from the ownership change resulting from the SWS Merger. These RBILs that were recognized during a five year recognition period before January 1, 2020 are subject to the annual Section 382 limitation rules similar to the Company's net operating loss carryforwards. The RBILs are expected to be fully realized prior to any expiration.

Based on the Company's evaluation of its deferred tax assets, management determined that no valuation allowance against its gross deferred tax assets was necessary at December 31, 2020 or 2019.

GAAP requires the measurement of uncertain tax positions. Uncertain tax positions are the difference between a tax position taken, or expected to be taken, in a tax return and the benefit recognized for accounting purposes. At December 31, 2020 and 2019, the total amount of gross unrecognized tax benefits was \$3.8 million and \$2.8 million, respectively, of which \$3.0 million and \$2.1 million, respectively, if recognized, would favorably impact the Company's effective tax rate.

The aggregate changes in gross unrecognized tax benefits, which excludes interest and penalties, are as follows (in thousands).

	Year Ended December 31,		
	2020	2019	2018
Balance, beginning of year	\$ 2,808	\$ 3,056	\$ 1,574
Increases related to tax positions taken during a prior year	327	317	770
Decreases related to tax positions taken during a prior year	—	(423)	—
Increases related to tax positions taken during the current year	1,017	288	712
Decreases related to expiration of the statute of limitations	(374)	(430)	—
Balance, end of year	\$ 3,778	\$ 2,808	\$ 3,056

Specific positions that may be resolved include issues involving apportionment and tax credits. At December 31, 2020, the unrecognized tax benefit is a component of taxes receivable, which is included in other assets within the consolidated balance sheet.

The Company files income tax returns in U.S. federal and numerous state jurisdictions. The Company is subject to tax examinations in numerous jurisdictions in the United States until the applicable statute of limitations expires. The Company is no longer subject to U.S. federal tax examinations for tax years prior to 2017. The Company is open for various state tax examinations for tax years 2016 and later.

## 19. Employee Benefits

Hilltop and its subsidiaries have benefit plans that provide for elective deferrals by employees under Section 401(k) of the Internal Revenue Code. Employee contributions are determined by the level of employee participation and related salary levels per Internal Revenue Service regulations. Hilltop and its subsidiaries match a portion of employee contributions based on the amount of eligible employees' contributions and salaries. The amount charged to operating expense for these matching contributions totaled \$17.7 million, \$15.5 million and \$14.8 million during 2020, 2019 and 2018, respectively.

In July 2020, pursuant to stockholders' approval, the Company adopted the Hilltop Holdings Inc. Employee Stock Purchase Plan (the "ESPP") to provide a means for eligible employees of the Company to purchase shares of Hilltop

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

common stock at a discounted price by accumulating funds, normally through payroll deductions and is intended to qualify under Section 423 of the Internal Revenue Code. Participating employees may purchase shares of common stock at 90% of the fair market value on the last day of each quarterly offering period. The initial offering period commenced on January 1, 2021.

Effective upon the completion of the PlainsCapital Merger, the Company recorded a liability associated with separate retention agreements originally entered into between Hilltop and two executive officers. At December 31, 2020 and 2019, the recorded liability, including interest, was \$2.6 million and related to a single executive officer.

The Bank purchased \$15.0 million of flexible premium universal life insurance in 2001 to help finance the annual expense incurred in providing various employee benefits. At December 31, 2020 and 2019, the carrying value of the policies included in other assets was \$26.8 million and \$26.2 million, respectively. During each of 2020, 2019 and 2018, the Bank recorded income of \$0.5 million, \$1.0 million and \$0.6 million, respectively, related to the policies that was reported in other noninterest income within the consolidated statement of operations.

*Deferred Compensation Plan*

As a result of the SWS Merger, the Company assumed a deferred compensation plan (the “SWS Plan”) that allows former SWS eligible officers and employees to defer a portion of their bonus compensation and commissions. The SWS Plan matched 15% of the deferrals made by participants up to a predetermined limit through matching contributions that vest ratably over four years. Pursuant to the terms of the SWS Plan, the trustee periodically purchased the former SWS common stock in the open market. As a result of the SWS Merger, the former SWS common shares were converted into Hilltop common stock based on the terms of the merger agreement. No further contributions can be made to this plan.

The assets of the SWS Plan are held in a rabbi trust and primarily include investments in company-owned life insurance (“COLI”) and Hilltop common stock. These assets are consolidated with those of the Company. Investments in COLI are carried at the cash surrender value of the insurance policies and recorded in other assets within the consolidated balance sheet at December 31, 2020 and 2019, respectively. Investments in Hilltop common stock, which are carried at cost, and the corresponding liability related to the deferred compensation plan are presented as components of stockholders’ equity as employee stock trust and deferred compensation employee stock trust, net, respectively, at December 31, 2020 and 2019, respectively.

**20. Related Party Transactions**

Jeremy B. Ford, a director and the President and Chief Executive Officer of Hilltop, is the beneficiary of a trust that owns a 49% limited partnership interest in Diamond A Financial, L.P., which owned 18.9% of the outstanding Hilltop common stock at December 31, 2020.

Jeremy B. Ford is the son of Gerald J. Ford. Corey G. Prestidge, Hilltop’s General Counsel and Secretary, is the son-in-law of Gerald J. Ford. Accordingly, Messrs. Jeremy Ford and Corey Prestidge are brothers-in-law.

In the ordinary course of business, the Bank has granted loans to certain directors, executive officers and their affiliates (collectively referred to as related parties) totaling \$0.6 million and \$5 thousand at December 31, 2020 and 2019, respectively. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other unaffiliated persons and do not involve more than normal risk of collectability. For such loans during 2020, principal additions and payments were \$0.6 million and \$2 thousand, respectively.

At December 31, 2020 and 2019, the Bank held deposits of related parties of \$154.1 million and \$141.2 million, respectively.

A related party is the lessor in an operating lease with Hilltop. Hilltop’s minimum payment under the lease is \$0.5 million annually through 2028, for an aggregate remaining obligation of \$4.2 million at December 31, 2020.

The Bank purchased loans from a company for which a related party served as a director, president and chief executive officer. At December 31, 2020 and 2019, the outstanding balance of the purchased loans was \$0.5 million and \$0.7 million, respectively. The loans were purchased with recourse in the ordinary course of business and the related party had no direct financial interest in the transaction.

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

*Hilltop Plaza Investment*

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

In connection with the purchase of the land, Hillcrest Land LLC entered into a 99-year ground lease of the land with three tenants-in-common: SPC Park Plaza Partners LLC ("Park Plaza LLC"), an unaffiliated entity which received an undivided 50% leasehold interest; HTH Project LLC, a wholly owned subsidiary of Hilltop, which received an undivided 25% leasehold interest; and Diamond Hillcrest, LLC ("Diamond Hillcrest"), an entity owned by Mr. Gerald J. Ford, which received an undivided 25% leasehold interest (collectively, the "Co-Owners"). The ground lease is triple net. The base rent from the Co-Owners under the ground lease commences 18 months after the ground lease was signed at \$1.8 million per year and increases 1.0% per year each January 1 thereafter. The ground lease was classified as an operating lease under ASC 840, and the accounting commencement date was determined to be July 31, 2018, the date the land was available to the Co-Owners.

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

Hilltop and the Bank entered into leases for a significant portion of the total rentable corporate office space in Hilltop Plaza which serves as the headquarters for both companies. Affiliates of Mr. Gerald J. Ford also entered into leases for office space in the building. The two separate 129-month office and retail leases of Hilltop and the Bank, respectively, have combined total base rent of approximately \$35 million with the first nine months of rent abated. The accounting commencement date of both leases was determined to be June 20, 2019, the date the building was delivered in order for tenant improvement work to commence. The combined operating lease liability, net of lease incentives, recognized during the second quarter of 2019 as a result of the commencement of these leases was \$18.9 million. During 2018, the office and retail leases were considered under the build-to-suit provisions of ASC 840, and the Company was determined to be the accounting owner of the project as its affiliate, HTH Project LLC, has an equity investment in the project. As such, the assets of Hilltop Plaza were recognized during the construction period through December 31, 2018, as costs were incurred to construct the asset, with a corresponding liability representing the costs paid for by the lessor (the Co-Owners). At December 31, 2018, the \$27.8 million of costs incurred to date were included within premises and equipment and other liabilities, respectively, in the consolidated balance sheets. The Company reassessed its accounting ownership of the Hilltop Plaza assets under construction as of January 1, 2019, under the build-to-suit provisions of the newly adopted ASC 842, *Leases* and concluded it was not the accounting owner. As such, the assets and liabilities of the project were derecognized on January 1, 2019, with the \$1.4 million offset representing deferred expenses recognized on the date through December 31, 2018, recorded as an increase to retained earnings.

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

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

## **21. Commitments and Contingencies**

During 2020, the Bank acted as agent on behalf of certain correspondent banks in the purchase and sale of federal funds that aggregated to \$2.5 million and zero at December 31, 2020 and 2019, respectively.

### *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.

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

### *Indemnification Liability Reserve*

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

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

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 December 31, 2020 and 2019, the mortgage origination segment's indemnification liability reserve totaled \$21.5 million and \$11.8 million, respectively. The provision for indemnification losses was \$11.2 million, \$3.1 million, and \$3.2 million during 2020, 2019, and 2018, respectively.

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

	<b>Representation and Warranty Specific Claims</b>		
	<b>Activity - Origination Loan Balance</b>		
	<b>Year Ended December 31,</b>		
	<b>2020</b>	<b>2019</b>	<b>2018</b>
Balance, beginning of year	\$ 32,144	\$ 33,784	\$ 33,702
Claims made	17,429	20,054	22,156
Claims resolved with no payment	(7,778)	(14,154)	(13,169)
Repurchases	(11,588)	(6,170)	(8,250)
Indemnification payments	(122)	(1,370)	(655)
Balance, end of year	<u>\$ 30,085</u>	<u>\$ 32,144</u>	<u>\$ 33,784</u>
	<b>Indemnification Liability Reserve Activity</b>		
	<b>Year Ended December 31,</b>		
	<b>2020</b>	<b>2019</b>	<b>2018</b>
Balance, beginning of year	\$ 11,776	\$ 10,701	\$ 23,472
Additions for new sales	9,991	3,116	3,170
Repurchases	(768)	(495)	(612)
Early payment defaults	(624)	(380)	(368)
Indemnification payments (1)	(39)	(352)	(13,687)
Change in reserves for loans sold in prior years	1,195	(814)	(1,274)
Balance, end of year	<u>\$ 21,531</u>	<u>\$ 11,776</u>	<u>\$ 10,701</u>
	<b>December 31,</b>		
	<b>2020</b>	<b>2019</b>	
Reserve for Indemnification Liability:			
Specific claims	\$ 961	\$ 1,071	
Incurred but not reported claims	20,570	10,705	
Total	<u>\$ 21,531</u>	<u>\$ 11,776</u>	

(1) Indemnification payments in 2018 included \$13.5 million related to agreements with the DOJ and HUD in exchange for release of any civil claims related to certain loans originated by PrimeLending. These claims were included in incurred but not reported claims in prior periods.

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

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

*Other Contingencies*

As discussed in Note 19 to the consolidated financial statements, effective upon completion of the PlainsCapital Merger, Hilltop entered into separate retention agreements with certain executive officers. As of December 31, 2020, a single retention agreement remains, with an initial term of two years (with automatic one-year renewals at the end of the first year and each anniversary thereof). This retention agreement provides for severance pay benefits if the executive officer's employment is terminated without "cause".

In addition to this retention agreement, Hilltop and its subsidiaries maintain employment contracts with certain officers that provide for benefits in the event of a "change in control" as defined in these agreements.

**22. 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 \$1.9 billion at December 31, 2020 and outstanding financial and performance standby letters of credit of \$91.5 million at December 31, 2020.

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.

*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.



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

**23. 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.” The Equity Plans provide for the grant of nonqualified stock options, stock appreciation rights, restricted stock, RSUs, performance awards, dividend equivalent rights and other awards to employees of the Company, its subsidiaries and outside directors of the Company. Shares available for grant under the 2012 Plan that were reserved but not issued as of the effective date of the 2020 Plan were added to the reserves of the 2020 Plan. No additional awards may be made under the 2012 Plan, but the 2012 Plan remains in effect as to outstanding awards. Outstanding awards under the Equity Plans continue to be subject to the terms and conditions of the respective Plans. The number of shares authorized for issuance pursuant to awards under the 2020 Plan is 3,650,000 plus any shares that become available upon the forfeiture, expiration, cancellation or settlement in cash awards outstanding under the 2012 Plan as of April 30, 2020. At December 31, 2020, 3,428,547 shares of common stock remained available for issuance pursuant to awards granted under the 2020 Plan, excluding shares that may be delivered pursuant to outstanding awards. Compensation expense related to the Equity Plans was \$14.6 million, \$11.8 million and \$9.1 million during 2020, 2019 and 2018, respectively.

During 2020, 2019 and 2018, Hilltop granted 31,222, 26,659 and 30,400 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 Compensation Committee of the board of directors of the Company issued RSUs to certain employees pursuant to the Equity Plans.

Certain RSUs are subject to time-based vesting conditions and generally provided for a cliff vest on the third anniversary of the grant date, while other RSUs provided for vesting based upon the achievement of certain performance goals over a three-year period subject to service conditions set forth in the award agreements, with associated costs generally recognized on a straight-line basis over the respective vesting periods. The RSUs are not transferable, and the shares of common stock issuable upon conversion of vested RSUs may be subject to transfer restrictions for a period of one year following conversion, subject to certain exceptions. In addition, the applicable RSU award agreements provide for accelerated vesting under certain conditions.

The following table summarizes information about nonvested RSU activity (shares in thousands).

	RSUs	
	Outstanding	Weighted Average Grant Date Fair Value
Balance, December 31, 2017	1,318	\$ 20.89
Granted	510	\$ 24.00
Vested/Released	(406)	\$ 19.92
Forfeited	(152)	\$ 20.97
Balance, December 31, 2018	1,270	\$ 22.44
Granted	719	\$ 20.02
Vested/Released	(496)	\$ 18.17
Forfeited	(56)	\$ 24.12
Balance, December 31, 2019	1,437	\$ 22.64
Granted	777	\$ 21.79
Vested/Released	(350)	\$ 26.83
Forfeited	(31)	\$ 22.38
Balance, December 31, 2020	1,833	\$ 21.48

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

Vested/Released RSUs include an aggregate of 238,914 shares withheld to satisfy employee statutory tax obligations during 2020, 2019 and 2018. Pursuant to certain RSU award agreements, an aggregate of 5,482 vested RSUs at December 31, 2020 require deferral of the settlement in shares and statutory tax obligations to a future date.

During 2020, the Compensation Committee of the board of directors of the Company awarded certain executives and key employees an aggregate of 763,140 RSUs pursuant to the Equity Plans. At December 31, 2020, 636,208 of these RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 122,232 of these outstanding RSUs will cliff vest based upon the achievement of certain performance goals over a three-year period.

At December 31, 2020, in the aggregate, 1,543,756 of the RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 289,493 outstanding RSUs cliff vest based upon the achievement of certain performance goals over a three-year period. At December 31, 2020, unrecognized compensation expense related to outstanding RSUs of \$20.1 million is expected to be recognized over a weighted average period of 1.49 years.

## **24. 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.

In addition, bank holding companies with less than \$15 billion in assets as of December 31, 2009 are allowed to include junior subordinated debentures in Tier 1 capital, subject to certain restrictions. However, because Hilltop has grown above \$15 billion in assets, if we make an acquisition in the future, the debentures issued to the PCC Statutory Trusts I, II, III and IV (the “Trusts”) may be phased out of Tier 1 and into Tier 2 capital. All of the debentures issued to the Trusts, less the common stock of the Trusts, qualified as Tier 1 capital as of December 31, 2020, under guidance issued by the Board of Governors of the Federal Reserve System.

The following tables show PlainsCapital’s and Hilltop’s actual capital amounts and ratios in accordance with Basel III compared to the regulatory minimum capital requirements including conservation buffer 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 December 31, 2020 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. Capital amounts and ratios in the following table as of December 31, 2019 are presented on a consolidated basis and include discontinued operations and those assets and liabilities classified as discontinued.

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

	<u>Actual</u>		<u>Minimum Capital Requirements Including Conservation Buffer</u>	<u>To Be Well Capitalized</u>
	<u>Amount</u>	<u>Ratio</u>	<u>Ratio</u>	<u>Ratio</u>
<b><u>December 31, 2020</u></b>				
Tier 1 capital (to average assets):				
PlainsCapital	\$ 1,385,842	10.44 %	4.0 %	5.0 %
Hilltop	2,111,580	12.64 %	4.0 %	N/A
Common equity Tier 1 capital (to risk-weighted assets):				
PlainsCapital	1,385,842	14.40 %	7.0 %	6.5 %
Hilltop	2,046,580	18.97 %	7.0 %	N/A
Tier 1 capital (to risk-weighted assets):				
PlainsCapital	1,385,842	14.40 %	8.5 %	8.0 %
Hilltop	2,111,580	19.57 %	8.5 %	N/A
Total capital (to risk-weighted assets):				
PlainsCapital	1,470,364	15.27 %	10.5 %	10.0 %
Hilltop	2,409,684	22.34 %	10.5 %	N/A
	<u>Actual</u>		<u>Minimum Capital Requirements Including Conservation Buffer</u>	<u>To Be Well Capitalized</u>
	<u>Amount</u>	<u>Ratio</u>	<u>Ratio</u>	<u>Ratio</u>
<b><u>December 31, 2019</u></b>				
Tier 1 capital (to average assets):				
PlainsCapital	\$ 1,236,289	11.61 %	4.0 %	5.0 %
Hilltop	1,822,970	12.71 %	4.0 %	N/A
Common equity Tier 1 capital (to risk-weighted assets):				
PlainsCapital	1,236,289	13.45 %	7.0 %	6.5 %
Hilltop	1,776,381	16.70 %	7.0 %	N/A
Tier 1 capital (to risk-weighted assets):				
PlainsCapital	1,236,289	13.45 %	8.5 %	8.0 %
Hilltop	1,822,970	17.13 %	8.5 %	N/A
Total capital (to risk-weighted assets):				
PlainsCapital	1,299,453	14.13 %	10.5 %	10.0 %
Hilltop	1,867,771	17.55 %	10.5 %	N/A

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

A reconciliation of equity capital to common equity Tier 1, Tier 1 and total capital (as defined) is as follows (in thousands).

	<u>December 31, 2020</u>		<u>December 31, 2019</u>	
	<u>PlainsCapital</u>	<u>Hilltop</u>	<u>PlainsCapital</u>	<u>Hilltop</u>
Total equity capital	\$ 1,654,249	\$ 2,323,939	\$ 1,523,549	\$ 2,103,039
Add:				
Net unrealized holding losses (gains) on securities available for sale and held in trust	(17,763)	(17,763)	(9,452)	(11,419)
CECL transition adjustment	22,905	23,842	—	—
Deduct:				
Goodwill and other disallowed intangible assets	(273,330)	(283,187)	(276,249)	(313,756)
Other	(219)	(251)	(1,559)	(1,483)
Common equity Tier 1 capital (as defined)	<u>1,385,842</u>	<u>2,046,580</u>	<u>1,236,289</u>	<u>1,776,381</u>
Add: Tier 1 capital				
Trust preferred securities	—	65,000	—	65,000
Deduct:				
Additional Tier 1 capital deductions	—	—	—	(18,411)
Tier 1 capital (as defined)	<u>1,385,842</u>	<u>2,111,580</u>	<u>1,236,289</u>	<u>1,822,970</u>
Add: Allowable Tier 2 capital				
Allowance for credit losses, including unfunded commitments	120,334	134,853	63,164	63,212
Capital instruments	—	200,000	—	—
Deduct:				
Additional Tier 2 capital deductions	(35,812)	(36,749)	—	(18,411)
Total capital (as defined)	<u>\$ 1,470,364</u>	<u>\$ 2,409,684</u>	<u>\$ 1,299,453</u>	<u>\$ 1,867,771</u>

*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 requirement 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 December 31, 2020, the net capital position of each of the Hilltop Broker-Dealers was as follows (in thousands).

	<u>Hilltop Securities</u>	<u>Momentum Independent Network</u>
Net capital	\$ 291,228	\$ 3,220
Less: required net capital	7,045	250
Excess net capital	<u>\$ 284,183</u>	<u>\$ 2,970</u>
Net capital as a percentage of aggregate debit items	82.7 %	
Net capital in excess of 5% aggregate debit items	<u>\$ 273,616</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 December 31, 2020 and 2019, the Hilltop Broker-Dealers held cash of \$290.4 million and \$157.4 million, respectively, segregated in special reserve bank accounts for the benefit of customers. The Hilltop Broker-Dealers were not required to segregate cash or securities in special reserve accounts for the benefit of proprietary accounts of introducing broker-dealers at December 31, 2020.

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

*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 December 31, 2020, PrimeLending and its subsidiaries net worth and liquidity exceeded the amounts required by HUD and GNMA, as applicable.

**25. Stockholders' Equity**

The Bank is subject to certain restrictions on the amount of dividends it may declare without prior regulatory approval. At December 31, 2020, \$248.1 million of its earnings was available for dividend declaration without prior regulatory approval.

*Dividends*

During 2020, 2019 and 2018, the Company declared and paid cash dividends of \$0.36, \$0.32 and \$0.28 per common share, or \$32.5 million, \$29.6 million and \$26.7 million, respectively.

On January 28, 2021, the Company announced that its board of directors declared a quarterly cash dividend of \$0.12 per common share, payable on February 26, 2021, to all common stockholders of record as of the close of business on February 15, 2021.

*Stock Repurchase Programs*

The Company's board of directors has periodically approved stock repurchase programs under which it authorized the Company to repurchase its outstanding common stock. Under the respective stock repurchase program authorized, the Company could repurchase shares in open-market purchases or through privately negotiated transactions as permitted under Rule 10b-18 promulgated under the Exchange Act. The extent to which the Company repurchased its shares and the timing of such repurchases depended upon market conditions and other corporate considerations, as determined by Hilltop's management team. Repurchased shares will be returned to the Company's pool of authorized but unissued shares of common stock.

In January 2018, the Hilltop board of directors authorized a stock repurchase program through January 2019 pursuant to which the Company was originally authorized to repurchase, in the aggregate, up to \$50.0 million of its outstanding common stock. In July 2018, the Hilltop board of directors authorized an increase to the aggregate amount of common stock the Company may repurchase under this program to \$100.0 million, inclusive of repurchases to offset dilution related to grants of stock-based compensation. During 2018, the Company paid \$59.0 million to repurchase an aggregate of 2,729,568 shares of common stock at a weighted average price of \$21.61 per share. This stock repurchase program expired in January 2019. The purchases were funded from available cash balances.

In January 2019, the Hilltop board of directors authorized a stock repurchase program through January 2020, pursuant to which the Company was authorized to repurchase, in the aggregate, up to \$50.0 million of its outstanding common stock. On August 19, 2019, the Company entered into a Securities Purchase Agreement to purchase 2,175,404 shares of its common stock from Oak Hill Capital Partners III, L.P., Oak Hill Capital Management Partners III, L.P. and Oak Hill Capital Management, LLC (collectively, "Oak Hill Capital"). The Hilltop board of directors, other than Messrs. J. Taylor Crandall and Gerald J. Ford, considered and approved the purchase of the shares of Hilltop common stock from Oak Hill Capital. Hilltop director J. Taylor Crandall is a founding Managing Partner of Oak Hill Capital Management, LLC. The purchase was consummated on August 20, 2019 at a purchase price of \$48.4 million, or \$22.25 per share. The purchase price per share was determined by the weighted average of the closing prices of Hilltop common stock as reported by the New York Stock Exchange for each trading day commencing on August 12, 2019 and ending on August 16, 2019. The repurchase of shares by Hilltop from Oak Hill Capital fully utilized all remaining availability of the stock repurchase program previously authorized in January 2019.

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

During 2019, the Company paid \$73.4 million to repurchase an aggregate of 3,390,247 shares of common stock at a weighted average price of \$21.64 per share. These amounts are inclusive of the repurchase of shares by Hilltop from Oak Hill Capital discussed above. This stock repurchase program expired in January 2020. The purchases were funded from available cash balances.

In January 2020, the Hilltop board of directors authorized a new stock repurchase program through January 2021, pursuant to which the Company is authorized to repurchase, in the aggregate, up to \$75.0 million of its outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation. As previously announced on April 30, 2020, in light of the uncertain outlook for 2020 due to the COVID-19 pandemic, Hilltop's board of directors suspended its stock repurchase program. During 2020, prior to its suspension, the Company paid \$15.2 million to repurchase an aggregate of 720,901 shares of common stock at a weighted average price of \$21.13 per share associated with the stock repurchase program

In January 2021, the Hilltop board of directors authorized a new stock repurchase program through January 2022, pursuant to which the Company is authorized to repurchase, in the aggregate, up to \$75.0 million of its outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation.

*Tender Offer*

On September 23, 2020, the Company announced the commencement of a modified "Dutch auction" tender offer to purchase shares of its common stock for an aggregate cash purchase price up to \$350 million. On November 17, 2020, the Company completed its 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. The Company funded the tender offer with cash on hand.

**26. Other Noninterest Income and Expense**

The following table shows the components of other noninterest income and expense (in thousands).

	<b>Year Ended December 31,</b>		
	<b>2020</b>	<b>2019</b>	<b>2018</b>
Other noninterest income:			
Net gains from trading securities portfolio	\$ 121,983	\$ 20,521	\$ 6,197
Net gains from Hilltop Broker-Dealer structured product and derivative activities	81,111	129,571	41,543
Service charges on depositor accounts	14,845	15,170	14,484
Trust fees	9,804	10,255	9,807
Other	15,862	10,833	18,365
	<u>\$ 243,605</u>	<u>\$ 186,350</u>	<u>\$ 90,396</u>
Other noninterest expense:			
Software and information technology	\$ 56,872	\$ 50,751	\$ 52,882
Mortgage origination and servicing	27,808	19,892	19,705
Brokerage commissions and fees	24,113	20,039	20,674
Unreimbursed loan closing costs	21,696	16,784	16,798
Business development	10,190	12,940	15,853
Amortization of intangible assets	6,301	7,567	8,026
Travel, meals and entertainment	4,804	12,160	11,968
Funding fees	4,461	5,393	5,414
Office supplies	3,953	4,809	5,788
Other	64,560	43,051	55,284
	<u>\$ 224,758</u>	<u>\$ 193,386</u>	<u>\$ 212,392</u>

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

**27. 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 U.S. Treasury bond, 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 5 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 12 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).

	Year Ended December 31,		
	2020	2019	2018
Increase (decrease) in fair value of derivatives during period:			
PrimeLending	\$ 33,714	\$ 8,550	\$ (12,788)
Hilltop Broker-Dealers	3,969	(3,085)	(381)
Bank	(7)	(148)	30

*Hedging Derivative Instruments*

During 2020, the Company entered into interest rate swap contracts with the initial notional amount of \$61 million to manage the exposure to changes in fair value associated with certain available for sale fixed rate collateralized mortgage backed securities attributable to changes in the designated benchmark interest rate. 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. Under these interest rate swap contracts, we receive a floating rate and pay a fixed rate on the outstanding notional amount. The Company recorded a cumulative basis adjustment. The Company has assessed the hedge effectiveness both at the onset of the hedge and at regular intervals throughout the life of the derivative. For derivatives designated and that qualify as fair value hedges, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in interest income.

The Company has outstanding interest rate swap contracts utilized to manage the variability of cash flows associated with our variable rate borrowings. Under these interest rate swap contract, we receive a floating rate and pay a fixed rate on the outstanding notional amount. The Company has designated the interest rate swap as a cash flow hedge and

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

assessed 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 interest rate swap is highly effective in offsetting the variability of the hedged cash flows, 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 hedge that the interest rate swap will be a highly effective hedge throughout the term of the contract, any portion of fair value swap subsequently determined to be ineffective will be recognized in earnings.

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

	December 31, 2020		December 31, 2019	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Derivative instruments (not designated as hedges):				
IRLCs	\$ 2,470,013	\$ 76,048	\$ 914,526	\$ 18,222
Customer-based written options	—	—	31,200	—
Customer-based purchased options	—	—	31,200	—
Commitments to purchase MBSs	2,478,041	22,311	3,346,946	3,321
Commitments to sell MBSs	6,141,079	(40,621)	5,988,198	(5,904)
Interest rate swaps	43,786	(2,196)	15,012	(178)
U.S. Treasury bond futures and options <sup>(1)</sup>	225,400	—	283,500	—
Eurodollar futures <sup>(1)</sup>	—	—	934,000	—
Derivative instruments (designated as hedges):				
Interest rate swaps designated as cash flow hedges	\$ 105,000	\$ (3,112)	\$ 50,000	\$ 528
Interest rate swaps designated as fair value hedges <sup>(2)</sup>	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 \$60.6 million as the hedged amount (from a closed portfolio of prepayable available for sale securities with a carrying value of \$60.7 million as of December 31, 2020) in a last-of-layer hedging relationship, which commenced in the fourth quarter of 2020. The cumulative basis adjustment included in the carrying value of the hedged items totaled \$0.1 million.

The increase in the estimated fair value of the IRLCs at December 30, 2020, compared to December 31, 2019, was driven by the accelerated decrease in mortgage interest rates during 2020 triggered by the economic impact of the COVID-19 pandemic, and an increase in the average value of individual IRLCs. The increase in average value of individual IRLCs 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.

PrimeLending has cash collateral advances totaling \$26.1 million and \$4.5 million to offset net liability derivative positions on its commitments to sell MBSs at December 31, 2020 and 2019, respectively. In addition, PrimeLending and the Hilltop Broker-Dealers advanced cash collateral totaling \$2.7 million and \$3.7 million on its U.S. Treasury bond futures and options and Eurodollar futures at December 31, 2020 and 2019, respectively. These amounts are included in other assets within the consolidated balance sheets.



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

**28. 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>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>

<b>December 31, 2019</b>						
Securities borrowed:						
Institutional counterparties	\$ 1,634,782	\$ —	\$ 1,634,782	\$ (1,586,820)	\$ —	\$ 47,962
Reverse repurchase agreements:						
Institutional counterparties	59,031	—	59,031	(58,619)	—	412
Forward MBS derivatives:						
Institutional counterparties	3,640	—	3,640	(3,640)	—	—
	<u>\$ 1,697,453</u>	<u>\$ —</u>	<u>\$ 1,697,453</u>	<u>\$ (1,649,079)</u>	<u>\$ —</u>	<u>\$ 48,374</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>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>

<b>December 31, 2019</b>						
Securities loaned:						
Institutional counterparties	\$ 1,555,964	\$ —	\$ 1,555,964	\$ (1,509,933)	\$ —	\$ 46,031
Interest rate swaps:						
Institutional counterparties	178	—	178	(112)	—	66
Repurchase agreements:						
Institutional counterparties	586,651	—	586,651	(586,651)	—	—
Customer counterparties	25,474	—	25,474	(25,474)	—	—
Forward MBS derivatives:						
Institutional counterparties	6,890	(667)	6,223	(2,384)	—	3,839
	<u>\$ 2,175,157</u>	<u>\$ (667)</u>	<u>\$ 2,174,490</u>	<u>\$ (2,124,554)</u>	<u>\$ —</u>	<u>\$ 49,936</u>

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

*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 December 31, 2020 and 2019.

	<b>Remaining Contractual Maturities</b>				
	<b>Overnight and Continuous</b>	<b>Up to 30 Days</b>	<b>30-90 Days</b>	<b>Greater Than 90 Days</b>	<b>Total</b>
<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					<u>\$ 1,482,922</u>
Amount related to agreements not included in offsetting disclosure above					<u>\$ —</u>

	<b>Remaining Contractual Maturities</b>				
	<b>Overnight and Continuous</b>	<b>Up to 30 Days</b>	<b>30-90 Days</b>	<b>Greater Than 90 Days</b>	<b>Total</b>
<b>December 31, 2019</b>					
Repurchase agreement transactions:					
U.S. Treasury and agency securities	\$ 45,950	\$ —	\$ —	\$ —	\$ 45,950
Asset-backed securities	257,396	12,892	295,887	—	566,175
Securities lending transactions:					
Corporate securities	120	—	—	—	120
Equity securities	1,555,844	—	—	—	1,555,844
Total	<u>\$ 1,859,310</u>	<u>\$ 12,892</u>	<u>\$ 295,887</u>	<u>\$ —</u>	<u>\$ 2,168,089</u>
Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above					<u>\$ 2,168,089</u>
Amount related to agreements not included in offsetting disclosure above					<u>\$ —</u>

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

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

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

	December 31,	
	2020	2019
Receivables:		
Securities borrowed	\$ 1,338,855	\$ 1,634,782
Securities failed to deliver	58,244	18,726
Trades in process of settlement	—	104,922
Other	7,628	21,850
	\$ 1,404,727	\$ 1,780,280
Payables:		
Securities loaned	\$ 1,245,066	\$ 1,555,964
Correspondents	33,547	37,036
Securities failed to receive	61,589	8,568
Trades in process of settlement	21,765	—
Other	6,406	3,950
	\$ 1,368,373	\$ 1,605,518

**30. 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 and its assets and liabilities have been presented as discontinued operations in the consolidated financial statements. Income from discontinued operations before taxes was \$38.9 million, \$17.6 million and \$5.8 million during 2020, 2019 and 2018, respectively. At December 31, 2019, goodwill and assets of discontinued operations were \$24.0 million and \$248.4 million, respectively.

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).

Year Ended December 31, 2020	Banking	Broker-Dealer	Mortgage Origination	Corporate	All Other and Eliminations	Continuing Operations
Net interest income (expense)	\$ 390,871	\$ 39,912	\$ (10,489)	\$ (14,192)	\$ 18,064	\$ 424,166
Provision for credit losses	96,326	165	—	—	—	96,491
Noninterest income	41,376	491,355	1,172,450	3,945	(18,646)	1,690,480
Noninterest expense	232,447	415,463	753,917	53,040	(1,064)	1,453,803
Income (loss) from continuing operations before taxes	\$ 103,474	\$ 115,639	\$ 408,044	\$ (63,287)	\$ 482	\$ 564,352

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

<u>Year Ended December 31, 2019</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)	\$ 379,258	\$ 51,308	\$ (6,273)	\$ (5,541)	\$ 20,227	\$ 438,979
Provision for (reversal of) credit losses	7,280	(74)	—	—	—	7,206
Noninterest income	41,753	404,411	634,992	2,104	(20,443)	1,062,817
Noninterest expense	231,524	366,031	563,998	50,968	(632)	1,211,889
Income (loss) from continuing operations before taxes	<u>\$ 182,207</u>	<u>\$ 89,762</u>	<u>\$ 64,721</u>	<u>\$ (54,405)</u>	<u>\$ 416</u>	<u>\$ 282,701</u>

<u>Year Ended December 31, 2018</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)	\$ 370,732	\$ 50,878	\$ 1,485	\$ (9,176)	\$ 19,380	\$ 438,299
Provision for (reversal of) credit losses	5,319	(231)	—	—	—	5,088
Noninterest income	43,588	301,714	551,860	4,798	(21,830)	880,130
Noninterest expense	256,577	320,241	540,474	36,628	(592)	1,153,328
Income (loss) from continuing operations before taxes	<u>\$ 152,424</u>	<u>\$ 32,582</u>	<u>\$ 12,871</u>	<u>\$ (41,006)</u>	<u>\$ (1,858)</u>	<u>\$ 155,013</u>

<u>December 31, 2020</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>
Goodwill	\$ 247,368	\$ 7,008	\$ 13,071	\$ —	\$ —	\$ 267,447
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>

<u>December 31, 2019</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>
Goodwill	\$ 247,368	\$ 7,008	\$ 13,071	\$ —	\$ —	\$ 267,447
Total assets in continuing operations	<u>\$ 11,147,344</u>	<u>\$ 3,457,068</u>	<u>\$ 2,357,415</u>	<u>\$ 2,393,604</u>	<u>\$ (4,431,412)</u>	<u>\$ 14,924,019</u>

### 31. Earnings per Common Share

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

	<u>Year Ended December 31,</u>		
	<u>2020</u>	<u>2019</u>	<u>2018</u>
Basic earnings per share:			
Income from continuing operations	\$ 409,440	\$ 211,301	\$ 116,500
Income from discontinued operations	38,396	13,990	4,941
Income attributable to Hilltop	<u>\$ 447,836</u>	<u>\$ 225,291</u>	<u>\$ 121,441</u>
Weighted average shares outstanding - basic	89,280	92,345	94,969
Basic earnings per common share:			
Income from continuing operations	\$ 4.59	\$ 2.29	\$ 1.23
Income from discontinued operations	0.43	0.15	0.05
	<u>\$ 5.02</u>	<u>\$ 2.44</u>	<u>\$ 1.28</u>
Diluted earnings per share:			
Income from continuing operations	\$ 409,440	\$ 211,301	\$ 116,500
Income from discontinued operations	38,396	13,990	4,941
Income attributable to Hilltop	<u>\$ 447,836</u>	<u>\$ 225,291</u>	<u>\$ 121,441</u>
Weighted average shares outstanding - basic	89,280	92,345	94,969
Effect of potentially dilutive securities	24	49	98
Weighted average shares outstanding - diluted	<u>89,304</u>	<u>92,394</u>	<u>95,067</u>
Diluted earnings per common share:			
Income from continuing operations	\$ 4.58	\$ 2.29	\$ 1.23
Income from discontinued operations	0.43	0.15	0.05
	<u>\$ 5.01</u>	<u>\$ 2.44</u>	<u>\$ 1.28</u>

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

**32. Financial Statements of Parent**

The following tables present the condensed combined financial statements of the Company's bank holding company entities, Hilltop and PCC. The tables also include the corporate activities associated with Hilltop Opportunity Partners LLC and the Hilltop Plaza Entities (in thousands). Investments in subsidiaries are determined using the equity method of accounting.

*Condensed Combined Statements of Operations and Comprehensive Income*

	Year Ended December 31,		
	2020	2019	2018
Dividends from bank subsidiaries	\$ 249,771	\$ 143,000	\$ 42,000
Dividends from nonbank subsidiaries	56,150	36,950	37,500
Investment income	4,102	5,933	3,089
Interest expense	18,294	11,474	12,265
Other income	45,887	2,221	4,893
General and administrative expense	58,130	50,968	36,628
Income before income taxes and equity in undistributed earnings of subsidiaries activity	279,486	125,662	38,589
Income tax benefit	(13,897)	(12,706)	(7,767)
Equity in undistributed earnings of subsidiaries	176,294	94,609	79,371
Net income	\$ 469,677	\$ 232,977	\$ 125,727
Other comprehensive income (loss), net	6,344	20,046	(5,656)
Comprehensive income	\$ 476,021	\$ 253,023	\$ 120,071

*Condensed Combined Balance Sheets*

	December 31,		
	2020	2019	2018
Assets:			
Cash and cash equivalents	\$ 478,826	\$ 116,471	\$ 54,405
Investment in subsidiaries:			
Bank subsidiaries	1,654,249	1,523,549	1,459,984
Nonbank subsidiaries	453,847	533,844	483,593
Other assets	236,452	219,740	245,200
Total assets	\$ 2,823,374	\$ 2,393,604	\$ 2,243,182
Liabilities and Stockholders' Equity:			
Accounts payable and accrued expenses	\$ 64,635	\$ 53,418	\$ 58,319
Notes payable	412,764	215,780	215,620
Stockholders' equity	2,345,975	2,124,406	1,969,243
Total liabilities and stockholders' equity	\$ 2,823,374	\$ 2,393,604	\$ 2,243,182

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

*Condensed Combined Statements of Cash Flows*

	Year Ended December 31,		
	2020	2019	2018
Operating Activities:			
Net income	\$ 469,677	\$ 232,977	\$ 125,727
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	(176,294)	(94,609)	(79,371)
Net realized gains on equity investments	—	—	(5,336)
Net realized gains on disposal of discontinued operations	(41,901)	—	—
Deferred income taxes	4,432	(123)	217
Other, net	37,465	44,943	19,368
Net cash provided by operating activities	<u>293,379</u>	<u>183,188</u>	<u>60,605</u>
Investing Activities:			
Purchases of equity investments	(29,365)	—	(12,492)
Purchases of premises and equipment and other	(12,547)	(17,302)	(42,390)
Proceeds from sales of equity investments	—	—	16,174
Proceeds from sale of discontinued operations	154,963	—	—
Net cash provided by (used in) investing activities	<u>113,051</u>	<u>(17,302)</u>	<u>(38,708)</u>
Financing Activities:			
Payments to repurchase common stock	(208,664)	(73,385)	(58,990)
Proceeds from issuance of notes payable	196,657	—	—
Dividends paid on common stock	(32,524)	(29,627)	(26,698)
Net cash contributed from noncontrolling interest	825	100	19,250
Other, net	(369)	(908)	2,182
Net cash used in financing activities	<u>(44,075)</u>	<u>(103,820)</u>	<u>(64,256)</u>
Net change in cash and cash equivalents	362,355	62,066	(42,359)
Cash and cash equivalents, beginning of year	116,471	54,405	96,764
Cash and cash equivalents, end of year	<u>\$ 478,826</u>	<u>\$ 116,471</u>	<u>\$ 54,405</u>
Supplemental Schedule of Non-Cash Activities:			
Construction in progress related to build-to-suit lease obligations	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 27,802</u>
Note receivable contributed from nonbank subsidiary	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 111,653</u>

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

**33. Selected Quarterly Financial Information (Unaudited)**

Selected quarterly financial information is summarized as follows (in thousands, except per share data).

	Year Ended December 31, 2020				Full Year
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	
Interest income	\$ 136,861	\$ 129,828	\$ 134,931	\$ 144,875	\$ 546,495
Interest expense	29,489	27,928	30,373	34,539	122,329
Net interest income	107,372	101,900	104,558	110,336	424,166
Provision for (reversal of) credit losses	(3,482)	(602)	66,026	34,549	96,491
Noninterest income	447,931	502,711	468,125	271,713	1,690,480
Noninterest expense	402,348	399,345	370,209	281,901	1,453,803
Income from continuing operations before income taxes	156,437	205,868	136,448	65,599	564,352
Income tax expense	39,295	46,820	31,808	15,148	133,071
Income from continuing operations	117,142	159,048	104,640	50,451	431,281
Income from discontinued operations, net of income taxes	3,734	736	30,775	3,151	38,396
Net income	120,876	159,784	135,415	53,602	469,677
Less: Net income attributable to noncontrolling interest	4,431	6,505	6,939	3,966	21,841
Income attributable to Hilltop	<u>\$ 116,445</u>	<u>\$ 153,279</u>	<u>\$ 128,476</u>	<u>\$ 49,636</u>	<u>\$ 447,836</u>
Earnings per common share:					
Basic:					
Earnings from continuing operations	\$ 1.31	\$ 1.69	\$ 1.08	\$ 0.51	\$ 4.59
Earnings from discontinued operations	0.04	0.01	0.34	0.04	0.43
	<u>\$ 1.35</u>	<u>\$ 1.70</u>	<u>\$ 1.42</u>	<u>\$ 0.55</u>	<u>\$ 5.02</u>
Diluted:					
Earnings from continuing operations	\$ 1.30	\$ 1.69	\$ 1.08	\$ 0.51	\$ 4.58
Earnings from discontinued operations	0.05	0.01	0.34	0.04	0.43
	<u>\$ 1.35</u>	<u>\$ 1.70</u>	<u>\$ 1.42</u>	<u>\$ 0.55</u>	<u>\$ 5.01</u>
Cash dividends declared per common share	<u>\$ 0.09</u>	<u>\$ 0.09</u>	<u>\$ 0.09</u>	<u>\$ 0.09</u>	<u>\$ 0.36</u>

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

	Year Ended December 31, 2019				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Full Year
Interest income	\$ 151,818	\$ 160,940	\$ 149,000	\$ 148,938	\$ 610,696
Interest expense	41,058	48,294	41,716	40,649	171,717
Net interest income	110,760	112,646	107,284	108,289	438,979
Provision for (reversal of) credit losses	6,880	47	(672)	951	7,206
Noninterest income	263,646	306,505	276,703	215,963	1,062,817
Noninterest expense	307,868	321,186	304,088	278,747	1,211,889
Income from continuing operations before income taxes	59,658	97,918	80,571	44,554	282,701
Income tax expense	13,579	21,472	18,526	10,137	63,714
Income from continuing operations	46,079	76,446	62,045	34,417	218,987
Income (loss) from discontinued operations, net of income taxes	5,623	5,261	(2,254)	5,360	13,990
Net income	51,702	81,707	59,791	39,777	232,977
Less: Net income attributable to noncontrolling interest	2,426	2,289	1,980	991	7,686
Income attributable to Hilltop	<u>\$ 49,276</u>	<u>\$ 79,418</u>	<u>\$ 57,811</u>	<u>\$ 38,786</u>	<u>\$ 225,291</u>
Earnings per common share:					
Basic:					
Earnings from continuing operations	\$ 0.48	\$ 0.81	\$ 0.64	\$ 0.36	\$ 2.29
Earnings (losses) from discontinued operations	0.06	0.06	(0.02)	0.05	0.15
	<u>\$ 0.54</u>	<u>\$ 0.87</u>	<u>\$ 0.62</u>	<u>\$ 0.41</u>	<u>\$ 2.44</u>
Diluted:					
Earnings from continuing operations	\$ 0.48	\$ 0.81	\$ 0.64	\$ 0.36	\$ 2.29
Earnings (losses) from discontinued operations	0.06	0.05	(0.02)	0.05	0.15
	<u>\$ 0.54</u>	<u>\$ 0.86</u>	<u>\$ 0.62</u>	<u>\$ 0.41</u>	<u>\$ 2.44</u>
Cash dividends declared per common share	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.32</u>