

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2022

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

Commission File Number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of incorporation or organization)

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

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

75205
(Zip Code)

(214) 855-2177
(Registrant's telephone number, including area code)

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

The number of shares of the registrant's common stock outstanding at July 22, 2022 was 64,576,333.

HILLTOP HOLDINGS INC.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2022

TABLE OF CONTENTS

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements	
Consolidated Balance Sheets	3
Consolidated Statements of Operations	4
Consolidated Statements of Comprehensive Income (Loss).	5
Consolidated Statements of Stockholders' Equity.	6
Consolidated Statements of Cash Flows	8
Notes to Consolidated Financial Statements	9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	41
Item 3. Quantitative and Qualitative Disclosures About Market Risk.	82
Item 4. Controls and Procedures.	86

PART II — OTHER INFORMATION

Item 1. Legal Proceedings.	87
Item 1A. Risk Factors.	87
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.	87
Item 6. Exhibits	88

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

	June 30, 2022	December 31, 2021
Assets		
Cash and due from banks	\$ 1,783,554	\$ 2,823,138
Federal funds sold	381	385
Assets segregated for regulatory purposes	120,816	221,740
Securities purchased under agreements to resell	139,929	118,262
Securities:		
Trading, at fair value	593,273	647,998
Available for sale, at fair value, net (amortized cost of \$1,667,837 and \$2,148,635, respectively)	1,562,222	2,130,568
Held to maturity, at amortized cost, net (fair value of \$876,531 and \$276,296, respectively)	920,583	267,684
Equity, at fair value	197	250
	3,076,275	3,046,500
Loans held for sale	1,491,579	1,878,190
Loans held for investment, net of unearned income	7,930,619	7,879,904
Allowance for credit losses	(95,298)	(91,352)
Loans held for investment, net	7,835,321	7,788,552
Broker-dealer and clearing organization receivables	1,049,830	1,672,946
Premises and equipment, net	195,361	204,438
Operating lease right-of-use assets	106,806	112,328
Mortgage servicing rights	121,688	86,990
Other assets	513,570	452,880
Goodwill	267,447	267,447
Other intangible assets, net	13,182	15,284
Total assets	\$ 16,715,739	\$ 18,689,080
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	\$ 4,601,643	\$ 4,577,183
Interest-bearing	7,319,143	8,240,894
Total deposits	11,920,786	12,818,077
Broker-dealer and clearing organization payables	934,818	1,477,300
Short-term borrowings	822,649	859,444
Securities sold, not yet purchased, at fair value	135,968	96,586
Notes payable	389,722	387,904
Operating lease liabilities	124,406	130,960
Other liabilities	329,987	369,606
Total liabilities	14,658,336	16,139,877
Commitments and contingencies (see Notes 13 and 14)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, \$0.01 par value, 125,000,000 shares authorized; 64,576,333 and 78,964,978 shares issued and outstanding at June 30, 2022 and December 31, 2021, respectively	646	790
Additional paid-in capital	1,039,261	1,274,446
Accumulated other comprehensive loss	(95,279)	(10,219)
Retained earnings	1,085,208	1,257,014
Deferred compensation employee stock trust, net	695	752
Employee stock trust (33,635 and 5,749 shares, at cost, at June 30, 2022 and December 31, 2021, respectively)	(954)	(115)
Total Hilltop stockholders' equity	2,029,577	2,522,668
Noncontrolling interests	27,826	26,535
Total stockholders' equity	2,057,403	2,549,203
Total liabilities and stockholders' equity	\$ 16,715,739	\$ 18,689,080

See accompanying notes.

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Interest income:				
Loans, including fees	\$ 98,728	\$ 104,162	\$ 189,136	\$ 208,439
Securities borrowed	10,498	15,586	19,315	44,558
Securities:				
Taxable	17,288	11,125	32,869	21,376
Tax-exempt	2,141	2,338	4,560	4,440
Other	6,478	1,607	8,790	2,927
Total interest income	<u>135,133</u>	<u>134,818</u>	<u>254,670</u>	<u>281,740</u>
Interest expense:				
Deposits	5,456	6,176	9,649	13,917
Securities loaned	8,512	12,345	15,984	37,831
Short-term borrowings	3,020	2,374	5,065	4,386
Notes payable	3,809	5,253	8,246	10,050
Junior subordinated debentures	—	577	—	1,139
Other	2,280	177	3,679	819
Total interest expense	<u>23,077</u>	<u>26,902</u>	<u>42,623</u>	<u>68,142</u>
Net interest income	112,056	107,916	212,047	213,598
Provision for (reversal of) credit losses	<u>5,336</u>	<u>(28,720)</u>	<u>5,451</u>	<u>(33,829)</u>
Net interest income after provision for (reversal of) credit losses	<u>106,720</u>	<u>136,636</u>	<u>206,596</u>	<u>247,427</u>
Noninterest income:				
Net gains from sale of loans and other mortgage production income	97,543	199,625	208,437	466,705
Mortgage loan origination fees	42,378	42,146	74,440	85,301
Securities commissions and fees	34,757	38,300	71,903	76,614
Investment and securities advisory fees and commissions	32,002	32,268	61,707	59,963
Other	32,593	27,560	39,214	68,901
Total noninterest income	<u>239,273</u>	<u>339,899</u>	<u>455,701</u>	<u>757,484</u>
Noninterest expense:				
Employees' compensation and benefits	205,327	248,486	405,346	518,839
Occupancy and equipment, net	24,231	25,004	48,997	49,433
Professional services	16,246	16,239	26,309	29,824
Other	52,739	53,639	104,241	111,934
Total noninterest expense	<u>298,543</u>	<u>343,368</u>	<u>584,893</u>	<u>710,030</u>
Income before income taxes	47,450	133,167	77,404	294,881
Income tax expense	<u>12,127</u>	<u>31,234</u>	<u>17,942</u>	<u>69,004</u>
Net income	<u>35,323</u>	<u>101,933</u>	<u>59,462</u>	<u>225,877</u>
Less: Net income attributable to noncontrolling interest	2,063	2,873	3,952	6,473
Income attributable to Hilltop	<u>\$ 33,260</u>	<u>\$ 99,060</u>	<u>\$ 55,510</u>	<u>\$ 219,404</u>
Earnings per common share:				
Basic	<u>\$ 0.45</u>	<u>\$ 1.21</u>	<u>\$ 0.73</u>	<u>\$ 2.68</u>
Diluted	<u>\$ 0.45</u>	<u>\$ 1.21</u>	<u>\$ 0.73</u>	<u>\$ 2.66</u>
Weighted average share information:				
Basic	<u>73,693</u>	<u>81,663</u>	<u>76,389</u>	<u>81,914</u>
Diluted	<u>73,838</u>	<u>82,199</u>	<u>76,569</u>	<u>82,407</u>

See accompanying notes.

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Net income	\$ 35,323	\$ 101,933	\$ 59,462	\$ 225,877
Other comprehensive income (loss):				
Change in fair value of cash flow and fair value hedges, net of tax of \$808, \$(71), \$2,911 and \$434, respectively	14,532	(2,391)	36,409	3,644
Net unrealized gains (losses) on securities available for sale, net of tax of \$(8,804), \$1,799, \$(19,481) and \$(4,175), respectively	(31,775)	5,999	(67,318)	(14,242)
Reclassification adjustment for gains (losses) included in net income, net of tax of \$0, \$0, \$3 and \$(21), respectively	—	(1)	10	(72)
Adjustment for unrealized losses on securities transferred from available-for-sale to held-to-maturity, net of tax of \$0, \$0, \$(17,033) and \$0, respectively	—	—	(56,690)	—
Amortization of unrealized losses on securities transferred from available-for-sale to held-maturity, net of tax \$760, \$0, \$760 and \$0, respectively	2,529	—	2,529	—
Comprehensive income (loss)	<u>20,609</u>	<u>105,540</u>	<u>(25,598)</u>	<u>215,207</u>
Less: comprehensive income attributable to noncontrolling interest	<u>2,063</u>	<u>2,873</u>	<u>3,952</u>	<u>6,473</u>
Comprehensive income (loss) applicable to Hilltop	<u>\$ 18,546</u>	<u>\$ 102,667</u>	<u>\$ (29,550)</u>	<u>\$ 208,734</u>

See accompanying notes.

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

	Common Stock	Additional	Accumulated	Retained	Deferred	Employee	Total	Noncontrolling	Total
	Shares	Paid-in	Other	Earnings	Compensation	Stock Trust	Hilltop	Interest	Stockholders'
	Amount	Capital	Income (Loss)		Trust, Net	Amount	Stockholders' Equity		Equity
Balance, March 31, 2021	82,261	\$ 1,319,518	\$ 3,486	\$ 1,094,727	\$ 752	\$ (121)	\$ 2,419,185	\$ 26,830	\$ 2,446,015
Net income	—	—	—	99,060	—	—	99,060	2,873	101,933
Other comprehensive income	—	—	3,607	—	—	—	3,607	—	3,607
Stock-based compensation expense	—	4,192	—	—	—	—	4,192	—	4,192
Common stock issued to board members	4	150	—	—	—	—	150	—	150
Issuance of common stock related to share-based awards, net	129	(1,505)	—	—	—	—	(1,504)	—	(1,504)
Repurchases of common stock	(1,241)	(19,916)	—	(24,594)	—	—	(44,522)	—	(44,522)
Dividends on common stock (\$0.12 per share)	—	—	—	(9,889)	—	—	(9,889)	—	(9,889)
Deferred compensation plan	—	—	—	—	2	—	2	—	2
Net cash distributed to noncontrolling interest	—	—	—	—	—	—	—	(3,608)	(3,608)
Balance, June 30, 2021	81,153	\$ 1,302,439	\$ 7,093	\$ 1,159,304	\$ 754	\$ (121)	\$ 2,470,281	\$ 26,095	\$ 2,496,376
Balance, March 31, 2022	79,439	\$ 1,275,649	\$ (80,565)	\$ 1,267,415	\$ 744	\$ (104)	\$ 2,463,933	\$ 26,662	\$ 2,490,595
Net income	—	—	—	33,260	—	—	33,260	2,063	35,323
Other comprehensive loss	—	—	(14,714)	—	—	—	(14,714)	—	(14,714)
Stock-based compensation expense	—	2,105	—	—	—	—	2,105	—	2,105
Common stock issued to board members	6	153	—	—	—	—	153	—	153
Issuance of common stock related to share-based awards, net	—	(7)	—	—	—	—	(7)	—	(7)
Repurchases of common stock	(14,869)	(238,639)	—	(203,549)	—	—	(442,336)	—	(442,336)
Dividends on common stock (\$0.15 per share)	—	—	—	(11,918)	—	—	(11,918)	—	(11,918)
Deferred compensation plan	—	—	—	—	(49)	—	(49)	—	(49)
Net cash distributed to noncontrolling interest	—	—	—	—	—	—	—	(899)	(899)
Balance, June 30, 2022	64,576	\$ 1,039,261	\$ (95,279)	\$ 1,085,208	\$ 695	\$ (954)	\$ 2,029,577	\$ 27,826	\$ 2,057,403

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

	Common Stock	Additional	Accumulated	Retained	Deferred	Employee	Total	Noncontrolling	Total
	Shares	Capital	Other	Earnings	Compensation	Stock Trust	Hilltop	Interest	Stockholders'
	Amount		Comprehensive		Trust, Net	Shares	Stockholders'		Equity
		Income (Loss)	Income (Loss)		Trust, Net	Amount	Equity		Equity
Balance, December 31, 2020	82,185	\$ 1,317,929	\$ 17,763	\$ 986,792	\$ 771	7	\$ (138)	\$ 26,708	\$ 2,350,647
Net income	—	—	—	219,404	—	—	—	6,473	225,877
Other comprehensive loss	—	—	(10,670)	—	—	—	—	—	(10,670)
Stock-based compensation expense	—	8,786	—	—	—	—	—	—	8,786
Common stock issued to board members	8	—	—	—	—	—	—	—	297
Issuance of common stock related to share-based awards, net	—	—	—	—	—	—	—	—	—
Repurchases of common stock	351	(2,253)	—	—	—	—	—	—	(2,250)
Dividends on common stock (\$0.24 per share)	(1,391)	(22,320)	—	(27,138)	—	—	—	—	(49,471)
Deferred compensation plan	—	—	—	(19,754)	—	—	—	—	(19,754)
Net cash distributed to noncontrolling interest	—	—	—	—	(17)	(1)	17	—	—
Balance, June 30, 2021	81,153	\$ 1,302,439	\$ 7,093	\$ 1,159,304	\$ 754	6	\$ (121)	\$ (7,086)	\$ 2,496,376
Balance, December 31, 2021	78,965	\$ 1,274,446	\$ (10,219)	\$ 1,257,014	\$ 752	6	\$ (115)	\$ 26,535	\$ 2,549,203
Net income	—	—	—	55,510	—	—	—	3,952	59,462
Other comprehensive loss	—	—	(85,060)	—	—	—	—	—	(85,060)
Stock-based compensation expense	—	7,219	—	—	—	—	—	—	7,219
Common stock issued to board members	11	305	—	—	—	—	—	—	305
Issuance of common stock related to share-based awards, net	—	—	—	—	—	—	—	—	—
Repurchases of common stock	469	(4,070)	—	—	—	—	—	—	(4,066)
Dividends on common stock (\$0.30 per share)	(14,869)	(238,639)	—	(203,549)	—	—	—	—	(442,336)
Deferred compensation plan	—	—	—	(23,767)	—	—	—	—	(23,767)
Net cash distributed to noncontrolling interest	—	—	—	—	(57)	28	(839)	—	(896)
Balance, June 30, 2022	64,576	\$ 1,039,261	\$ (95,279)	\$ 1,085,208	\$ 695	34	\$ (954)	\$ (2,661)	\$ 2,057,403

See accompanying notes.

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

	Six Months Ended June 30,	
	2022	2021
Operating Activities		
Net income	\$ 59,462	\$ 225,877
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for (reversal of) credit losses	5,451	(33,829)
Depreciation, amortization and accretion, net	14,171	10,531
Deferred income taxes	2,585	2,380
Other, net	7,296	10,077
Net change in securities purchased under agreements to resell	(21,667)	(122,319)
Net change in trading securities	54,725	11,772
Net change in broker-dealer and clearing organization receivables	893,304	(190,385)
Net change in other assets	(1,432)	(45,972)
Net change in broker-dealer and clearing organization payables	(629,481)	44,751
Net change in other liabilities	(40,489)	(105,218)
Net change in securities sold, not yet purchased	39,382	53,161
Proceeds from sale of mortgage servicing rights asset	1,876	84,633
Change in valuation of mortgage servicing rights asset	(18,064)	(15,273)
Net gains from sales of loans	(208,437)	(466,705)
Loans originated for sale	(8,206,551)	(13,539,646)
Proceeds from loans sold	8,793,501	13,750,233
Net cash provided by (used in) operating activities	745,632	(325,932)
Investing Activities		
Proceeds from maturities and principal reductions of securities held to maturity	39,631	22,887
Proceeds from sales, maturities and principal reductions of securities available for sale	190,943	385,411
Purchases of securities held to maturity	(6,254)	—
Purchases of securities available for sale	(470,617)	(764,283)
Purchases of equity securities	(30)	—
Net change in loans held for investment	(316,887)	249,069
Purchases of premises and equipment and other assets	(4,559)	(16,696)
Proceeds from sales of premises and equipment and other real estate owned	1,803	3,263
Net cash paid to Federal Home Loan Bank and Federal Reserve Bank stock	(144)	(72)
Net cash used in investing activities	(566,114)	(120,421)
Financing Activities		
Net change in deposits	(810,292)	517,962
Net change in short-term borrowings	(37,200)	220,024
Proceeds from notes payable	412,421	488,341
Payments on notes payable and junior subordinated debentures	(410,832)	(473,891)
Payments to repurchase common stock	(442,336)	(49,471)
Dividends paid on common stock	(23,767)	(19,754)
Net cash distributed to noncontrolling interest	(2,661)	(7,086)
Other, net	(5,363)	(2,586)
Net cash provided by (used in) financing activities	(1,320,030)	673,539
Net change in cash, cash equivalents and restricted cash	(1,140,512)	227,186
Cash, cash equivalents and restricted cash, beginning of period	3,045,263	1,353,303
Cash, cash equivalents and restricted cash, end of period	\$ 1,904,751	\$ 1,580,489
Reconciliation of Cash, Cash Equivalents and Restricted Cash to Consolidated Balance Sheets		
Cash and due from banks	\$ 1,783,554	\$ 1,372,818
Federal funds sold	381	387
Assets segregated for regulatory purposes	120,816	207,284
Total cash, cash equivalents and restricted cash	\$ 1,904,751	\$ 1,580,489
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	\$ 42,273	\$ 69,479
Cash paid for income taxes, net of refunds	\$ 6,840	\$ 55,498
Supplemental Schedule of Non-Cash Activities		
Conversion of loans to other real estate owned	\$ 179	\$ 1,805
Additions to mortgage servicing rights	\$ 18,510	\$ 50,115
Carrying amount of AFS securities transferred to HTM, net of \$70,435 unrealized loss	\$ 686,840	\$ —

See accompanying notes.

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

1. Summary of Significant Accounting and Reporting Policies

Nature of Operations

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

The Company, headquartered in Dallas, Texas, provides its products and services through two primary business units, 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.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (“GAAP”), and in conformity with the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of management, these financial statements contain all adjustments necessary for a fair statement of the results of the interim periods presented. Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2021 (“2021 Form 10-K”). Results for interim periods are not necessarily indicative of results to be expected for a full year or any future period.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates regarding the allowance for credit losses, the fair values of financial instruments, the mortgage loan indemnification liability, and the potential impairment of goodwill and identifiable intangible assets are particularly subject to change. The Company has applied its critical accounting policies and estimation methods consistently in all periods presented in these consolidated financial statements. Actual amounts and values as of the balance sheet dates may be materially different than the amounts and values reported due to the inherent uncertainty in the estimation process. Also, future amounts and values could differ materially from those estimates due to changes in values and circumstances after the balance sheet date.

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

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

PCC also owned 100% of the outstanding common securities of PCC Statutory Trusts I, II, III and IV (the “Trusts”), which were 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. Following receipt of regulatory approval, during June, July and August 2021, PCC submitted to the trustees of each of the Trusts notices to redeem in full outstanding junior subordinated debentures of \$67.0 million issued by PCC, which resulted in the full

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

redemption to the holders of the associated preferred securities and common securities during the third quarter of 2021. For further details, see Note 16 to the consolidated financial statements included in the Company's 2021 Form 10-K.

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

In addition, Hilltop owns 100% of the membership interest in each of HTH Hillcrest Project LLC ("HTH Project LLC") and Hilltop Investments I, LLC. Hilltop Investments I, LLC owns 50% of the membership interest in HTH Diamond Hillcrest Land LLC ("Hillcrest Land LLC") which is consolidated under the aforementioned VIE Subsections of the ASC. These entities are related to the Hilltop Plaza investment discussed in detail in Note 19 to the consolidated financial statements included in the Company's 2021 Form 10-K and are collectively referred to as the "Hilltop Plaza Entities."

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

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

Significant accounting policies are detailed in Note 1 to the consolidated financial statements included in the Company's 2021 Form 10-K.

2. Recently Issued Accounting Standards

Accounting Standards Adopted During 2022

In March 2022, the FASB issued ASU 2022-01 to expand and clarify the guidance on fair value hedge accounting of interest rate risk for portfolios of financial assets. ASU 2022-01 amends the guidance in ASU 2017-12 that, among other things, established the "last-of-layer" method for making the fair value hedge accounting for these portfolios more accessible. The amendment further improves the last-of-layer (renamed the "portfolio layer") concepts to expand to nonprepayable financial assets and allows more flexibility in the derivative structures used to hedge the interest rate risk. For entities that have already adopted ASU 2017-12 this update is available for immediate adoption. As permitted within the amendment, the Company elected to early adopt the provisions as of April 1, 2022 on a prospective basis. The adoption of this amendment did not have a material impact on the Company's consolidated financial statements.

Accounting Standards Issued But Not Yet Adopted

In March 2022, the FASB issued ASU 2022-02 to eliminate the recognition and measurement guidance on troubled debt restructurings for creditors, and require enhanced disclosures about loan modifications for borrowers experiencing financial difficulty. The amendments are effective in periods beginning after December 15, 2022 using either a prospective or modified retrospective transition. Early adoption of certain or all of the amendments is permitted. The Company is currently evaluating the provisions of the amendments and the impact on its future consolidated financial statements.

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

In June 2022, the FASB issued ASU 2022-03 to clarify the guidance on the fair value measurement of an equity security that is subject to a contractual sale restriction, and require specific disclosures for equity securities that are subject to such restrictions. The amendments are effective in periods beginning after December 15, 2023, with early adoption permitted. The Company is currently evaluating the provisions of the amendments and the impact on its future consolidated financial statements.

3. Fair Value Measurements

Fair Value Measurements and Disclosures

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

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

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

Fair Value Option

The Company has elected to measure substantially all of PrimeLending’s mortgage loans held for sale and the retained mortgage servicing rights (“MSR”) asset at fair value, under the provisions of the Fair Value Option. The Company elected to apply the provisions of the Fair Value Option to these items so that it would have the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. At June 30, 2022 and December 31, 2021, the aggregate fair value of PrimeLending’s mortgage loans held for sale accounted for under the Fair Value Option was \$1.37 billion and \$1.78 billion, respectively, and the unpaid principal balance of those loans was \$1.35 billion and \$1.73 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.

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

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

<u>June 30, 2022</u>	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Fair Value</u>
Trading securities	\$ 8,594	\$ 584,679	\$ —	\$ 593,273
Available for sale securities	—	1,562,222	—	1,562,222
Equity securities	197	—	—	197
Loans held for sale	—	1,330,651	41,732	1,372,383
Loans held for investment	—	—	9,027	9,027
Derivative assets	—	82,918	—	82,918
MSR asset	—	—	121,688	121,688
Securities sold, not yet purchased	68,543	67,425	—	135,968
Derivative liabilities	—	26,661	—	26,661
<u>December 31, 2021</u>	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Fair Value</u>
Trading securities	\$ 8,628	\$ 639,370	\$ —	\$ 647,998
Available for sale securities	—	2,130,568	—	2,130,568
Equity securities	250	—	—	250
Loans held for sale	—	1,734,875	47,716	1,782,591
Derivative assets	—	48,122	—	48,122
MSR asset	—	—	86,990	86,990
Securities sold, not yet purchased	45,973	50,613	—	96,586
Derivative liabilities	—	21,816	—	21,816

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

	<u>Balance, Beginning of Period</u>	<u>Purchases/ Additions</u>	<u>Sales/ Reductions</u>	<u>Transfers to (from) Level 3</u>	<u>Total Gains or Losses (Realized or Unrealized)</u>		<u>Balance, End of Period</u>
					<u>Included in Net Income</u>	<u>Included in Other Comprehensive Income (Loss)</u>	
<u>Three months ended June 30, 2022</u>							
Loans held for sale	\$ 45,977	\$ 13,456	\$ (12,090)	\$ 1,094	\$ (6,705)	\$ —	\$ 41,732
Loans held for investment	9,611	—	(562)	—	(22)	—	9,027
MSR asset	100,475	11,210	—	—	10,003	—	121,688
Total	<u>\$ 156,063</u>	<u>\$ 24,666</u>	<u>\$ (12,652)</u>	<u>\$ 1,094</u>	<u>\$ 3,276</u>	<u>\$ —</u>	<u>\$ 172,447</u>
<u>Six months ended June 30, 2022</u>							
Loans held for sale	\$ 47,716	\$ 20,442	\$ (24,748)	\$ 5,838	\$ (7,516)	\$ —	\$ 41,732
Loans held for investment	—	9,611	(562)	—	(22)	—	9,027
MSR asset	86,990	18,510	(1,876)	—	18,064	—	121,688
Total	<u>\$ 134,706</u>	<u>\$ 48,563</u>	<u>\$ (27,186)</u>	<u>\$ 5,838</u>	<u>\$ 10,526</u>	<u>\$ —</u>	<u>\$ 172,447</u>
<u>Three months ended June 30, 2021</u>							
Loans held for sale	\$ 77,275	\$ 18,962	\$ (22,272)	\$ (2,549)	\$ 17	\$ —	\$ 71,433
MSR asset	142,125	15,815	(31,850)	—	(1,593)	—	124,497
Total	<u>\$ 219,400</u>	<u>\$ 34,777</u>	<u>\$ (54,122)</u>	<u>\$ (2,549)</u>	<u>\$ (1,576)</u>	<u>\$ —</u>	<u>\$ 195,930</u>
<u>Six months ended June 30, 2021</u>							
Loans held for sale	\$ 71,816	\$ 31,456	\$ (29,511)	\$ (1,808)	\$ (520)	\$ —	\$ 71,433
MSR asset	143,742	50,115	(84,633)	—	15,273	—	124,497
Total	<u>\$ 215,558</u>	<u>\$ 81,571</u>	<u>\$ (114,144)</u>	<u>\$ (1,808)</u>	<u>\$ 14,753</u>	<u>\$ —</u>	<u>\$ 195,930</u>

All net realized and unrealized gains (losses) in the tables above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at June 30, 2022.

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

For material Level 3 financial instruments measured at fair value on a recurring basis at June 30, 2022 and December 31, 2021, the significant unobservable inputs used in the fair value measurements were as follows.

Financial instrument	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)	
			June 30, 2022	December 31, 2021
Loans held for sale	Market comparable	Projected price	86 - 89 % (87 %)	94 - 95 % (95 %)
Loans held for investment	Discounted cash flow	Discount rate	11.00 %	—
MSR asset	Discounted cash flow	Constant prepayment rate	8.42 %	10.02 %
		Discount rate	12.15 %	14.32 %

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

The fair value of certain loans held for investment by the Company's merchant bank subsidiary is measured using the income approach with Level 3 inputs. The fair value of such loans is based upon estimates of expected cash flows using unobservable inputs, including credit spreads derived from comparable securities and benchmark credit curves, and management's knowledge of underlying collateral.

The MSR asset is reported at fair value using Level 3 inputs. The MSR asset is valued by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair value of the MSR asset is impacted by a variety of factors. Prepayment and discount rates, the most significant unobservable inputs, are discussed further in Note 7 to the consolidated financial statements. The decrease in the prepayment rate used to value the MSR asset at June 30, 2022, compared to December 31, 2021, reflects the effect of increased mortgage rates reducing consumer refinancing activity, while the decrease in the discount rate addresses recent market trends related to MSR sales during the same period.

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 material instruments recognized in the consolidated statements of operations that are accounted for under the Fair Value Option (in thousands).

	Three Months Ended June 30, 2022			Three Months Ended June 30, 2021		
	Net	Other	Total	Net	Other	Total
	Gains (Losses)	Noninterest	Changes in	Gains (Losses)	Noninterest	Changes in
		Income	Fair Value		Income	Fair Value
Loans held for sale	\$ 14,862	\$ —	\$ 14,862	\$ 45,439	\$ —	\$ 45,439
Loans held for investment	(283)	—	(283)	—	—	—
MSR asset	10,003	—	10,003	(1,593)	—	(1,593)
	Six Months Ended June 30, 2022			Six Months Ended June 30, 2021		
	Net	Other	Total	Net	Other	Total
	Gains (Losses)	Noninterest	Changes in	Gains (Losses)	Noninterest	Changes in
		Income	Fair Value		Income	Fair Value
Loans held for sale	\$ (35,994)	\$ —	\$ (35,994)	\$ (22,517)	\$ —	\$ (22,517)
Loans held for investment	(283)	—	(283)	—	—	—
MSR asset	18,064	—	18,064	15,273	—	15,273

The Fair Value of Financial Instruments Subsection of the ASC requires disclosure of the fair value of financial assets and liabilities, including the financial assets and liabilities previously discussed. There have been no changes to the methods for determining estimated fair value for financial assets and liabilities as described in detail in Note 4 to the consolidated financial statements included in the Company's 2021 Form 10-K.

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

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

June 30, 2022	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Financial assets:					
Cash and cash equivalents	\$ 1,783,935	\$ 1,783,935	\$ —	\$ —	\$ 1,783,935
Assets segregated for regulatory purposes	120,816	120,816	—	—	120,816
Securities purchased under agreements to resell	139,929	—	139,929	—	139,929
Held to maturity securities	920,583	—	876,531	—	876,531
Loans held for sale	119,197	—	119,197	—	119,197
Loans held for investment, net	7,826,294	—	463,004	7,265,441	7,728,445
Broker-dealer and clearing organization receivables	1,049,830	—	1,049,830	—	1,049,830
Other assets	70,069	—	68,397	1,672	70,069
Financial liabilities:					
Deposits	11,920,786	—	11,907,658	—	11,907,658
Broker-dealer and clearing organization payables	934,818	—	934,818	—	934,818
Short-term borrowings	822,649	—	822,649	—	822,649
Debt	389,722	—	389,722	—	389,722
Other liabilities	3,895	—	3,895	—	3,895

December 31, 2021	Carrying Amount	Estimated Fair Value			Total
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Financial assets:					
Cash and cash equivalents	\$ 2,823,523	\$ 2,823,523	\$ —	\$ —	\$ 2,823,523
Assets segregated for regulatory purposes	221,740	221,740	—	—	221,740
Securities purchased under agreements to resell	118,262	—	118,262	—	118,262
Held to maturity securities	267,684	—	276,296	—	276,296
Loans held for sale	95,599	—	95,599	—	95,599
Loans held for investment, net	7,788,552	—	733,193	7,266,732	7,999,925
Broker-dealer and clearing organization receivables	1,672,946	—	1,672,946	—	1,672,946
Other assets	73,041	—	71,290	1,751	73,041
Financial liabilities:					
Deposits	12,818,077	—	12,821,138	—	12,821,138
Broker-dealer and clearing organization payables	1,477,300	—	1,477,300	—	1,477,300
Short-term borrowings	859,444	—	859,444	—	859,444
Debt	387,904	—	387,904	—	387,904
Other liabilities	3,944	—	3,944	—	3,944

The Company held equity investments other than securities of \$62.2 million and \$54.0 million at June 30, 2022 and December 31, 2021, respectively, which are included within other assets in the consolidated balance sheets. Of the \$62.2 million of such equity investments held at June 30, 2022, \$28.2 million do not have readily determinable fair values and each is measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The following table presents the adjustments to the carrying value of these investments during the periods presented (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Balance, beginning of period	\$ 27,986	\$ 22,905	\$ 16,817	\$ 22,844
Additional investments	—	—	11,000	—
Upward adjustments	231	5,763	445	5,884
Impairments and downward adjustments	(34)	(704)	(79)	(764)
Dispositions	—	(975)	—	(975)
Balance, end of period	<u>\$ 28,183</u>	<u>\$ 26,989</u>	<u>\$ 28,183</u>	<u>\$ 26,989</u>

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

4. Securities

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

	June 30, 2022	December 31, 2021
U.S. Treasury securities	\$ 3,689	\$ 3,728
U.S. government agencies:		
Bonds	17,303	3,410
Residential mortgage-backed securities	133,290	152,093
Collateralized mortgage obligations	124,997	126,389
Corporate debt securities	64,543	60,671
States and political subdivisions	226,986	285,376
Private-label securitized product	16,529	11,377
Other	5,936	4,954
Totals	<u>\$ 593,273</u>	<u>\$ 647,998</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 obligations may exceed the amount recognized in the financial statements. These securities, which are carried at fair value and reported as securities sold, not yet purchased in the consolidated balance sheets, had a value of \$136.0 million and \$96.6 million at June 30, 2022 and December 31, 2021, respectively.

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

	Available for Sale			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2022				
U.S. Treasury securities	\$ 24,937	\$ —	\$ (600)	\$ 24,337
U.S. government agencies:				
Bonds	77,283	482	(443)	77,322
Residential mortgage-backed securities	486,800	80	(32,942)	453,938
Commercial mortgage-backed securities	189,572	62	(23,618)	166,016
Collateralized mortgage obligations	848,031	76	(45,584)	802,523
States and political subdivisions	41,214	163	(3,291)	38,086
Totals	<u>\$ 1,667,837</u>	<u>\$ 863</u>	<u>\$ (106,478)</u>	<u>\$ 1,562,222</u>
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2021				
U.S. Treasury securities	\$ 14,937	\$ —	\$ (75)	\$ 14,862
U.S. government agencies:				
Bonds	43,448	838	(153)	44,133
Residential mortgage-backed securities	900,084	7,979	(9,617)	898,446
Commercial mortgage-backed securities	219,460	367	(9,128)	210,699
Collateralized mortgage obligations	926,783	2,547	(12,464)	916,866
States and political subdivisions	43,923	1,839	(200)	45,562
Totals	<u>\$ 2,148,635</u>	<u>\$ 13,570</u>	<u>\$ (31,637)</u>	<u>\$ 2,130,568</u>

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

June 30, 2022	Held to Maturity			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agencies:				
Residential mortgage-backed securities	\$ 315,666	\$ —	\$(15,987)	\$ 299,679
Commercial mortgage-backed securities	196,733	19	(6,543)	190,209
Collateralized mortgage obligations	336,313	—	(15,802)	320,511
States and political subdivisions	71,871	28	(5,767)	66,132
Totals	\$ 920,583	\$ 47	\$(44,099)	\$ 876,531

December 31, 2021	Held to Maturity			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agencies:				
Residential mortgage-backed securities	\$ 9,892	\$ 400	\$ —	\$ 10,292
Commercial mortgage-backed securities	145,742	5,311	—	151,053
Collateralized mortgage obligations	43,990	476	—	44,466
States and political subdivisions	68,060	2,428	(3)	70,485
Totals	\$ 267,684	\$ 8,615	\$ (3)	\$ 276,296

Additionally, the Company had unrealized net gains of \$0.1 million and \$0.2 million at June 30, 2022 and December 31, 2021 from equity securities with fair values of \$0.2 million and \$0.2 million held at June 30, 2022 and December 31, 2021. The Company recognized net losses of \$0.1 million during both the three and six months ended June 30, 2022 and 2021, due to changes in the fair value of equity securities still held at the balance sheet date. During the three and six months ended June 30, 2022 and 2021, net losses and gains recognized from equity securities sold were nominal.

The Company transferred certain agency-issued securities from the available-for-sale to held-to-maturity portfolio on March 31, 2022 having a book value of approximately \$782 million and a market value of approximately \$708 million. As of the date of transfer, the related pre-tax net unrecognized losses of approximately \$74 million within the accumulated other comprehensive loss balance are being amortized over the remaining term of the securities using the effective interest method. This transfer was completed after careful consideration of the Company's intent and ability to hold these securities to maturity. Factors used in assessing the ability to hold these securities to maturity were future liquidity needs and sources of funding.

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

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

	June 30, 2022			December 31, 2021		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Available for Sale						
U.S. treasury securities:						
Unrealized loss for less than twelve months	3	\$ 24,337	\$ 600	2	\$ 14,862	\$ 75
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	3	24,337	600	2	14,862	75
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	1	4,831	168	2	9,904	94
Unrealized loss for twelve months or longer	2	10,841	275	1	6,184	59
	3	15,672	443	3	16,088	153
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	108	388,795	25,793	52	548,392	6,915
Unrealized loss for twelve months or longer	8	58,313	7,149	17	104,378	2,702
	116	447,108	32,942	69	652,770	9,617
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	10	109,985	13,622	5	65,636	1,776
Unrealized loss for twelve months or longer	5	49,979	9,996	14	138,619	7,352
	15	159,964	23,618	19	204,255	9,128
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	117	748,245	42,634	72	618,464	11,316
Unrealized loss for twelve months or longer	8	22,853	2,950	10	62,647	1,148
	125	771,098	45,584	82	681,111	12,464
States and political subdivisions:						
Unrealized loss for less than twelve months	42	22,054	2,535	14	5,576	200
Unrealized loss for twelve months or longer	6	1,970	756	—	—	—
	48	24,024	3,291	14	5,576	200
Total available for sale:						
Unrealized loss for less than twelve months	281	1,298,247	85,352	147	1,262,834	20,376
Unrealized loss for twelve months or longer	29	143,956	21,126	42	311,828	11,261
	310	\$ 1,442,203	\$ 106,478	189	\$ 1,574,662	\$ 31,637

	June 30, 2022			December 31, 2021		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Held to Maturity						
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	30	\$ 196,968	\$ 9,481	—	\$ —	\$ —
Unrealized loss for twelve months or longer	15	102,710	6,506	—	—	—
	45	299,678	15,987	—	—	—
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	31	180,360	6,347	—	—	—
Unrealized loss for twelve months or longer	1	3,073	196	—	—	—
	32	183,433	6,543	—	—	—
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	47	247,023	11,557	—	—	—
Unrealized loss for twelve months or longer	9	73,481	4,245	—	—	—
	56	320,504	15,802	—	—	—
States and political subdivisions:						
Unrealized loss for less than twelve months	161	57,790	5,713	2	558	1
Unrealized loss for twelve months or longer	1	214	54	1	266	2
	162	58,004	5,767	3	824	3
Total held to maturity:						
Unrealized loss for less than twelve months	269	682,141	33,098	2	558	1
Unrealized loss for twelve months or longer	26	179,478	11,001	1	266	2
	295	\$ 861,619	\$ 44,099	3	\$ 824	\$ 3

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

Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The amortized cost and fair value of securities, excluding trading and equity securities, at June 30, 2022 are shown by contractual maturity below (in thousands).

	Available for Sale		Held to Maturity	
	Amortized		Amortized	
	Cost	Fair Value	Cost	Fair Value
Due in one year or less	\$ 34,547	\$ 34,413	\$ 275	\$ 275
Due after one year through five years	23,446	22,607	1,386	1,359
Due after five years through ten years	21,963	21,878	16,580	15,840
Due after ten years	63,478	60,847	53,630	48,658
	143,434	139,745	71,871	66,132
Residential mortgage-backed securities	486,800	453,938	315,666	299,679
Commercial mortgage-backed securities	189,572	166,016	196,733	190,209
Collateralized mortgage obligations	848,031	802,523	336,313	320,511
	\$ 1,667,837	\$ 1,562,222	\$ 920,583	\$ 876,531

The Company recognized net gains of \$6.8 million and \$11.1 million from its trading portfolio during the three months ended June 30, 2022 and 2021, respectively, and net losses of \$4.7 million and net gains of \$19.8 million during the six months ended June 30, 2022 and 2021. In addition, the Hilltop Broker-Dealers realized net gains from structured product trading activities of \$2.4 million and net losses from structured product trading activities of \$8.9 million during the three months ended June 30, 2022 and 2021, respectively, and net gains from structured product trading activities of \$9.1 million and \$35.1 million during the six months ended June 30, 2022 and 2021. The Company had nominal other realized gains and losses on securities during the three months ended June 30, 2022 and 2021, respectively. Other realized gains on securities during the six months ended June 30, 2022 were nominal, compared with other realized losses on securities of \$0.1 million during the six months ended June 30, 2021. All such realized gains and losses are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of \$806.5 million and \$809.9 million (with a fair value of \$753.9 million and \$817.7 million, respectively) at June 30, 2022 and December 31, 2021, respectively, were pledged by the Bank to secure public and trust deposits, federal funds purchased and securities sold under agreements to repurchase, and for other purposes as required or permitted by law. Substantially all of these pledged securities were included in the available for sale and held to maturity securities portfolios at June 30, 2022 and December 31, 2021.

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

5. 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)
(Unaudited)

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

	June 30, 2022	December 31, 2021
Commercial real estate	\$ 3,262,628	\$ 3,042,729
Commercial and industrial ⁽¹⁾	1,786,116	1,875,420
Construction and land development	922,047	892,783
1-4 family residential	1,468,962	1,303,430
Consumer	27,862	32,349
Broker-dealer ⁽²⁾	463,004	733,193
	<u>7,930,619</u>	<u>7,879,904</u>
Allowance for credit losses	(95,298)	(91,352)
Total loans held for investment, net of allowance	<u>\$ 7,835,321</u>	<u>\$ 7,788,552</u>

(1) Included loans totaling \$7.0 million and \$77.7 million at June 30, 2022 and December 31, 2021, respectively, funded through the Paycheck Protection Program.

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

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

	Non-accrual Loans						Interest Income Recognized			
	June 30, 2022			December 31, 2021			Three Months Ended June 30, 2022		Six Months Ended June 30, 2021	
	With Allowance	With No Allowance	Total	With Allowance	With No Allowance	Total	2022	2021	2022	2021
Commercial real estate:										
Non-owner occupied	\$ 603	\$ 653	\$ 1,256	\$ 413	\$ 1,853	\$ 2,266	\$ 60	\$ 54	\$ 157	\$ 128
Owner occupied	3,084	607	3,691	3,058	1,277	4,335	334	139	417	229
Commercial and industrial	9,112	4,203	13,315	16,536	5,942	22,478	439	331	627	474
Construction and land development	1	—	1	2	—	2	8	20	15	35
1-4 family residential	531	12,831	13,362	902	17,306	18,208	1,304	1,106	1,725	2,030
Consumer	19	—	19	23	—	23	—	(121)	—	(121)
Broker-dealer	—	—	—	—	—	—	—	—	—	—
	<u>\$ 13,350</u>	<u>\$ 18,294</u>	<u>\$ 31,644</u>	<u>\$ 20,934</u>	<u>\$ 26,378</u>	<u>\$ 47,312</u>	<u>\$ 2,145</u>	<u>\$ 1,529</u>	<u>\$ 2,941</u>	<u>\$ 2,775</u>

At June 30, 2022 and December 31, 2021, \$3.2 million and \$2.9 million, respectively, of real estate loans secured by residential properties and classified as held for sale were in non-accrual status.

Loans accounted for on a non-accrual basis decreased from December 31, 2021 to June 30, 2022, by \$15.7 million. The change in nonaccrual loans was primarily due to decreases in commercial and industrial loans of \$9.2 million, 1-4 family residential loans of \$4.8 million, and commercial real estate non-owner occupied loans of \$1.0 million. The respective decreases in commercial and industrial loans and commercial real estate non-owner occupied loans in non-accrual status since December 31, 2021 were primarily due to principal paydowns, settlements, and charge-offs associated with five relationships.

The Company considers non-accrual loans to be collateral-dependent unless there are underlying mitigating circumstances, such as expected cash flow recovery. 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

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

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,” extended certain relief provisions from the CARES Act to January 1, 2022. The Bank’s novel coronavirus (“COVID-19”) payment deferral programs allowed for a deferral of principal and/or interest payments with such deferred principal payments due and payable on maturity date of the existing loan.

There were two TDRs granted during the three months ended June 30, 2022 with a balance at date of extension of \$3.0 million and a balance at June 30, 2022 of \$3.0 million that do not qualify for the CARES Act exemption. There were three TDRs granted during the six months ended June 30, 2022 with a balance at date of extension of \$3.6 million and a balance at June 30, 2022 of \$3.1 million that do not qualify for the CARES Act exemption. During the three and six months ended June 30, 2021 there was one TDR granted with a balance at date of extension of \$0.7 million and a balance at June 30, 2021 of \$0.7 million that did not qualify for the CARES Act exemption. The Bank had no unadvanced commitments to borrowers whose loans had been restructured in TDRs at June 30, 2022 and nominal unadvanced commitments to such borrowers at December 31, 2021. There were no TDRs granted during the twelve months preceding June 30, 2022 and 2021 for which a payment was at least 30 days past due.

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

June 30, 2022	Loans Past Due			Total Past Due Loans	Current Loans	Total Loans	Accruing Loans Past Due 90 Days or More
	30-59 Days	60-89 Days	90 Days or More				
Commercial real estate:							
Non-owner occupied	\$ —	\$ —	\$ 198	\$ 198	\$ 1,910,938	\$ 1,911,136	\$ —
Owner occupied	3,020	36	83	3,139	1,348,353	1,351,492	—
Commercial and industrial	9,086	59	8,025	17,170	1,768,946	1,786,116	—
Construction and land development	4,288	116	—	4,404	917,643	922,047	—
1-4 family residential	4,709	1,551	5,876	12,136	1,456,826	1,468,962	102
Consumer	191	15	18	224	27,638	27,862	—
Broker-dealer	—	—	—	—	463,004	463,004	—
	<u>\$ 21,294</u>	<u>\$ 1,777</u>	<u>\$ 14,200</u>	<u>\$ 37,271</u>	<u>\$ 7,893,348</u>	<u>\$ 7,930,619</u>	<u>\$ 102</u>

December 31, 2021	Loans Past Due			Total Past Due Loans	Current Loans	Total Loans	Accruing Loans Past Due 90 Days or More
	30-59 Days	60-89 Days	90 Days or More				
Commercial real estate:							
Non-owner occupied	\$ 117	\$ —	\$ 1,173	\$ 1,290	\$ 1,728,409	\$ 1,729,699	\$ —
Owner occupied	590	688	2,273	3,551	1,309,479	1,313,030	—
Commercial and industrial	1,059	277	13,640	14,976	1,860,444	1,875,420	1
Construction and land development	946	—	—	946	891,837	892,783	—
1-4 family residential	7,642	2,738	4,842	15,222	1,288,208	1,303,430	100
Consumer	123	22	22	167	32,182	32,349	—
Broker-dealer	—	—	—	—	733,193	733,193	—
	<u>\$ 10,477</u>	<u>\$ 3,725</u>	<u>\$ 21,950</u>	<u>\$ 36,152</u>	<u>\$ 7,843,752</u>	<u>\$ 7,879,904</u>	<u>\$ 101</u>

In addition to the loans shown in the tables above, PrimeLending had \$82.3 million and \$60.7 million of loans included in loans held for sale (with an aggregate unpaid principal balance of \$82.8 million and \$61.7 million, respectively) that were 90 days past due and accruing interest at June 30, 2022 and December 31, 2021, respectively. These loans are guaranteed by U.S. government agencies and include loans that are subject to repurchase, or have been repurchased, by PrimeLending.

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

Additionally, the Company granted temporary forbearance to borrowers of a federally backed mortgage loan experiencing financial hardship due, directly or indirectly, to the COVID-19 pandemic. The CARES Act, which among other things, established the ability for financial institutions to grant a forbearance for up to 180 days, which can be extended for an additional 180-day period upon the request of the borrower. During that time, no fees, penalties or interest beyond the

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

amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the mortgage contract will accrue on the borrower's account. As of June 30, 2022, PrimeLending had \$36.1 million of loans subject to repurchase under a forbearance agreement related to delinquencies on or after April 1, 2020.

Management tracks credit quality trends on a quarterly basis related to: (i) past due levels, (ii) non-performing asset levels, (iii) classified loan levels, and (iv) general economic conditions in state and local markets. The Company defines classified loans as loans with a risk rating of substandard, doubtful or loss. There have been no changes to the risk rating internal grades utilized for commercial loans as described in detail in Note 6 to the consolidated financial statements in the Company's 2021 Form 10-K.

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

June 30, 2022	Amortized Cost Basis by Origination Year						2017 and Prior	Revolving	Total
	2022	2021	2020	2019	2018	2017			
Commercial real estate: non-owner occupied									
Internal Grade 1-3 (Pass low risk)	\$ 44,621	\$ 74,976	\$ 20,075	\$ 9,882	\$ 8,788	\$ 11,757	\$ 2	\$ 170,101	
Internal Grade 4-7 (Pass normal risk)	284,152	296,372	143,410	115,193	41,986	80,885	28,181	990,179	
Internal Grade 8-11 (Pass high risk and watch)	82,153	166,149	181,713	81,382	72,866	92,202	1,550	678,015	
Internal Grade 12 (Special mention)	—	—	—	—	—	—	—	—	
Internal Grade 13 (Substandard accrual)	37,929	14,659	4,093	8,222	25	6,657	—	71,585	
Internal Grade 14 (Substandard non-accrual)	—	403	—	—	—	853	—	1,256	
Commercial real estate: owner occupied									
Internal Grade 1-3 (Pass low risk)	\$ 24,732	\$ 111,984	\$ 58,631	\$ 18,662	\$ 13,920	\$ 60,532	\$ 6,002	\$ 294,463	
Internal Grade 4-7 (Pass normal risk)	128,192	178,018	96,688	88,070	93,945	73,876	13,760	672,549	
Internal Grade 8-11 (Pass high risk and watch)	45,893	70,970	92,234	30,607	63,765	30,528	13,571	347,568	
Internal Grade 12 (Special mention)	—	—	—	—	—	—	—	—	
Internal Grade 13 (Substandard accrual)	4,185	487	6,090	3,029	6,246	13,184	—	33,221	
Internal Grade 14 (Substandard non-accrual)	108	893	—	(4)	335	2,359	—	3,691	
Commercial and industrial									
Internal Grade 1-3 (Pass low risk)	\$ 17,214	\$ 29,527	\$ 28,377	\$ 23,373	\$ 2,385	\$ 2,819	\$ 41,940	\$ 145,635	
Internal Grade 4-7 (Pass normal risk)	111,653	136,239	70,470	17,397	12,734	18,508	367,904	734,905	
Internal Grade 8-11 (Pass high risk and watch)	53,684	81,940	53,889	20,382	3,850	5,998	268,569	488,312	
Internal Grade 12 (Special mention)	92	—	—	—	—	—	—	92	
Internal Grade 13 (Substandard accrual)	3,220	1,910	7,413	6,175	7,624	7,377	9,433	43,152	
Internal Grade 14 (Substandard non-accrual)	241	1,442	11,094	—	229	309	—	13,315	
Construction and land development									
Internal Grade 1-3 (Pass low risk)	\$ 9,291	\$ 18,711	\$ 22,587	\$ 929	\$ 1,514	\$ 3,151	\$ —	\$ 56,183	
Internal Grade 4-7 (Pass normal risk)	172,579	283,798	51,938	15,522	3,381	2,208	60,345	589,771	
Internal Grade 8-11 (Pass high risk and watch)	93,777	102,553	32,549	862	118	1,596	15,517	246,972	
Internal Grade 12 (Special mention)	—	—	—	—	—	—	—	—	
Internal Grade 13 (Substandard accrual)	—	1,328	—	23	—	5,276	—	6,627	
Internal Grade 14 (Substandard non-accrual)	—	—	—	—	—	1	—	1	
Construction and land development - individuals									
FICO less than 620	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
FICO between 620 and 720	530	72	—	—	993	—	—	1,595	
FICO greater than 720	11,714	5,822	55	—	—	—	—	17,591	
Substandard non-accrual	—	—	—	—	—	—	—	—	
Other ⁽¹⁾	3,133	174	—	—	—	—	—	3,307	
1-4 family residential									
FICO less than 620	\$ 204	\$ 814	\$ 784	\$ 834	\$ 3,561	\$ 23,679	\$ 253	\$ 30,129	
FICO between 620 and 720	3,130	14,876	8,634	5,992	6,269	28,804	2,715	70,420	
FICO greater than 720	194,965	816,610	111,904	48,471	30,196	54,972	3,279	1,260,397	
Substandard non-accrual	—	—	(1)	—	266	13,097	—	13,362	
Other ⁽¹⁾	54,621	28,516	3,146	2,503	583	4,705	580	94,654	
Consumer									
FICO less than 620	\$ 1,288	\$ 411	\$ 138	\$ 83	\$ 15	\$ 47	\$ 336	\$ 2,318	
FICO between 620 and 720	2,824	2,020	670	573	44	401	1,809	8,341	
FICO greater than 720	3,184	2,063	1,614	542	120	2	3,072	10,597	
Substandard non-accrual	—	—	—	—	—	19	—	19	
Other ⁽¹⁾	3,627	1,924	492	241	8	25	270	6,587	
Total loans with credit quality measures	\$ 1,392,936	\$ 2,445,661	\$ 1,008,687	\$ 498,945	\$ 375,766	\$ 545,827	\$ 839,088	\$ 7,106,910	
Commercial and industrial (mortgage warehouse lending)								\$ 344,662	
Commercial and industrial (Paycheck Protection Program loans)								\$ 7,016	
Commercial and industrial (loans accounted for at fair value)								\$ 9,027	
Broker-Dealer (margin loans and correspondent receivables)								\$ 463,004	
Total loans held for investment								\$ 7,930,619	

(1) Loans classified in this category were assigned a FICO score for credit modeling purposes.

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

6. Allowance for Credit Losses

Available for Sale Securities and Held to Maturity Securities

The Company has evaluated available for sale debt securities that are in an unrealized loss position and has determined that any decline in value is unrelated to credit loss and related to changes in market interest rates since purchase. None of the available for sale debt securities held were past due at June 30, 2022. In addition, as of June 30, 2022, 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.

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's methodology for determining the allowance for credit losses uses the current expected credit losses ("CECL") standard. Management considers the level of allowance for credit losses to be a reasonable and supportable estimate of expected credit losses inherent within the loans held for investment portfolio as of June 30, 2022. While the Company believes it has an appropriate allowance for the existing loan portfolio at June 30, 2022, additional provision for losses on existing loans may be necessary in the future. Future changes in the allowance for credit losses are expected to be volatile given dependence upon, among other things, the portfolio composition and quality, as well as the impact of significant drivers, including prepayment assumptions and macroeconomic conditions and forecasts. In addition to the allowance for credit losses, the Company maintains a separate allowance for credit losses related to off-balance sheet credit exposures, including unfunded loan commitments, and this amount is included in other liabilities within the consolidated balance sheets. For further information on the policies that govern the estimation of the allowances for credit losses levels, see Note 1 to the consolidated financial statements in the Company's 2021 Form 10-K.

One of the most significant judgments involved in estimating the Company's allowance for credit losses relates to the macroeconomic forecasts used to estimate credit losses over the reasonable and supportable forecast period. To determine our best estimate of expected credit losses as of June 30, 2022, the Company utilized a single macroeconomic alternative scenario, or S7, published by Moody's Analytics in June 2022 that was updated to reflect the U.S. economic outlook. This alternative economic scenario expects inflation to rise more than the baseline scenario as the military conflict between Russia and Ukraine persists longer than anticipated. Inflation continues to trend higher than expectation as supply-chain issues and reductions in disposable income persist during the reasonable and supportable period. Federal Reserve monetary policy raises interest rates faster and higher than the baseline scenario where the federal funds rate increases to 3.5% by the third quarter of 2023. Other 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 adversely impacted financial markets and overall economic conditions, and may continue to have implications on borrowers across our lending portfolios. Significant judgment is required to estimate the severity and duration of the current economic uncertainties, as well as its potential impact on borrower defaults and loss severity. In particular, macroeconomic conditions and forecasts are rapidly changing and remain highly uncertain.

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

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

loan balances and qualitative factors from the prior quarter. The changes in the allowance during the three months ended June 30, 2021 were also impacted by net charge-offs of \$0.5 million, while the six months ended June 30, 2021 included net recoveries of \$0.1 million.

During the three and six months ended June 30, 2022, the increases in the allowance reflected a deteriorating U.S. economic outlook, partially offset by decreases in specific reserves and positive risk rating grade migration. The net impact to the allowance of changes associated with individually evaluated loans during the three and six months ended June 30, 2022 included a reversal of credit losses of \$1.3 million and \$1.0 million, respectively, while collectively evaluated loans included a provision for credit losses of \$6.6 million and \$6.4 million, respectively. The changes in the allowance for credit losses during the noted periods were primarily attributable to the Bank and also reflected other factors including, but not limited to, loan mix, and changes in loan balances and qualitative factors from the prior quarter. The changes in the allowance during the three and six months ended June 30, 2022 were also impacted by net charge-offs of \$1.2 million and \$1.5 million, respectively.

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

	Balance, Beginning of Period	Provision for (Reversal of) Credit Losses	Loans Charged Off	Recoveries on Charged Off Loans	Balance, End of Period
Three Months Ended June 30, 2022					
Commercial real estate	\$ 60,361	\$ 3,347	\$ —	\$ 11	\$ 63,719
Commercial and industrial	20,130	871	(1,892)	727	19,836
Construction and land development	5,515	(519)	—	—	4,996
1-4 family residential	4,340	1,212	(33)	35	5,554
Consumer	499	114	(99)	28	542
Broker-dealer	340	311	—	—	651
Total	<u>\$ 91,185</u>	<u>\$ 5,336</u>	<u>\$ (2,024)</u>	<u>\$ 801</u>	<u>\$ 95,298</u>
Six Months Ended June 30, 2022					
Commercial real estate	\$ 59,354	\$ 4,322	\$ —	\$ 43	\$ 63,719
Commercial and industrial	21,982	(679)	(3,101)	1,634	19,836
Construction and land development	4,674	322	—	—	4,996
1-4 family residential	4,589	965	(48)	48	5,554
Consumer	578	45	(212)	131	542
Broker-dealer	175	476	—	—	651
Total	<u>\$ 91,352</u>	<u>\$ 5,451</u>	<u>\$ (3,361)</u>	<u>\$ 1,856</u>	<u>\$ 95,298</u>
Three Months Ended June 30, 2021					
Commercial real estate	\$ 104,126	\$ (26,527)	\$ (186)	\$ 220	\$ 77,633
Commercial and industrial	28,513	(106)	(1,242)	701	27,866
Construction and land development	7,249	(2,064)	—	—	5,185
1-4 family residential	3,388	269	(51)	53	3,659
Consumer	944	(347)	(74)	69	592
Broker-dealer	279	55	—	—	334
Total	<u>\$ 144,499</u>	<u>\$ (28,720)</u>	<u>\$ (1,553)</u>	<u>\$ 1,043</u>	<u>\$ 115,269</u>
Six Months Ended June 30, 2021					
Commercial real estate	\$ 109,629	\$ (32,044)	\$ (186)	\$ 234	\$ 77,633
Commercial and industrial	27,703	450	(1,421)	1,134	27,866
Construction and land development	6,677	(1,492)	—	—	5,185
1-4 family residential	3,946	(588)	(161)	462	3,659
Consumer	876	(276)	(153)	145	592
Broker-dealer	213	121	—	—	334
Total	<u>\$ 149,044</u>	<u>\$ (33,829)</u>	<u>\$ (1,921)</u>	<u>\$ 1,975</u>	<u>\$ 115,269</u>

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

Unfunded Loan Commitments

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Balance, beginning of period	\$ 6,487	\$ 8,807	\$ 5,880	\$ 8,388
Other noninterest expense	444	(826)	1,051	(407)
Balance, end of period	<u>\$ 6,931</u>	<u>\$ 7,981</u>	<u>\$ 6,931</u>	<u>\$ 7,981</u>

During the three and six months ended June 30, 2021, the decreases in the reserve for unfunded commitments were primarily due to improvements in loan expected loss rates, while during the three and six months ended June 30, 2022, the increases in the reserve for unfunded commitments were primarily due to increases in both loan expected loss rates and available commitment balances.

7. 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).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Balance, beginning of period	\$ 100,475	\$ 142,125	\$ 86,990	\$ 143,742
Additions	11,210	15,815	18,510	50,115
Sales	—	(31,850)	(1,876)	(84,633)
Changes in fair value:				
Due to changes in model inputs or assumptions ⁽¹⁾	13,237	4,536	24,093	28,674
Due to customer payoffs	(3,234)	(6,129)	(6,029)	(13,401)
Balance, end of period	<u>\$ 121,688</u>	<u>\$ 124,497</u>	<u>\$ 121,688</u>	<u>\$ 124,497</u>

	June 30, 2022	December 31, 2021
Mortgage loans serviced for others ⁽²⁾	\$ 6,940,571	\$ 6,355,927
MSR asset as a percentage of serviced mortgage loans	1.75 %	1.37 %

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

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

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

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Weighted average constant prepayment rate	8.42 %	10.02 %
Weighted average discount rate	12.15 %	14.32 %
Weighted average life (in years)	7.9	7.1

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

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Constant prepayment rate:		
Impact of 10% adverse change	\$ (4,046)	\$ (2,603)
Impact of 20% adverse change	(7,852)	(5,315)
Discount rate:		
Impact of 10% adverse change	(5,612)	(4,070)
Impact of 20% adverse change	(10,716)	(7,753)

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

Contractually specified servicing fees, late fees and ancillary fees earned of \$8.9 million and \$16.2 million during the three months ended June 30, 2022 and 2021, respectively, and \$17.5 million and \$32.3 million during the six months ended June 30, 2022 and 2021, respectively, were included in net gains from sale of loans and other mortgage production income within the consolidated statements of operations.

8. Deposits

Deposits are summarized as follows (in thousands).

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Noninterest-bearing demand	\$ 4,601,643	\$ 4,577,183
Interest-bearing:		
Demand accounts	3,081,043	3,270,522
Brokered - demand	50,552	114,393
Money market	2,888,175	3,433,341
Brokered - money market	54,449	98,614
Savings	328,619	345,795
Time	900,828	962,752
Brokered - time	15,477	15,477
	<u>\$ 11,920,786</u>	<u>\$ 12,818,077</u>

At June 30, 2022, remaining maturities of uninsured time deposits greater than \$250,000 were \$405.3 million.

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

9. Short-term Borrowings

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

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Federal funds purchased	\$ 352,950	\$ 171,925
Securities sold under agreements to repurchase	180,645	191,547
Federal Home Loan Bank	—	—
Short-term bank loans	—	142,000
Commercial paper	289,054	353,972
	<u>\$ 822,649</u>	<u>\$ 859,444</u>

Federal Funds Purchased and Securities Sold under Agreements to Repurchase

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

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

	<u>Six Months Ended June 30,</u>	
	<u>2022</u>	<u>2021</u>
Average balance during the period	\$ 477,533	\$ 339,545
Average interest rate during the period	0.67 %	0.36 %
	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Average interest rate at end of period	1.48 %	0.31 %
Securities underlying the agreements at end of period:		
Carrying value	\$ 180,569	\$ 191,483
Estimated fair value	\$ 193,545	\$ 205,734

Federal Home Loan Bank (“FHLB”)

FHLB short-term borrowings mature over terms not exceeding 365 days and are collateralized by FHLB Dallas stock, nonspecified real estate loans and certain specific commercial real estate loans. The Company had no FHLB short-term borrowings during the three and six months ended June 30, 2022 and 2021.

Short-Term Bank Loans

The Hilltop Broker-Dealers use short-term bank loans periodically to finance securities owned, margin loans to customers and correspondents and underwriting activities. Interest on the borrowings varies with the federal funds rate. The Company had no such borrowings at June 30, 2022.

Commercial Paper

Hilltop Securities uses the net proceeds (after deducting related issuance expenses) from the sale of two commercial paper programs for general corporate purposes, including working capital and the funding of a portion of its securities inventories. The commercial paper notes (“CP Notes”) may be issued with maturities of 14 days to 270 days from the date of issuance. The CP Notes are issued under two separate programs, Series 2019-1 CP Notes and Series 2019-2 CP Notes, in maximum aggregate amounts of \$300 million and \$200 million, respectively. The CP Notes are not redeemable prior to maturity or subject to voluntary prepayment and do not bear interest, but are sold at a discount to

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

par. The CP Notes are secured by a pledge of collateral owned by Hilltop Securities. As of June 30, 2022, the weighted average maturity of the CP Notes was 160 days at a rate of 1.80%, with a weighted average remaining life of 70 days. At June 30, 2022, the aggregate amount outstanding under these secured arrangements was \$289.1 million, which was collateralized by securities held for firm accounts valued at \$315.3 million.

10. Notes Payable

Notes payable consisted of the following (in thousands).

	June 30, 2022	December 31, 2021
Senior Notes due April 2025, net of discount of \$794 and \$886, respectively	\$ 149,206	\$ 149,114
Subordinated Notes due May 2030, net of discount of \$658 and \$704, respectively	49,342	49,296
Subordinated Notes due May 2035, net of discount of \$2,130 and \$2,220, respectively	147,870	147,780
Ventures Management lines of credit	43,304	41,714
	<u>\$ 389,722</u>	<u>\$ 387,904</u>

11. Leases

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

	June 30, 2022	December 31, 2021
Finance leases:		
Premises and equipment	\$ 7,780	\$ 7,780
Accumulated depreciation	(5,653)	(5,358)
Premises and equipment, net	<u>\$ 2,127</u>	<u>\$ 2,422</u>

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Operating lease cost	\$ 9,352	\$ 9,746	\$ 18,958	\$ 19,403
Less operating lease and sublease income	(561)	(342)	(1,130)	(681)
Net operating lease cost	<u>\$ 8,791</u>	<u>\$ 9,404</u>	<u>\$ 17,828</u>	<u>\$ 18,722</u>
Finance lease cost:				
Amortization of ROU assets	\$ 147	\$ 147	\$ 295	\$ 295
Interest on lease liabilities	121	132	245	266
Total finance lease cost	<u>\$ 268</u>	<u>\$ 279</u>	<u>\$ 540</u>	<u>\$ 561</u>

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

	Six Months Ended June 30,	
	2022	2021
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ 18,713	\$ 19,162
Operating cash flows from finance leases	247	266
Financing cash flows from finance leases	372	336
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	\$ 8,266	\$ 28,935
Finance leases	—	—

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

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

Lease Classification	June 30, 2022		December 31, 2021	
	Weighted Average Remaining Lease Term (Years)	Weighted Average Discount Rate	Weighted Average Remaining Lease Term (Years)	Weighted Average Discount Rate
Operating	5.7	3.84 %	5.9	3.89 %
Finance	4.3	4.87 %	4.8	4.84 %

Future minimum lease payments under lease agreements as of June 30, 2022, are presented below (in thousands).

	Operating Leases	Finance Leases
2022	\$ 9,838	\$ 622
2023	32,725	1,280
2024	24,373	1,163
2025	17,811	886
2026	14,400	813
Thereafter	39,980	598
Total minimum lease payments	139,127	5,362
Less amount representing interest	(14,721)	(1,566)
Lease liabilities	\$ 124,406	\$ 3,796

As of June 30, 2022, the Company had an additional operating lease that has not yet commenced with aggregate future minimum lease payments of approximately \$0.1 million. This operating lease commenced in July 2022 with a lease term of three years.

12. Income Taxes

The Company applies an estimated annual effective rate to interim period pre-tax income to calculate the income tax provision for the quarter in accordance with the principal method prescribed by the accounting guidance established for computing income taxes in interim periods. The Company's effective tax rates were 25.6% and 23.5% for the three months ended June 30, 2022 and 2021, respectively, and 23.2% and 23.4% for the six months ended June 30, 2022 and 2021, respectively. The effective tax rate for the six months ended June 30, 2022 was higher than the applicable statutory rate primarily due to the impact of non-deductible compensation expense and other permanent adjustments.

13. Commitments and Contingencies

Legal Matters

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

Assessments of litigation and claims exposures are difficult due to many factors that involve inherent unpredictability. Those factors include the following: the varying stages of the proceedings, particularly in the early stages; unspecified, unsupported, or uncertain damages; damages other than compensatory, such as punitive damages; a matter presenting

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

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.

On June 8, 2022, WR Investments, LP ("WR") filed claims against Hilltop Securities, et al. through FINRA Dispute Resolution, Midwest Region. WR alleges it suffered a \$13.0 million loss in its sale of subordinated bonds related to a portfolio of senior living facilities sold by an affiliate of WR. Hilltop Securities believes the claims are without merit and intends to vigorously defend against such claims. There can be no assurance, however, that Hilltop Securities will be successful. At present, Hilltop Securities is unable to estimate the probability or amount of potential losses, if any, related to these claims.

In September 2020, PrimeLending received an investigative inquiry from the United States Attorney for the Western District of Virginia regarding PrimeLending's float down option. At this time, the United States Attorney has requested certain materials with respect to this matter, and PrimeLending is fully cooperating with such requests.

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

Indemnification Liability Reserve

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

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

An additional reserve has been established for probable agency, investor or other party losses that may have been incurred, but not yet reported to the mortgage origination segment based upon a reasonable estimate of such losses.

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

Factors considered in the calculation of this reserve include, but are not limited to, the total volume of loans sold exclusive of specific claimant requests, actual claim settlements and the severity of estimated losses resulting from future claims, and the mortgage origination segment's history of successfully curing defects identified in claim requests. In addition, the mortgage origination segment has considered that GNMA, FNMA and FHLMC have imposed certain restrictions on loans the agencies will accept under a forbearance agreement resulting from the COVID-19 pandemic, which could increase the magnitude of indemnification losses on these loans.

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

At June 30, 2022 and December 31, 2021, the mortgage origination segment's indemnification liability reserve totaled \$23.8 million and \$27.4 million, respectively. The provision for indemnification losses was \$0.8 million and \$2.5 million during the three months ended June 30, 2022 and 2021, respectively, and \$1.2 million and \$5.5 million during the six months ended June 30, 2022 and 2021, 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).

	Representation and Warranty Specific Claims			
	Activity - Origination Loan Balance			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Balance, beginning of period	\$ 30,271	\$ 30,137	\$ 31,407	\$ 30,085
Claims made	18,216	8,575	28,058	13,687
Claims resolved with no payment	(3,454)	(1,956)	(7,974)	(4,870)
Repurchases	(16,318)	(3,446)	(22,776)	(5,257)
Indemnification payments	—	(547)	—	(882)
Balance, end of period	<u>\$ 28,715</u>	<u>\$ 32,763</u>	<u>\$ 28,715</u>	<u>\$ 32,763</u>
	Indemnification Liability Reserve Activity			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Balance, beginning of period	\$ 27,250	\$ 24,261	\$ 27,424	\$ 21,531
Additions for new sales	762	2,858	1,515	5,865
Repurchases	(4,211)	(274)	(4,775)	(398)
Early payment defaults	(51)	(25)	(122)	(36)
Indemnification payments	—	(122)	—	(264)
Change in reserves for loans sold in prior years	—	(326)	(292)	(326)
Balance, end of period	<u>\$ 23,750</u>	<u>\$ 26,372</u>	<u>\$ 23,750</u>	<u>\$ 26,372</u>
	June 30,	December 31,		
	2022	2021		
Reserve for Indemnification Liability:				
Specific claims	\$ 829	\$ 345		
Incurred but not reported claims	22,921	27,079		
Total	<u>\$ 23,750</u>	<u>\$ 27,424</u>		

Although management considers the total indemnification liability reserve to be appropriate, there may be changes in the reserve over time to address incurred losses due to unanticipated adverse changes in the economy and historical loss patterns, discrete events adversely affecting specific borrowers or industries, and/or actions taken by institutions or investors. The impact of such matters is considered in the reserving process when probable and estimable.

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

14. Financial Instruments with Off-Balance Sheet Risk

Banking

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

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

In the aggregate, the Bank had outstanding unused commitments to extend credit of \$2.5 billion at June 30, 2022 and outstanding financial and performance standby letters of credit of \$103.6 million at June 30, 2022.

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.

15. 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.

During the six months ended June 30, 2022 and 2021, Hilltop granted 10,748 and 8,285 shares of common stock, respectively, pursuant to the 2020 Equity Plan to certain non-employee members of the Company's board of directors for services rendered to the Company.

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

Restricted Stock Units

The following table summarizes information about nonvested restricted stock unit (“RSU”) activity for the six months ended June 30, 2022 (shares in thousands).

	RSUs	
	Outstanding	Weighted Average Grant Date Fair Value
Balance, December 31, 2021	1,869	\$ 23.16
Granted	537	\$ 33.41
Vested/Released	(599)	\$ 19.19
Forfeited	(117)	\$ 23.83
Balance, June 30, 2022	1,690	\$ 27.78

Vested/Released RSUs include an aggregate of 129,919 shares withheld to satisfy employee statutory tax obligations during the six months ended June 30, 2022.

During the six months ended June 30, 2022, the Compensation Committee of the board of directors of the Company awarded certain executives and key employees an aggregate of 463,727 RSUs pursuant to the 2020 Equity Plan. Of the RSUs granted during the six months ended June 30, 2022, 321,504 that were outstanding at June 30, 2022, are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date. Of the RSUs granted during the six months ended June 30, 2022, 135,558 that were outstanding at June 30, 2022, provide for cliff vesting based upon the achievement of certain performance goals over a three-year period.

At June 30, 2022, in the aggregate, 1,281,740 of the outstanding RSUs are subject to time-based vesting conditions and generally cliff vest on the third anniversary of the grant date, and 408,458 outstanding RSUs cliff vest based upon the achievement of certain performance goals over a three-year period. At June 30, 2022, unrecognized compensation expense related to outstanding RSUs of \$26.1 million is expected to be recognized over a weighted average period of 1.45 years.

16. Regulatory Matters

Banking and Hilltop

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

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

The following table shows PlainsCapital’s and Hilltop’s actual capital amounts and ratios in accordance with Basel III compared to the regulatory minimum capital requirements including conservation buffer ratio in effect at the end of the period (dollars in thousands). Based on actual capital amounts and ratios shown in the following table, PlainsCapital’s

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

ratios place it in the “well capitalized” (as defined) capital category under regulatory requirements. Actual capital amounts and ratios as of June 30, 2022 reflect PlainsCapital’s and Hilltop’s decision to elect the transition option as issued by the federal banking regulatory agencies in March 2020 that permits banking institutions to mitigate the estimated cumulative regulatory capital effects from CECL over a five-year transitional period.

	June 30, 2022		December 31, 2021		Minimum Capital Requirements Including Conservation Buffer Ratio	To Be Well Capitalized Ratio
	Amount	Ratio	Amount	Ratio		
Tier 1 capital (to average assets):						
PlainsCapital	\$ 1,406,640	9.67 %	\$ 1,469,695	10.20 %	4.0 %	5.0 %
Hilltop	1,853,729	10.53 %	2,262,356	12.58 %	4.0 %	N/A
Common equity Tier 1 capital (to risk-weighted assets):						
PlainsCapital	1,406,640	14.65 %	1,469,695	16.00 %	7.0 %	6.5 %
Hilltop	1,853,729	17.24 %	2,262,356	21.22 %	7.0 %	N/A
Tier 1 capital (to risk-weighted assets):						
PlainsCapital	1,406,640	14.65 %	1,469,695	16.00 %	8.5 %	8.0 %
Hilltop	1,853,729	17.24 %	2,262,356	21.22 %	8.5 %	N/A
Total capital (to risk-weighted assets):						
PlainsCapital	1,492,639	15.55 %	1,540,100	16.77 %	10.5 %	10.0 %
Hilltop	2,139,683	19.90 %	2,532,008	23.75 %	10.5 %	N/A

Broker-Dealer

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

At June 30, 2022, the net capital position of each of the Hilltop Broker-Dealers was as follows (in thousands).

	Hilltop Securities	Momentum Independent Network
Net capital	\$ 234,260	\$ 4,035
Less: required net capital	10,505	250
Excess net capital	\$ 223,755	\$ 3,785
Net capital as a percentage of aggregate debit items	44.6 %	
Net capital in excess of 5% aggregate debit items	\$ 207,997	

Under certain conditions, Hilltop Securities may be required to segregate cash and securities in a special reserve account for the benefit of customers under Rule 15c3-3 promulgated under the Exchange Act. Assets segregated for regulatory purposes under the provisions of the Exchange Act are restricted and not available for general corporate purposes. At June 30, 2022 and December 31, 2021, the Hilltop Broker-Dealers held cash of \$120.8 million and \$221.7 million, respectively, segregated in special reserve bank accounts for the benefit of customers. The Hilltop Broker-Dealers were not required to segregate cash and securities in special reserve accounts for the benefit of proprietary accounts of introducing broker-dealers at June 30, 2022 or December 31, 2021.

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

Mortgage Origination

As a mortgage originator, PrimeLending and its subsidiaries are subject to minimum net worth and liquidity requirements established by HUD and GNMA, as applicable. On an annual basis, PrimeLending and its subsidiaries submit audited financial statements to HUD and GNMA, as applicable, documenting their respective compliance with minimum net worth and liquidity requirements. As of June 30, 2022, PrimeLending and its subsidiaries' net worth and liquidity exceeded the amounts required by both HUD and GNMA, as applicable.

17. Stockholders' Equity

Dividends

During the six months ended June 30, 2022 and 2021, the Company declared and paid cash dividends of \$0.30 and \$0.24 per common share, or an aggregate of \$23.8 million and \$19.8 million, respectively.

On July 21, 2022, Hilltop's board of directors declared a quarterly cash dividend of \$0.15 per common share, payable on August 26, 2022, to all common stockholders of record as of the close of business on August 12, 2022.

Stock Repurchases

In January 2022, the Hilltop board of directors authorized a new stock repurchase program through January 2023, pursuant to which the Company was originally authorized to repurchase, in the aggregate, up to \$100.0 million of its outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation. The Company's stock repurchase program, prior year repurchases and related accounting policy are discussed in detail in Note 1 and Note 24 to the consolidated financial statements included in the Company's 2021 Form 10-K.

Tender Offer

On May 2, 2022, 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 \$400 million. On May 27, 2022, including the exercise of its right to purchase up to an additional 2% of its outstanding shares, the Company completed its tender offer, repurchasing 14,868,469 shares of outstanding common stock at a price of \$29.75 per share for a total of \$442.3 million, excluding fees and expenses. The Company funded the tender offer with cash on hand. As a result of share repurchases during 2022, Hilltop has no further available share repurchase capacity associated with its previously authorized stock repurchase program.

18. Derivative Financial Instruments

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

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

Non-Hedging Derivative Instruments and the Fair Value Option

As discussed in Note 3 to the consolidated financial statements, the Company has elected to measure substantially all mortgage loans held for sale at fair value under the provisions of the Fair Value Option. The election provides the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without applying 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 7 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).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Increase (decrease) in fair value of derivatives during period:				
PrimeLending	\$ (35,303)	\$ 4,033	\$ (13,251)	\$ (225)
Hilltop Broker-Dealers	10,906	6,923	9,579	(15,272)
Bank	17	8	46	19

Hedging Derivative Instruments

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

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

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

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

	<u>June 30, 2022</u>		<u>December 31, 2021</u>	
	<u>Notional Amount</u>	<u>Estimated Fair Value</u>	<u>Notional Amount</u>	<u>Estimated Fair Value</u>
Derivative instruments (not designated as hedges):				
IRLCs	\$ 1,404,328	\$ 15,061	\$ 1,283,152	\$ 25,489
Commitments to purchase MBSs	736,656	2,201	1,575,264	(674)
Commitments to sell MBSs	2,972,796	(4,938)	3,314,173	(355)
Interest rate swaps	46,849	836	68,413	(1,949)
U.S. Treasury bond futures and options ⁽¹⁾	257,900	—	247,800	—
Eurodollar and other futures ⁽¹⁾	2,807,000	—	2,061,800	—
Credit default swaps	2,000	2	7,000	(15)
Derivative instruments (designated as hedges):				
Interest rate swaps designated as cash flow hedges	\$ 360,000	\$ 13,195	\$ 190,000	\$ 603
Interest rate swaps designated as fair value hedges ⁽²⁾	336,034	29,900	221,232	3,207

(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 \$336.0 million and \$221.2 million as the hedged amount (from a closed portfolio of prepayable available for sale securities and loans held for investment with a carrying value of \$306.1 million and \$218.0 million as of June 30, 2022 and December 31, 2021, respectively), of which, a subset of these hedges are in last-of-layer hedging relationships. The cumulative basis adjustment included in the carrying value of the hedged items totaled \$29.9 million and \$3.2 million as of June 30, 2022 and December 31, 2021, respectively.

PrimeLending held cash collateral advances, in other liabilities within the consolidated balance sheets, of \$9.3 million to offset net asset derivative positions on its commitments to sell MBSs at June 30, 2022. PrimeLending had advanced cash collateral totaling \$0.5 million and \$0.1 million to offset net liability positions on its commitments to sell MBSs at June 30, 2022 and December 31, 2021, respectively. In addition, PrimeLending and the Hilltop Broker-Dealers had advanced cash collateral totaling \$10.5 million and \$4.2 million on various derivative instruments at June 30, 2022 and December 31, 2021, respectively. The advanced cash collateral amounts are included in other assets within the consolidated balance sheets.

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

19. 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	
June 30, 2022						
Securities borrowed:						
Institutional counterparties	\$ 1,013,025	\$ —	\$ 1,013,025	\$ (955,303)	\$ —	\$ 57,722
Interest rate swaps:						
Institutional counterparties	836	—	836	(820)	—	16
Credit default swaps:						
Institutional counterparties	2	—	2	(2)	—	—
Reverse repurchase agreements:						
Institutional counterparties	139,929	—	139,929	(138,023)	—	1,906
Forward MBS derivatives:						
Institutional counterparties	2,877	—	2,877	(2,877)	—	—
	<u>\$ 1,156,669</u>	<u>\$ —</u>	<u>\$ 1,156,669</u>	<u>\$ (1,097,025)</u>	<u>\$ —</u>	<u>\$ 59,644</u>
December 31, 2021						
Securities borrowed:						
Institutional counterparties	\$ 1,518,372	\$ —	\$ 1,518,372	\$ (1,445,590)	\$ —	\$ 72,782
Reverse repurchase agreements:						
Institutional counterparties	118,262	—	118,262	(118,262)	—	—
Forward MBS derivatives:						
Institutional counterparties	2,955	(1,773)	1,182	(744)	—	438
	<u>\$ 1,639,589</u>	<u>\$ (1,773)</u>	<u>\$ 1,637,816</u>	<u>\$ (1,564,596)</u>	<u>\$ —</u>	<u>\$ 73,220</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	
June 30, 2022						
Securities loaned:						
Institutional counterparties	\$ 851,192	\$ —	\$ 851,192	\$ (797,948)	\$ —	\$ 53,244
Repurchase agreements:						
Institutional counterparties	180,569	—	180,569	(193,282)	—	(12,713)
Forward MBS derivatives:						
Institutional counterparties	11,451	(5,836)	5,615	(3,229)	—	2,386
	<u>\$ 1,043,212</u>	<u>\$ (5,836)</u>	<u>\$ 1,037,376</u>	<u>\$ (994,459)</u>	<u>\$ —</u>	<u>\$ 42,917</u>
December 31, 2021						
Securities loaned:						
Institutional counterparties	\$ 1,432,196	\$ —	\$ 1,432,196	\$ (1,359,850)	\$ —	\$ 72,346
Interest rate swaps:						
Institutional counterparties	1,949	—	1,949	(1,919)	—	30
Credit default swaps:						
Institutional counterparties	15	—	15	(15)	—	—
Repurchase agreements:						
Institutional counterparties	191,483	—	191,483	(205,734)	—	(14,251)
Forward MBS derivatives:						
Institutional counterparties	2,211	—	2,211	(2,211)	—	—
	<u>\$ 1,627,854</u>	<u>\$ —</u>	<u>\$ 1,627,854</u>	<u>\$ (1,569,729)</u>	<u>\$ —</u>	<u>\$ 58,125</u>

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

Secured Borrowing Arrangements

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

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

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

The following tables present the remaining contractual maturities of repurchase agreement and securities lending transactions accounted for as secured borrowings (in thousands). The Company had no repurchase-to-maturity transactions outstanding at both June 30, 2022 and December 31, 2021.

	Remaining Contractual Maturities				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
June 30, 2022					
Repurchase agreement transactions:					
Asset-backed securities	85,978	53,290	35,680	5,621	180,569
Securities lending transactions:					
Corporate securities	113	—	—	—	113
Equity securities	851,079	—	—	—	851,079
Total	<u>\$ 937,170</u>	<u>\$ 53,290</u>	<u>\$ 35,680</u>	<u>\$ 5,621</u>	<u>\$ 1,031,761</u>
Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above					<u>\$ 1,031,761</u>
Amount related to agreements not included in offsetting disclosure above					<u>\$ —</u>

	Remaining Contractual Maturities				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
December 31, 2021					
Repurchase agreement transactions:					
Asset-backed securities	\$ 93,651	\$ —	\$ 86,357	\$ 11,475	\$ 191,483
Securities lending transactions:					
Corporate securities	113	—	—	—	113
Equity securities	1,432,083	—	—	—	1,432,083
Total	<u>\$ 1,525,847</u>	<u>\$ —</u>	<u>\$ 86,357</u>	<u>\$ 11,475</u>	<u>\$ 1,623,679</u>
Gross amount of recognized liabilities for repurchase agreement and securities lending transactions in offsetting disclosure above					<u>\$ 1,623,679</u>
Amount related to agreements not included in offsetting disclosure above					<u>\$ —</u>

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

20. Broker-Dealer and Clearing Organization Receivables and Payables

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

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Receivables:		
Securities borrowed	\$ 1,013,025	\$ 1,518,372
Securities failed to deliver	27,945	5,664
Trades in process of settlement	—	144,773
Other	8,860	4,137
	<u>\$ 1,049,830</u>	<u>\$ 1,672,946</u>
Payables:		
Securities loaned	\$ 851,192	\$ 1,432,196
Correspondents	22,691	20,571
Securities failed to receive	40,775	18,808
Trades in process of settlement	14,008	—
Other	6,152	5,725
	<u>\$ 934,818</u>	<u>\$ 1,477,300</u>

21. Segment and Related Information

The Company has two primary business units, PCC (banking and mortgage origination) and Securities Holdings (broker-dealer). Under GAAP, the Company's 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.

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 reportable business segment revenues, operating results, goodwill and assets (in thousands).

<u>Three Months Ended June 30, 2022</u>	<u>Banking</u>	<u>Broker-Dealer</u>	<u>Mortgage Origination</u>	<u>Corporate</u>	<u>All Other and Eliminations</u>	<u>Hilltop Consolidated</u>
Net interest income (expense)	\$ 101,259	\$ 12,578	\$ (1,291)	\$ (3,190)	\$ 2,700	\$ 112,056
Provision for (reversal of) credit losses	5,025	311	—	—	—	5,336
Noninterest income	12,467	87,651	140,082	2,080	(3,007)	239,273
Noninterest expense	57,331	90,817	133,169	17,561	(335)	298,543
Income (loss) before taxes	<u>\$ 51,370</u>	<u>\$ 9,101</u>	<u>\$ 5,622</u>	<u>\$ (18,671)</u>	<u>\$ 28</u>	<u>\$ 47,450</u>
<u>Six Months Ended June 30, 2022</u>	<u>Banking</u>	<u>Broker-Dealer</u>	<u>Mortgage Origination</u>	<u>Corporate</u>	<u>All Other and Eliminations</u>	<u>Hilltop Consolidated</u>
Net interest income (expense)	\$ 193,329	\$ 24,096	\$ (3,127)	\$ (6,580)	\$ 4,329	\$ 212,047
Provision for (reversal of) credit losses	4,975	476	—	—	—	5,451
Noninterest income	25,237	148,341	283,276	3,846	(4,999)	455,701
Noninterest expense	115,761	171,464	268,027	30,354	(713)	584,893
Income (loss) before taxes	<u>\$ 97,830</u>	<u>\$ 497</u>	<u>\$ 12,122</u>	<u>\$ (33,088)</u>	<u>\$ 43</u>	<u>\$ 77,404</u>

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

Three Months Ended June 30, 2021	Banking	Broker-Dealer	Mortgage Origination	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	\$ 105,468	\$ 10,682	\$ (5,953)	\$ (4,687)	\$ 2,406	\$ 107,916
Provision for (reversal of) credit losses	(28,775)	55	—	—	—	(28,720)
Noninterest income	10,242	83,463	241,965	6,877	(2,648)	339,899
Noninterest expense	57,514	87,234	186,963	12,072	(415)	343,368
Income (loss) before taxes	<u>\$ 86,971</u>	<u>\$ 6,856</u>	<u>\$ 49,049</u>	<u>\$ (9,882)</u>	<u>\$ 173</u>	<u>\$ 133,167</u>
Six Months Ended June 30, 2021	Banking	Broker-Dealer	Mortgage Origination	Corporate	All Other and Eliminations	Hilltop Consolidated
Net interest income (expense)	\$ 209,352	\$ 21,196	\$ (13,051)	\$ (9,379)	\$ 5,480	\$ 213,598
Provision for (reversal of) credit losses	(33,950)	121	—	—	—	(33,829)
Noninterest income	21,566	182,086	552,409	7,383	(5,960)	757,484
Noninterest expense	113,302	178,638	397,297	21,660	(867)	710,030
Income (loss) before taxes	<u>\$ 151,566</u>	<u>\$ 24,523</u>	<u>\$ 142,061</u>	<u>\$ (23,656)</u>	<u>\$ 387</u>	<u>\$ 294,881</u>
June 30, 2022	Banking	Broker-Dealer	Mortgage Origination	Corporate	All Other and Eliminations	Hilltop Consolidated
Goodwill	<u>\$ 247,368</u>	<u>\$ 7,008</u>	<u>\$ 13,071</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 267,447</u>
Total assets	<u>\$ 13,826,898</u>	<u>\$ 2,659,850</u>	<u>\$ 1,820,074</u>	<u>\$ 2,444,889</u>	<u>\$ (4,035,972)</u>	<u>\$ 16,715,739</u>
December 31, 2021	Banking	Broker-Dealer	Mortgage Origination	Corporate	All Other and Eliminations	Hilltop Consolidated
Goodwill	<u>\$ 247,368</u>	<u>\$ 7,008</u>	<u>\$ 13,071</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 267,447</u>
Total assets	<u>\$ 14,944,249</u>	<u>\$ 3,673,346</u>	<u>\$ 2,207,822</u>	<u>\$ 2,940,670</u>	<u>\$ (5,077,007)</u>	<u>\$ 18,689,080</u>

22. Earnings per Common Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Basic earnings per share:				
Income attributable to Hilltop	\$ 33,260	\$ 99,060	\$ 55,510	\$ 219,404
Weighted average shares outstanding - basic	73,693	81,663	76,389	81,914
Basic earnings per common share:	<u>\$ 0.45</u>	<u>\$ 1.21</u>	<u>\$ 0.73</u>	<u>\$ 2.68</u>
Diluted earnings per share:				
Income attributable to Hilltop	\$ 33,260	\$ 99,060	\$ 55,510	\$ 219,404
Weighted average shares outstanding - basic	73,693	81,663	76,389	81,914
Effect of potentially dilutive securities	145	536	180	493
Weighted average shares outstanding - diluted	<u>73,838</u>	<u>82,199</u>	<u>76,569</u>	<u>82,407</u>
Diluted earnings per common share	<u>\$ 0.45</u>	<u>\$ 1.21</u>	<u>\$ 0.73</u>	<u>\$ 2.66</u>

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

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

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

FORWARD-LOOKING STATEMENTS

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

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

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

- risks associated with concentration in real estate related loans;
- the effects of our indebtedness on our ability to manage our business successfully, including the restrictions imposed by the indenture governing our indebtedness;
- changes in state and federal laws, regulations or policies affecting one or more of our business segments, including changes in regulatory fees, deposit insurance premiums, capital requirements and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”);
- cost and availability of capital;
- changes in key management;
- competition in our banking, broker-dealer and mortgage origination segments from other banks and financial institutions as well as investment banking and financial advisory firms, mortgage bankers, asset-based non-bank lenders and government agencies;
- legal and regulatory proceedings;
- risks associated with merger and acquisition integration; and
- our ability to use excess capital in an effective manner.

For a more detailed discussion of these and other factors that may affect our business and that could cause the actual results to differ materially from those anticipated in these forward-looking statements, see “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2021 (“2021 Form 10-K”), which was filed with the Securities and Exchange Commission (the “SEC”) on February 15, 2022, this Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and other filings we have made with the SEC. We caution that the foregoing list of factors is not exhaustive, and new factors may emerge, or changes to the foregoing factors may occur, that could impact our business. All subsequent written and oral forward-looking statements concerning our business attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements above. We do not undertake any obligation to update any forward-looking statement, whether written or oral, relating to the matters discussed in this Quarterly Report except to the extent required by federal securities laws.

OVERVIEW

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

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

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

The following historical consolidated data for the periods indicated has been derived from our historical consolidated financial statements included elsewhere in this Quarterly Report (dollars in thousands, except per share data).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Statement of Operations Data:				
Net interest income	\$ 112,056	\$ 107,916	\$ 212,047	\$ 213,598
Provision for (reversal of) credit losses	5,336	(28,720)	5,451	(33,829)
Total noninterest income	239,273	339,899	455,701	757,484
Total noninterest expense	298,543	343,368	584,893	710,030
Income before income taxes	47,450	133,167	77,404	294,881
Income tax expense	12,127	31,234	17,942	69,004
Net income	35,323	101,933	59,462	225,877
Less: Net income attributable to noncontrolling interest	2,063	2,873	3,952	6,473
Income attributable to Hilltop	\$ 33,260	\$ 99,060	\$ 55,510	\$ 219,404
Per Share Data:				
Diluted earnings per common share	\$ 0.45	\$ 1.21	\$ 0.73	\$ 2.66
Diluted weighted average shares outstanding	73,838	82,199	76,569	82,407
Cash dividends declared per common share	\$ 0.15	\$ 0.12	\$ 0.30	\$ 0.24
Dividend payout ratio ⁽²⁾	33.33 %	9.92 %	41.10 %	8.99 %
Book value per common share (end of period)			\$ 31.43	\$ 30.44
Tangible book value per common share ⁽¹⁾ (end of period)			\$ 27.08	\$ 26.93
Balance Sheet Data:				
Total assets			\$ 16,715,739	\$ 18,689,080
Cash and due from banks			1,783,554	2,823,138
Securities			3,076,275	3,046,500
Loans held for sale			1,491,579	1,878,190
Loans held for investment, net of unearned income			7,930,619	7,879,904
Allowance for credit losses			(95,298)	(91,352)
Total deposits			11,920,786	12,818,077
Notes payable			389,722	387,904
Total stockholders' equity			2,057,403	2,549,203
Capital Ratios:				
Common equity to assets ratio			12.14 %	13.50 %
Tangible common equity to tangible assets ⁽¹⁾			10.64 %	12.17 %

(1) For a reconciliation to the nearest GAAP measure, see “—Reconciliation and Management’s Explanation of Non-GAAP Financial Measures.”

(2) Dividend payout ratio is defined as cash dividends declared per common share divided by basic earnings per common share.

Consolidated income before income taxes during the three and six months ended June 30, 2022 included the following contributions from our reportable business segments.

- The banking segment contributed \$51.4 million and \$97.8 million of income before income taxes during the three and six months ended June 30, 2022;
- The broker-dealer segment contributed \$9.1 million and \$0.5 million of income before income taxes during the three and six months ended June 30, 2022; and
- The mortgage origination segment contributed \$5.6 million and \$12.1 million of income before income taxes during the three and six months ended June 30, 2022.

During the six months ended June 30, 2022, we declared and paid total common dividends of \$23.8 million.

On July 21, 2022, our board of directors declared a quarterly cash dividend of \$0.15 per common share, payable on August 26, 2022 to all common stockholders of record as of the close of business on August 12, 2022.

On May 2, 2022, 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 \$400 million, inclusive of the aforementioned stock repurchase program. On May 27, 2022, including the exercise of our right to purchase up to an additional 2% of our outstanding shares, we completed our tender offer, repurchasing 14,868,469 shares of outstanding common stock at a price of \$29.75 per share for a total of \$442.3 million, excluding fees and expenses. We funded the tender offer with cash on hand. As a result of share repurchases during 2022, we have no further available share repurchase capacity associated with our previously authorized stock repurchase program.

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 accounting principles generally accepted in the United States (“GAAP”). “Tangible book value per common share” is defined as our total stockholders’ equity 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 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).

	June 30,	
	2022	2021
Book value per common share	\$ 31.43	\$ 30.44
Effect of goodwill and intangible assets per share	(4.35)	(3.51)
Tangible book value per common share	\$ 27.08	\$ 26.93
	June 30,	December 31,
	2022	2021
Hilltop stockholders’ equity	\$ 2,029,577	\$ 2,522,668
Less: goodwill and intangible assets, net	280,629	282,731
Tangible common equity	\$ 1,748,948	\$ 2,239,937
Total assets	\$ 16,715,739	\$ 18,689,080
Less: goodwill and intangible assets, net	280,629	282,731
Tangible assets	\$ 16,435,110	\$ 18,406,349
Equity to assets	12.14 %	13.50 %
Tangible common equity to tangible assets	10.64 %	12.17 %

Recent Developments

COVID-19

The COVID-19 pandemic and related governmental control measures severely disrupted financial markets and overall economic conditions throughout 2020. While the impact of the pandemic and the uncertainties have remained into 2022, significant progress associated with COVID-19 vaccination levels in the United States has resulted in easing of restrictive measures in the United States even as additional variants have emerged. Further, the U.S. federal government enacted policies to provide fiscal stimulus to the economy and relief to those affected by the pandemic, with the stimulus intended to bolster household finances as well as those of small businesses, states and municipalities. Throughout the pandemic, we have taken a number of precautionary steps to safeguard our business and our employees from COVID-19, including, but not limited to, banking by appointment, implementing employee travel restrictions and telecommuting arrangements, while maintaining business continuity so that we can continue to deliver service to and meet the demands of our clients. Beginning in the second quarter of 2021, we returned a majority of our employees to their respective office locations based initially on a rotational team schedule and, with limited exceptions due to the emergence of new variants of the virus, have since generally returned to pre-pandemic work arrangements with available hybrid options for designated roles. We are continuing to monitor and assess the impacts of the COVID-19 pandemic on our employees and customers on a regular basis.

Asset Valuation

As discussed in more detail within “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our 2021 Form 10-K, at each reporting date between annual impairment tests, we consider potential indicators of impairment including the condition of the economy and financial services industry; government intervention and regulatory updates; the impact of recent events to financial performance and cost factors of the reporting unit; performance of our stock and other relevant events. We continue to monitor developments regarding the overall economic conditions, COVID-19 pandemic and measures implemented in response to the pandemic, market capitalization, and any other triggering events or circumstances that may indicate an impairment in the future.

Loan Portfolio

In response to the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) and the Paycheck Protection Program and Health Care Enhancement Act (the “PPP/HCE Act”) were passed in March 2020, which were intended to provide emergency relief to several groups and individuals impacted by the COVID-19 pandemic. Among the numerous provisions contained in the CARES Act was the creation of the Paycheck Protection Program (“PPP”) that provided federal government loan forgiveness for Small Business Administration (“SBA”) Section 7(a) loans for small businesses to pay up to eight weeks of employee compensation and other basic expenses such as electric and telephone bills. 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. Further, the CARES Act allowed the Bank to suspend the troubled debt restructuring (“TDR”) requirements for certain loan modifications to be categorized as a TDR through January 1, 2022.

Starting in March 2020, the Bank implemented several actions to better support our impacted banking clients and allow for loan modifications such as principal and/or interest payment deferrals, participation in both the initial and second round PPP efforts 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 allowed 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 PPP efforts included approval and funding of over 4,100 PPP loans, with approximately \$7 million remaining outstanding at June 30, 2022. The PPP loans made by the Bank are guaranteed by the SBA and, if used by the borrower for authorized purposes, may be fully forgiven. On October 2, 2020, the SBA began approving the Bank’s PPP forgiveness applications and remitting forgiveness payments to PPP lenders for PPP borrowers. Through July 15, 2022, the SBA had approved approximately 4,100 PPP forgiveness applications from the Bank totaling approximately \$893 million, with PPP loans of approximately \$2 million currently pending SBA review and approval.

In addition, the Bank’s loan portfolio includes collateralized loans extended to businesses that depend on the energy industry, including those within the exploration and production, field services, pipeline construction and transportation sectors. Crude oil prices have increased since historical lows observed in 2020, but uncertainty remains given future supply and demand for oil are influenced by the Russia-Ukraine conflict, return to business travel, new energy policies

and government regulation, and the pace of transition towards renewable energy resources. At June 30, 2022, the Bank's energy loan exposure was approximately \$66 million of loans held for investment with unfunded commitment balances of approximately \$32 million. The allowance for credit losses on the Bank's energy portfolio was \$0.1 million, or 0.2% of loans held for investment at June 30, 2022.

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 2022

Our balance sheet, operating results and certain metrics during 2021 reflected strong credit quality, significant reversals of credit losses, heightened capital and liquidity levels, and low mortgage interest rates. As noted within our 2021 Form 10-K, we identified expected headwinds in 2022, including tight housing inventories on mortgage volumes, declining deposit balances, and increases in market interest rates, while also noting that inflationary pressures associated with compensation, occupancy and software costs within our business segments were expected to be uncertain in 2022. These headwinds, coupled with a declining economic forecast, rapid increases in the 10-year U.S. treasury bond yield and mortgage interest rates, and exposure to increasing funding costs during the first half of 2022 have had, and are expected to continue to have, an adverse impact on our operating results during the remainder of 2022.

The COVID-19 pandemic may also continue to adversely impact financial markets and overall economic conditions. The extent of the impact of the pandemic on our operational and financial performance for the remainder of 2022 remains uncertain.

See "Item 1A. Risk Factors" of our 2021 Form 10-K for additional discussion of the potential adverse impact of COVID-19 on our business, results of operations and financial condition.

Factors Affecting Results of Operations

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

Factors Affecting Comparability of Results of Operations

LIBOR

As discussed in more detail within "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of our 2021 Form 10-K, one week and two-month LIBOR ceased to be published on December 31, 2021, and all remaining USD LIBOR tenors will cease to be published or lose representativeness immediately after June 30, 2023.

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

The Alternative Reference Rates Committee ("ARRC") has proposed a paced market transition plan to the Secured Overnight Financing Rate ("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. The ARRC has formally recommended SOFR as its preferred alternative rate for LIBOR. However, at this time, no consensus exists as to what rate or rates may become acceptable alternatives to LIBOR and it is impossible to predict the effect of any such

alternatives on the value of LIBOR-based securities and variable rate loans, or other securities or financial arrangements, given LIBOR's role in determining market interest rates globally.

We have completed our targeted assessment of exposures across the organization associated with the migration away from LIBOR and have transitioned to the impact assessment and implementation stages. In light of the above described recent changes to the LIBOR phase out dates being pushed out to 2023, we have begun taking necessary actions, including negotiating certain of our agreements based on alternative benchmark rates that have been established. Since the third quarter of 2020, PrimeLending has been originating conventional adjustable-rate mortgage, or ARM, loan products utilizing a SOFR rate with terms consistent with government-sponsored enterprise, or GSE, guidelines. In addition, the Bank's management team continues to work with its commercial relationships that have LIBOR-based contracts maturing in 2022 and future periods to amend terms and establish an alternative benchmark rate. We also continue to evaluate the impacts of the LIBOR phase-out and transition requirements as it pertains to contracts, models and systems. To date, an immaterial amount of expenses have been incurred as a result of our efforts; however, in the future we may incur additional expenses as we finalize the transition of our systems and processes away from LIBOR.

Segment Information

The Company has two primary business units, PCC (banking and mortgage origination) and Securities Holdings (broker-dealer). Under GAAP, the Company's 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 21, Segment and Related Information, in the notes to our consolidated financial statements.

The following table presents certain information about the 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.

	Three Months Ended June 30,		Variance 2022 vs 2021		Six Months Ended June 30,		Variance 2022 vs 2021	
	2022	2021	Amount	Percent	2022	2021	Amount	Percent
Net interest income (expense):								
Banking	\$ 101,259	\$ 105,468	\$ (4,209)	(4)	\$ 193,329	\$ 209,352	\$ (16,023)	(8)
Broker-Dealer	12,578	10,682	1,896	18	24,096	21,196	2,900	14
Mortgage Origination	(1,291)	(5,953)	4,662	78	(3,127)	(13,051)	9,924	76
Corporate	(3,190)	(4,687)	1,497	32	(6,580)	(9,379)	2,799	30
All Other and Eliminations	2,700	2,406	294	12	4,329	5,480	(1,151)	(21)
Hilltop Consolidated	\$ 112,056	\$ 107,916	\$ 4,140	4	\$ 212,047	\$ 213,598	\$ (1,551)	(1)
Provision for (reversal of) credit losses:								
Banking	\$ 5,025	\$ (28,775)	\$ 33,800	117	\$ 4,975	\$ (33,950)	\$ 38,925	115
Broker-Dealer	311	55	256	NM	476	121	355	NM
Mortgage Origination	—	—	—	—	—	—	—	—
Corporate	—	—	—	—	—	—	—	—
All Other and Eliminations	—	—	—	—	—	—	—	—
Hilltop Consolidated	\$ 5,336	\$ (28,720)	\$ 34,056	119	\$ 5,451	\$ (33,829)	\$ 39,280	116
Noninterest income:								
Banking	\$ 12,467	\$ 10,242	\$ 2,225	22	\$ 25,237	\$ 21,566	\$ 3,671	17
Broker-Dealer	87,651	83,463	4,188	5	148,341	182,086	(33,745)	(19)
Mortgage Origination	140,082	241,965	(101,883)	(42)	283,276	552,409	(269,133)	(49)
Corporate	2,080	6,877	(4,797)	(70)	3,846	7,383	(3,537)	(48)
All Other and Eliminations	(3,007)	(2,648)	(359)	(14)	(4,999)	(5,960)	961	16
Hilltop Consolidated	\$ 239,273	\$ 339,899	\$ (100,626)	(30)	\$ 455,701	\$ 757,484	\$ (301,783)	(40)
Noninterest expense:								
Banking	\$ 57,331	\$ 57,514	\$ (183)	(0)	\$ 115,761	\$ 113,302	\$ 2,459	2
Broker-Dealer	90,817	87,234	3,583	4	171,464	178,638	(7,174)	(4)
Mortgage Origination	133,169	186,963	(53,794)	(29)	268,027	397,297	(129,270)	(33)
Corporate	17,561	12,072	5,489	45	30,354	21,660	8,694	40
All Other and Eliminations	(335)	(415)	80	19	(713)	(867)	154	18
Hilltop Consolidated	\$ 298,543	\$ 343,368	\$ (44,825)	(13)	\$ 584,893	\$ 710,030	\$ (125,137)	(18)
Income (loss) before taxes:								
Banking	\$ 51,370	\$ 86,971	\$ (35,601)	(41)	\$ 97,830	\$ 151,566	\$ (53,736)	(35)
Broker-Dealer	9,101	6,856	2,245	33	497	24,523	(24,026)	(98)
Mortgage Origination	5,622	49,049	(43,427)	(89)	12,122	142,061	(129,939)	(91)
Corporate	(18,671)	(9,882)	(8,789)	(89)	(33,088)	(23,656)	(9,432)	(40)
All Other and Eliminations	28	173	(145)	(84)	43	387	(344)	(89)
Hilltop Consolidated	\$ 47,450	\$ 133,167	\$ (85,717)	(64)	\$ 77,404	\$ 294,881	\$ (217,477)	(74)

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 recoveries (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. Net interest income decreased during the six months ended June 30, 2022, compared with the same period in 2021, primarily due to a decrease within our banking segment, significantly offset by increases within our mortgage origination and broker-dealer 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 \$133.6 million and \$136.6 million in securities commissions and fees and investment and securities advisory fees and commissions, and \$13.9 million and \$39.7 million in gains from derivative and trading portfolio activities (included within other noninterest income), respectively, during the six months ended June 30, 2022 and 2021.
- (ii) *Income from mortgage operations.* Through PrimeLending, we generate noninterest income by originating and selling mortgage loans. During the six months ended June 30, 2022 and 2021, we generated \$282.9 million and \$552.0 million, respectively, in net gains from sale of loans, other mortgage production income (including income associated with retained mortgage servicing rights), and mortgage loan origination fees.

In the aggregate, we experienced a decrease in noninterest income during the six months ended June 30, 2022, compared to the same period in 2021, as noted in the segment results table previously presented, primarily due to a decrease of \$269.1 million in net gains from sale of loans, other mortgage production income and mortgage loan origination fees within our mortgage origination segment and decreases in gains from derivative and trading portfolio activities and fixed income services business line revenues 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 applicable to common stockholders during the three months ended June 30, 2022 was \$33.3 million, or \$0.45 per diluted share, compared with \$99.1 million, or \$1.21 per diluted share, during the three months ended June 30, 2021. Income applicable to common stockholders during the six months ended June 30, 2022 was \$55.5 million, or \$0.73 per diluted share, compared with \$219.4 million, or \$2.66 per diluted share, during the six months ended June 30, 2021. Hilltop's financial results for the three and six months ended June 30, 2022, compared with the same periods in 2021, reflect significant decreases in year-over-year mortgage origination segment net gains from sales of loans and other mortgage production income, declines in net revenues within certain of the broker-dealer segment's business lines, and declines in the year-over-year changes in provision for (reversal of) credit losses within the banking segment.

Certain items included in net income for the three and six months ended June 30, 2022 and 2021 resulted from purchase accounting associated with the merger of PlainsCapital Corporation with and into a wholly owned subsidiary of Hilltop on November 30, 2012, the FDIC-assisted transaction whereby the Bank acquired certain assets and assumed certain liabilities of FNB, the acquisition of SWS Group, Inc. in a stock and cash transaction, and the acquisition of The Bank of River Oaks in an all-cash transaction (collectively, the "Bank Transactions"). Income before income taxes during the three months ended June 30, 2022 and 2021 included net accretion on earning assets and liabilities of \$3.1 million and \$6.2 million, respectively, and amortization of identifiable intangibles of \$1.1 million and \$1.3 million, respectively, related to the Bank Transactions. During the six months ended June 30, 2022 and 2021, income before income taxes included net accretion on earning assets and liabilities of \$5.7 million and \$11.0 million, respectively, and amortization of identifiable intangibles of \$2.2 million and \$2.7 million, respectively, related to the Bank Transactions.

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Return on average stockholders' equity ⁽¹⁾	5.82 %	16.42 %	4.67 %	18.47 %
Return on average assets ⁽²⁾	0.80 %	2.29 %	0.66 %	2.59 %
Net interest margin ^{(3) (4)}	2.75 %	2.62 %	2.55 %	2.66 %
Leverage ratio ⁽⁵⁾ (end of period)			10.53 %	12.87 %
Common equity Tier 1 risk-based capital ratio ⁽⁶⁾ (end of period)			17.24 %	20.22 %

- (1) Return on average stockholders' equity is defined as consolidated income attributable to Hilltop divided by average total Hilltop stockholders' equity.
- (2) Return on average assets is defined as consolidated net income divided by average assets.
- (3) Net interest margin is defined as net interest income divided by average interest-earning assets. We consider net interest margin as a key indicator of profitability, as it represents interest earned on our interest-earning assets compared to interest incurred.
- (4) The securities financing operations within our broker-dealer segment had the effect of lowering both the net interest margin and taxable equivalent net interest margin by 18 basis points and 17 basis points during the three months ended June 30, 2022 and 2021, respectively, and 18 basis points and 18 basis points during the six months ended June 30, 2022 and 2021, respectively.
- (5) The leverage ratio is a regulatory capital ratio and is defined as Tier 1 risk-based capital divided by average consolidated assets.
- (6) The common equity Tier 1 risk-based capital ratio is a regulatory capital ratio and is defined as common equity Tier 1 risk-based capital divided by risk weighted assets. Common equity includes common equity Tier 1 capital (common stockholders' equity and certain minority interests in the equity capital accounts of consolidated subsidiaries, but excluding goodwill and various intangible assets) and additional Tier 1 capital (certain qualifying minority interests not included in common equity Tier 1 capital, certain preferred stock and related surplus, and certain subordinated debt).

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

During the three months ended June 30, 2022 and 2021, purchase accounting contributed 8 and 16 basis points, respectively, to our consolidated taxable equivalent net interest margin of 2.76% and 2.63%, respectively. During the six months ended June 30, 2022 and 2021, purchase accounting contributed 7 and 15 basis points respectively, to our consolidated taxable equivalent net interest margin of 2.56% and 2.66%, respectively. The purchase accounting activity was primarily related to the accretion of discount of loans which totaled \$3.0 million and \$6.0 million during the three months ended June 30, 2022 and 2021, respectively, associated with the Bank Transactions. The purchase accounting activity was primarily related to the accretion of discount of loans which totaled \$5.5 million and \$10.9 million during the six months ended June 30, 2022 and 2021, respectively, associated with the Bank Transactions.

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

	Three Months Ended June 30,					
	2022			2021		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
Assets						
Interest-earning assets						
Loans held for sale	\$ 1,375,395	\$ 14,302	4.16 %	\$ 2,450,897	\$ 17,128	2.80 %
Loans held for investment, gross ⁽¹⁾	7,838,090	84,426	4.32 %	7,725,906	87,034	4.48 %
Investment securities - taxable	2,779,458	17,288	2.49 %	2,443,486	11,106	1.82 %
Investment securities - non-taxable ⁽²⁾	250,303	2,557	4.09 %	320,685	2,731	3.41 %
Federal funds sold and securities purchased under agreements to resell	193,851	481	1.00 %	159,400	—	0.00 %
Interest-bearing deposits in other financial institutions	2,602,154	4,984	0.77 %	1,861,861	628	0.14 %
Securities borrowed	1,273,368	10,498	3.26 %	1,490,097	15,586	4.14 %
Other	53,962	1,013	7.53 %	49,579	994	8.04 %
Interest-earning assets, gross ⁽²⁾	16,366,581	135,549	3.32 %	16,501,911	135,207	3.26 %
Allowance for credit losses	(91,619)			(144,105)		
Interest-earning assets, net	16,274,962			16,357,806		
Noninterest-earning assets	1,516,266			1,475,422		
Total assets	\$ 17,791,228			\$ 17,833,228		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 7,768,772	\$ 5,456	0.28 %	\$ 7,740,066	\$ 6,176	0.32 %
Securities loaned	1,114,923	8,512	3.06 %	1,411,961	12,345	3.51 %
Notes payable and other borrowings	1,303,678	9,109	2.80 %	1,271,609	8,381	2.64 %
Total interest-bearing liabilities	10,187,373	23,077	0.91 %	10,423,636	26,902	1.03 %
Noninterest-bearing liabilities						
Noninterest-bearing deposits	4,552,424			4,090,425		
Other liabilities	731,635			872,916		
Total liabilities	15,471,432			15,386,977		
Stockholders' equity	2,292,816			2,420,436		
Noncontrolling interest	26,980			25,815		
Total liabilities and stockholders' equity	\$ 17,791,228			\$ 17,833,228		
Net interest income ⁽²⁾		\$ 112,472			\$ 108,305	
Net interest spread ⁽²⁾			2.41 %			2.23 %
Net interest margin ⁽²⁾			2.76 %			2.63 %
Six Months Ended June 30,						
	2022			2021		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
Assets						
Interest-earning assets						
Loans held for sale	\$ 1,421,440	\$ 26,266	3.70 %	\$ 2,511,653	\$ 33,361	2.66 %
Loans held for investment, gross ⁽¹⁾	7,838,566	162,870	4.21 %	7,686,116	175,078	4.55 %
Investment securities - taxable	2,774,183	32,869	2.37 %	2,356,083	21,338	1.81 %
Investment securities - non-taxable ⁽²⁾	286,990	5,439	3.79 %	302,444	4,998	3.31 %
Federal funds sold and securities purchased under agreements to resell	175,683	617	0.71 %	126,644	—	— %
Interest-bearing deposits in other financial institutions	2,857,841	6,412	0.45 %	1,714,688	1,210	0.14 %
Securities borrowed	1,363,765	19,315	2.82 %	1,471,504	44,558	6.02 %
Other	54,280	1,762	6.55 %	49,746	1,756	7.11 %
Interest-earning assets, gross ⁽²⁾	16,772,748	255,550	3.07 %	16,218,878	282,299	3.47 %
Allowance for credit losses	(91,927)			(146,737)		
Interest-earning assets, net	16,680,821			16,072,141		
Noninterest-earning assets	1,459,242			1,517,000		
Total assets	\$ 18,140,063			\$ 17,589,141		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 7,984,102	\$ 9,649	0.24 %	\$ 7,683,634	\$ 13,917	0.37 %
Securities loaned	1,242,660	15,984	2.59 %	1,384,108	37,831	5.51 %
Notes payable and other borrowings	1,276,600	16,990	2.68 %	1,201,230	16,394	2.73 %
Total interest-bearing liabilities	10,503,362	42,623	0.82 %	10,268,972	68,142	1.34 %
Noninterest-bearing liabilities						
Noninterest-bearing deposits	4,530,166			3,911,205		
Other liabilities	681,989			986,810		
Total liabilities	15,715,517			15,166,987		
Stockholders' equity	2,398,015			2,395,994		
Noncontrolling interest	26,531			26,160		
Total liabilities and stockholders' equity	\$ 18,140,063			\$ 17,589,141		
Net interest income ⁽²⁾		\$ 212,927			\$ 214,157	
Net interest spread ⁽²⁾			2.25 %			2.13 %
Net interest margin ⁽²⁾			2.56 %			2.66 %

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- (1) Average balance includes non-accrual loans.
 - (2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on the applicable corporate federal income tax rate of 21% for the periods presented. The adjustment to interest income was \$0.4 million and \$0.4 million for the three months ended June 30, 2022 and 2021, respectively, and \$0.9 million and \$0.6 million for the six months ended June 30, 2022 and 2021, 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, such as securities borrowed in the broker-dealer segment and securities loaned 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.

On a consolidated basis, the changes in net interest income during the three and six months ended June 30, 2022, compared with the same periods in 2021, were primarily due to the effects of volume and rate changes within the mortgage warehouse lending, securities and deposits portfolios within the banking segment and increased net yields on mortgage loans held for sale within the 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 necessary to maintain the allowance for credit losses at the amount of expected credit losses inherent within the loans held for investment portfolio. The amount of expense and the corresponding level of allowance for credit losses for loans are based on our evaluation of the collectability of the loan portfolio based on historical loss experience, reasonable and supportable forecasts, and other significant qualitative and quantitative factors. Substantially all of our consolidated provision for (reversal of) credit losses is related to the banking segment. During the three and six months ended June 30, 2022, the increases in the allowance reflected a deteriorating U.S. economic outlook since the prior quarter, partially offset by decreases in specific reserves and positive risk rating grade migration. Refer to the discussion in the "Financial Condition – Allowance for Credit Losses on Loans" section that follows for more details regarding the significant assumptions and estimates involved in estimating credit losses.

Noninterest income decreased during the three months ended June 30, 2022, compared with the same period in 2021, primarily due to decreases in total mortgage loan sales volume and average loan sales margin within our mortgage origination segment. The decrease in noninterest income during the six months ended June 30, 2022, compared with the same period in 2021, was primarily due to decreases in total mortgage loan sales volume and average loan sales margin, and changes in net fair value and related derivative activity within our mortgage origination segment, as well as declines in net revenues within the broker-dealer segment's structured finance and fixed income services business lines.

Noninterest expense decreased during the three months ended June 30, 2022, compared with the same period in 2021, primarily due to decreases in both variable and non-variable compensation within our mortgage origination segment associated with the decreased mortgage loan originations. Noninterest expense decreased during the six months ended June 30, 2022, compared with the same period in 2021, primarily due to decreases in both variable and non-variable compensation within our mortgage origination segment associated with the decreased mortgage loan originations, and a decline in variable compensation within our broker-dealer segment. We have experienced an increase in certain noninterest expenses during the first half of 2022, including compensation, occupancy, and software costs, due to inflationary pressures. We expect such inflationary headwinds to continue and result in higher fixed costs during the remainder of 2022.

Effective income tax rates during the three months ended June 30, 2022 and 2021 were 25.6% and 23.5%, respectively, and for the six months ended June 30, 2022 and 2021, were 23.2% and 23.4%, respectively. The effective tax rate for the six months ended June 30, 2022 was higher than the applicable statutory rate primarily due to the impact of non-deductible compensation expense and other permanent adjustments during the second quarter of 2022.

Segment Results

Banking Segment

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

	Three Months Ended June 30,		Variance	Six Months Ended June 30,		Variance
	2022	2021	2022 vs 2021	2022	2021	2022 vs 2021
Net interest income	\$ 101,259	\$ 105,468	\$ (4,209)	\$ 193,329	\$ 209,352	\$ (16,023)
Provision for (reversal of) credit losses	5,025	(28,775)	33,800	4,975	(33,950)	38,925
Noninterest income	12,467	10,242	2,225	25,237	21,566	3,671
Noninterest expense	57,331	57,514	(183)	115,761	113,302	2,459
Income (loss) before income taxes	\$ 51,370	\$ 86,971	\$ (35,601)	\$ 97,830	\$ 151,566	\$ (53,736)

The decreases in income before income taxes during the three and six months ended June 30, 2022, compared with the same periods in 2021, were primarily due to declines in the respective year-over-year changes in provision for (reversal of) credit losses and the combined impact of net interest income volume and rate changes within the loans held for investment and mortgage warehouse lending portfolios. Changes to net interest income related to the component changes in the volume of average interest-earning assets and interest-bearing liabilities and changes in the rates earned or paid on those items are discussed in more detail below.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Efficiency ratio ⁽¹⁾	50.41 %	49.71 %	52.96 %	49.07 %
Return on average assets ⁽²⁾	1.09 %	1.91 %	1.03 %	1.70 %
Net interest margin ⁽³⁾	2.97 %	3.19 %	2.81 %	3.25 %
Net recoveries (charge-offs) to average loans outstanding ⁽⁴⁾	(0.07)%	0.03 %	(0.04)%	0.00 %

- (1) Efficiency ratio is defined as noninterest expenses divided by the sum of total noninterest income and net interest income for the period. We consider the efficiency ratio to be a measure of the banking segment's profitability.
- (2) Return on average assets is defined as net income divided by average assets.
- (3) Net interest margin is defined as net interest income divided by average interest-earning assets. We consider net interest margin as a key indicator of profitability, as it represents interest earned on interest-earning assets compared to interest incurred.
- (4) Net recoveries (charge-offs) to average loans outstanding is defined as the greater of recoveries or charge-offs during the reported period minus charge-offs or recoveries divided by average loans outstanding. We use the ratio to measure the credit performance of our loan portfolio.

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

During the three months ended June 30, 2022 and 2021, purchase accounting contributed 10 and 20 basis points, respectively, to the banking segment's taxable equivalent net interest margin of 2.98% and 3.20%, respectively. During the six months ended June 30, 2022 and 2021, purchase accounting contributed 9 and 18 basis points, respectively, to the banking segment's taxable equivalent net interest margin of 2.81% and 3.25%, respectively. These purchase accounting items are primarily related to accretion of discount of loans associated with the Bank Transactions presented in the Consolidated Operating Results section.

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

	Three Months Ended June 30,					
	2022			2021		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
Assets						
Interest-earning assets						
Loans held for investment, gross ⁽¹⁾	\$ 7,302,343	\$ 79,305	4.36 %	\$ 7,158,625	\$ 82,987	4.61 %
Subsidiary warehouse lines of credit	1,298,673	14,483	4.41 %	2,349,513	22,292	3.75 %
Investment securities - taxable	2,354,096	9,841	1.67 %	1,961,289	7,244	1.48 %
Investment securities - non-taxable ⁽²⁾	106,178	929	3.50 %	116,391	1,001	3.44 %
Federal funds sold and securities purchased under agreements to resell	117,476	311	1.06 %	413	—	0.14 %
Interest-bearing deposits in other financial institutions	2,451,889	4,984	0.82 %	1,617,437	406	0.10 %
Other	36,824	99	1.08 %	36,912	155	1.68 %
Interest-earning assets, gross ⁽²⁾	13,667,479	109,952	3.23 %	13,240,580	114,085	3.42 %
Allowance for credit losses	(91,155)			(143,857)		
Interest-earning assets, net	13,576,324			13,096,723		
Noninterest-earning assets	933,480			968,430		
Total assets	\$ 14,509,804			\$ 14,065,153		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 7,614,093	\$ 7,286	0.38 %	\$ 7,589,397	\$ 8,014	0.42 %
Notes payable and other borrowings	287,335	1,209	1.69 %	130,157	397	1.22 %
Total interest-bearing liabilities	7,901,428	8,495	0.43 %	7,719,554	8,411	0.44 %
Noninterest-bearing liabilities						
Noninterest-bearing deposits	4,850,513			4,525,940		
Other liabilities	141,979			138,282		
Total liabilities	12,893,920			12,383,776		
Stockholders' equity	1,615,884			1,681,377		
Total liabilities and stockholders' equity	\$ 14,509,804			\$ 14,065,153		
Net interest income ⁽²⁾		\$ 101,457			\$ 105,674	
Net interest spread ⁽²⁾			2.80 %			2.98 %
Net interest margin ⁽²⁾			2.98 %			3.20 %
Six Months Ended June 30,						
	2022			2021		
	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate	Average Outstanding Balance	Interest Earned or Paid	Annualized Yield or Rate
Assets						
Interest-earning assets						
Loans held for investment, gross ⁽¹⁾	\$ 7,229,731	\$ 153,116	4.27 %	\$ 7,171,946	\$ 167,506	4.66 %
Subsidiary warehouse lines of credit	1,321,090	27,200	4.12 %	2,344,094	44,202	3.75 %
Investment securities - taxable	2,347,813	18,683	1.59 %	1,874,582	13,517	1.44 %
Investment securities - non-taxable ⁽²⁾	107,508	1,862	3.46 %	115,734	1,986	3.43 %
Federal funds sold and securities purchased under agreements to resell	141,111	485	0.69 %	399	—	0.07 %
Interest-bearing deposits in other financial institutions	2,698,431	6,412	0.48 %	1,452,810	727	0.10 %
Other	36,812	22	0.12 %	36,861	229	1.24 %
Interest-earning assets, gross ⁽²⁾	13,882,496	207,780	3.02 %	12,996,426	228,167	3.50 %
Allowance for credit losses	(91,481)			(146,455)		
Interest-earning assets, net	13,791,015			12,849,971		
Noninterest-earning assets	912,748			982,294		
Total assets	\$ 14,703,763			\$ 13,832,265		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 7,854,733	\$ 12,275	0.32 %	\$ 7,550,463	\$ 17,595	0.47 %
Notes payable and other borrowings	238,956	1,773	1.50 %	139,598	800	1.15 %
Total interest-bearing liabilities	8,093,689	14,048	0.35 %	7,690,061	18,395	0.48 %
Noninterest-bearing liabilities						
Noninterest-bearing deposits	4,826,177			4,302,949		
Other liabilities	127,952			163,294		
Total liabilities	13,047,818			12,156,304		
Stockholders' equity	1,655,945			1,675,961		
Total liabilities and stockholders' equity	\$ 14,703,763			\$ 13,832,265		
Net interest income ⁽²⁾		\$ 193,732			\$ 209,772	
Net interest spread ⁽²⁾			2.67 %			3.02 %
Net interest margin ⁽²⁾			2.81 %			3.25 %

(1) Average balance includes non-accrual loans.

(2) Presented on a taxable equivalent basis with annualized taxable equivalent adjustments based on the applicable corporate federal income tax rates of 21% for all the periods presented. The adjustment to interest income was \$0.2 million and \$0.2 million for the three months ended June 30, 2022 and 2021, respectively, and \$0.4 million and \$0.4 million for the six months ended June 30, 2022 and 2021, 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 following table summarizes the changes in the banking segment's net interest income for the periods indicated below, including the component changes in the volume of average interest-earning assets and interest-bearing liabilities and changes in the rates earned or paid on those items (in thousands).

	<u>Three Months Ended June 30,</u>			<u>Six Months Ended June 30,</u>		
	<u>2022 vs. 2021</u>			<u>2022 vs. 2021</u>		
	<u>Change Due To ⁽¹⁾</u>			<u>Change Due To ⁽¹⁾</u>		
	<u>Volume</u>	<u>Yield/Rate</u>	<u>Change</u>	<u>Volume</u>	<u>Yield/Rate</u>	<u>Change</u>
Interest income						
Loans held for investment, gross ⁽²⁾	\$ 1,652	\$ (5,334)	\$ (3,682)	\$ 1,335	\$ (15,725)	\$ (14,390)
Subsidiary warehouse lines of credit ⁽³⁾	(9,834)	2,025	(7,809)	(19,026)	2,024	(17,002)
Investment securities - taxable	1,447	1,150	2,597	3,384	1,782	5,166
Investment securities - non-taxable ⁽⁴⁾	(88)	16	(72)	(140)	16	(124)
Federal funds sold and securities purchased under agreements to resell	41	270	311	51	434	485
Interest-bearing deposits in other financial institutions	210	4,368	4,578	624	5,061	5,685
Other	—	(56)	(56)	—	(207)	(207)
Total interest income ⁽⁴⁾	<u>(6,572)</u>	<u>2,439</u>	<u>(4,133)</u>	<u>(13,772)</u>	<u>(6,615)</u>	<u>(20,387)</u>
Interest expense						
Deposits	\$ 26	\$ (754)	\$ (728)	\$ 709	\$ (6,029)	\$ (5,320)
Notes payable and other borrowings	479	333	812	569	404	973
Total interest expense	<u>505</u>	<u>(421)</u>	<u>84</u>	<u>1,278</u>	<u>(5,625)</u>	<u>(4,347)</u>
Net interest income ⁽⁴⁾	<u>\$ (7,077)</u>	<u>\$ 2,860</u>	<u>\$ (4,217)</u>	<u>\$ (15,050)</u>	<u>\$ (990)</u>	<u>\$ (16,040)</u>

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

(2) Changes in the yields earned on loans held for investment, gross included declines during the three and six months ended June 30, 2022, compared to the same periods in 2021, of \$4.1 million and \$10.0 million, respectively, in PPP loan-related fee income and \$3.0 million and \$5.4 million, respectively, in accretion of discount on loans. Accretion of discount on loans is expected to decrease in future periods as loans acquired in the Bank Transactions are repaid, refinanced or renewed.

(3) Subsidiary warehouse lines of credit extended to PrimeLending are eliminated from the consolidated financial statements.

(4) Annualized taxable equivalent.

With regard to the net interest income, the banking segment maintains an asset sensitive rate risk position, meaning 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. During a period of rising interest rates, being asset sensitive tends to result in an increase in net interest income.

Our portfolio includes loans that periodically reprice or mature prior to the end of an amortized term. The extent and timing of this impact on interest income 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. At June 30, 2022, approximately \$1 billion of our floating rate loans held for investment remained at or below their applicable rate floor, exclusive of our mortgage warehouse lending program, of which approximately half are not scheduled to reprice for more than one year. If interest rates rise further, yields on the portion of our loan portfolio that remain at applicable rate floors would rise more slowly than increases in market interest rates, unless such loans are refinanced or repaid. Competition for loan growth could also continue to put pressure on new loan origination rates. If interest rates were to fall, the impact on our interest income for certain variable-rate loans would be limited by these rate floors.

Additionally, within our banking segment, the composition of the deposit base and ultimate cost of funds on deposits and net interest income 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. Deposit products and pricing structures relative to the

market are regularly evaluated to maintain competitiveness over time. Consistent with our loan portfolio, rising interest rates may increase our cost of funds on deposit, and therefore, negatively impact net interest income.

To help mitigate net interest income spread compression between our assets and liabilities as the Federal Reserve increases interest rates, management continues to execute certain derivative trades, as either cash flow hedges or fair value hedges, that benefit the banking segment as interest rates rise. 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.

We will continue to monitor developments regarding the COVID-19 pandemic and measures implemented in response to the pandemic, market capitalization, overall economic conditions, effectiveness of vaccinations, the emergence of new variants, government stimulus, payment deferral programs and any other triggering events or circumstances that may indicate an impairment of goodwill or core deposit intangible assets in the future. See further discussion in the “Recent Developments” section above.

The banking segment retained approximately \$104.3 million and \$181.1 million during the three months ended June 30, 2022 and 2021, respectively, and \$213.0 million and \$339.8 million during the six months ended June 30, 2022 and 2021, 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. The determination of mortgage loan retention levels by the banking segment will be impacted by, among other things, an ongoing review of the prevailing mortgage rates, balance sheet positioning at Hilltop and the banking segment’s outlook for commercial loan growth.

The banking segment’s provision for (reversal of) credit losses has been subject to significant year-over-year and quarterly changes primarily attributable to the effects of changes in the economic outlook, macroeconomic forecast assumptions and resulting impact on reserves. Specifically, during the three and six months ended June 30, 2022, the banking segment’s increases in the allowance reflected a deteriorating U.S. economic outlook since the prior quarter, partially offset by decreases in specific reserves and positive risk rating grade migration. The net impact to the allowance of changes associated with collectively evaluated loans during the three and six months ended June 30, 2022 included a provision for credit losses of \$6.6 million and \$6.4 million, respectively, while individually evaluated loans included a reversal of credit losses of \$1.6 million and \$1.5 million, respectively. The changes in the allowance for credit losses during the three and six months ended June 30, 2022 were also impacted by net charge-offs of \$1.2 million and \$1.5 million, respectively. The banking segment’s reversals of credit losses during the three and six months ended June 30, 2021 of \$27.7 million and \$34.2 million, respectively, were primarily due to improvements in the macroeconomic forecast assumptions and positive risk rating grade migration, including a high concentration of credits within the restaurant and commercial real estate industry sectors. The net impact to the allowance of changes associated with individually evaluated loans during the three months ended June 30, 2021 was a reversal of credit losses of \$1.1 million, while the six months ended June 30, 2021 included a provision of credit losses of \$0.3 million. The changes in the allowance for credit losses during the three and six months ended June 30, 2021 were also impacted by net charge-offs of \$0.5 million and net recoveries of \$0.1 million, respectively. The changes in the allowance for credit losses during the noted periods also reflected other factors including, but not limited to, loan growth, loan mix and changes in risk grades and qualitative factors from the prior quarter. Refer to the discussion in the “Financial Condition – Allowance for Credit Losses on Loans” section that follows for more details regarding the significant assumptions and estimates involved in estimating credit losses.

The banking segment’s noninterest income increased during the three and six months ended June 30, 2022, compared to the same periods in 2021, primarily due to increased wealth management fee income as well as service charges on depositor accounts.

The banking segment’s noninterest expense increased during the six months ended June 30, 2022, compared to the same period in 2021, primarily due to increases in expenses associated with employees’ compensation and benefits and professional fees.

Broker-Dealer Segment

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

	Three Months Ended June 30,		Variance	Six Months Ended June 30,		Variance
	2022	2021	2022 vs 2021	2022	2021	2022 vs 2021
Net interest income:						
Wealth management:						
Securities lending	\$ 1,986	\$ 3,241	\$ (1,255)	\$ 3,331	\$ 6,727	\$ (3,396)
Clearing services	1,989	1,784	205	4,110	3,233	877
Structured finance	1,640	477	1,163	3,451	873	2,578
Fixed income services	5,500	4,185	1,315	10,613	8,313	2,300
Other	1,463	995	468	2,591	2,050	541
Total net interest income	12,578	10,682	1,896	24,096	21,196	2,900
Noninterest income:						
Securities commissions and fees by business line ⁽¹⁾ :						
Fixed income services	7,476	15,239	(7,763)	18,674	28,913	(10,239)
Wealth management:						
Retail	19,011	18,035	976	37,623	36,789	834
Clearing services	6,362	5,580	782	11,482	11,822	(340)
Structured finance	2,640	337	2,303	4,585	671	3,914
Other	1,009	843	166	1,959	1,887	72
Total	36,498	40,034	(3,536)	74,323	80,082	(5,759)
Investment and securities advisory fees and commissions by business line:						
Public finance services	21,554	23,187	(1,633)	40,150	40,650	(500)
Fixed income services	1,553	212	1,341	3,378	2,116	1,262
Wealth management:						
Retail	8,141	7,781	360	16,480	15,031	1,449
Clearing services	462	563	(101)	948	1,008	(60)
Structured finance	201	446	(245)	566	1,002	(436)
Other	91	79	12	185	156	29
Total	32,002	32,268	(266)	61,707	59,963	1,744
Other:						
Structured finance	15,757	10,248	5,509	16,391	34,799	(18,408)
Fixed income services	4,340	(1,089)	5,429	(2,618)	4,946	(7,564)
Other	(946)	2,002	(2,948)	(1,462)	2,296	(3,758)
Total	19,151	11,161	7,990	12,311	42,041	(29,730)
Total noninterest income	87,651	83,463	4,188	148,341	182,086	(33,745)
Net revenue ⁽²⁾	100,229	94,145	6,084	172,437	203,282	(30,845)
Noninterest expense:						
Variable compensation ⁽³⁾	37,471	34,409	3,062	64,096	71,820	(7,724)
Non-variable compensation and benefits	27,023	27,880	(857)	56,223	56,626	(403)
Segment operating costs ⁽⁴⁾	26,634	25,000	1,634	51,621	50,313	1,308
Total noninterest expense	91,128	87,289	3,839	171,940	178,759	(6,819)
Income before income taxes	\$ 9,101	\$ 6,856	\$ 2,245	\$ 497	\$ 24,523	\$ (24,026)

- (1) Securities commissions and fees includes income of \$1.7 million and \$1.7 million during the three months ended June 30, 2022 and 2021, respectively, and \$2.4 million and \$3.5 million during the six months ended June 30, 2022 and 2021, respectively, that is eliminated in consolidation.
- (2) Net revenue is defined as the sum of total net interest income and total noninterest income. We consider net revenue to be a key performance measure in the evaluation of the broker-dealer segment's financial position and operating performance as we believe it is the primary revenue performance measure used by investors and analysts. Net revenue provides for some level of comparability of trends across the financial services industry as it reflects both noninterest income, including investment and securities advisory fees and commissions, as well as net interest income. Internally, we assess the broker-dealer segment's performance on a revenue basis for comparability with our banking segment.
- (3) Variable compensation represents performance-based commissions and incentives.
- (4) Segment operating costs include provision for credit losses associated with the broker-dealer segment within other noninterest expenses.

The changes in net revenue and income before income taxes between the noted periods were primarily related to the combined impacts of the rising interest rate environment and market turbulence, which impacted period-over-period customer demand and volumes within our various business lines. Specifically, during the second quarter of 2022, the broker-dealer segment's structured finance business line experienced an increase in net revenues compared to the second quarter of 2021 despite lower production volumes and continued rate volatility. Though not to the levels of 2020, the business line has noted an improvement in the environment resulting in a net increase of \$5.5 million in other noninterest income. The decrease in net revenues in the broker-dealer segment's public finance business line was due to the unfavorable issuance trends both nationally and in Texas in the second quarter of 2022 compared to the second quarter of 2021. Net revenues in the broker-dealer segment's fixed income services and wealth management business lines were relatively flat when compared to the second quarter of 2021.

The changes in the broker-dealer segment's income before income taxes during the three and six months ended June 30, 2022 compared with the same periods in 2021, were primarily as a result of the following:

- decreases in the broker-dealer segment's structured finance business line's net revenues for the six months ended June 30, 2022 as a result of lower volumes and market turbulence in the first quarter of 2022, resulting in

decreases in the business line's other noninterest income. As noted above, the structured finance business line's net revenues increased for the three months ended June 30, 2022. Specifically, for the six months ended June 30, 2022, the decreases were due to lower mortgage originations, with mortgage loan lock volumes totaling \$1.8 billion during the six months ended June 30, 2022, a 52% decline compared with the same period in 2021. Additionally, the structured finance business line, particularly in the three months ended March 31, 2022, saw weaker demand from the buy-side for call-protected collateral given the expectation that interest rates would continue to rise. The environment improved modestly in the second quarter of 2022 despite a 62% decline in the mortgage loan lock volumes.

- decreases in the broker-dealer segment's fixed income services net revenues for the six months ended June 30, 2022 primarily resulted from declines within each trading division as a result of lower customer demand and a less favorable trading environment. Specifically, in the first quarter of 2022, all product areas experienced declines in customer demand and volumes as compared to the same period in 2021 given higher inflation and the expectation of higher interest rates. However, results for the second quarter of 2022 were relatively similar to the same period in 2021.
- decrease in compensation expense for the six months ended June 30, 2022, of which \$7.7 million was primarily due to the decreases in variable compensation associated with revenue declines in our structured finance and fixed income services business lines. Compensation expense for the three months ended June 30, 2022 increased \$2.2 million compared to the same period of 2021. This increase was primarily comprised of an increase of \$3.1 million in variable compensation associated with the increases in revenues within our structured finance business line, partially offset by a decline in non-variable compensation.

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. The broker-dealer segment is also exposed to interest rate risk through its structured finance business line, which is dependent on mortgage loan production that tends to be adversely impacted by increasing interest rates and may result in valuation-related adjustments.

In the broker-dealer segment, interest is earned from securities lending activities, interest charged on customer margin loan balances and interest earned on investment securities used to support sales, underwriting and other customer activities. The increases in net interest income during the three and six months ended June 30, 2022, compared with the same periods in 2021, were primarily due to the increases in net interest income from our structured finance and fixed income services business lines, partially offset by a decrease in net interest income from the securities lending division of our wealth management business line. With the 45-basis point decrease in the weighted average interest rate spread for the three months ended June 30, 2022 and 36-basis point decrease in the weighted average interest rate spread for the six months ended June 30, 2022, net interest earned within the broker-dealer segment's stock lending business decreased \$1.3 million and \$3.4 million for the three and six months ended June 30, 2022, respectively, when compared with the same periods in 2021.

Noninterest income increased during the three months ended June 30, 2022 and decreased during the six months ended June 30, 2022, compared with the same periods in 2021, primarily due to changes in securities commissions and fees as well as other noninterest income.

Securities commissions and fees decreased during the three and six months ended June 30, 2022, compared with the same periods in 2021, primarily due to the decrease in customer demand for fixed income services as previously discussed. In addition, securities commissions and fees during the three and six months ended June 30, 2022, compared with the same periods in 2021, were impacted by decreases of \$0.9 million and \$1.6 million, respectively, in commissions earned in insurance product sales transactions, decreases of \$0.4 million and \$0.9 million, respectively, in net clearing revenues due to the decrease in clearing fees, and decreases in commissions earned on sales transactions, in particular corporate bonds for both the three and six months ended June 30, 2022. These decreases were offset by

increases of \$3.1 million and \$2.0 million, respectively, in our money market and FDIC sweep revenues. As money market and FDIC sweep revenues are closely correlated to short term interest rates, we expect that any additional increases in short term interest rates will cause these revenues to rise.

Investment and securities advisory fees and commissions increased during the six months ended June 30, 2022, compared with the same period in 2021, primarily due to increases in fees earned from our competitive underwriting transactions and from improved wealth management advisory services fees.

The increase in other noninterest income during the three months ended June 30, 2022, compared with the same period in 2021, was primarily due to improved trading gains earned from our structured finance and fixed income business lines. The decrease in other noninterest income during the six months ended June 30, 2022, compared with the same period in 2021, was primarily due to decreases in trading gains earned from our structured finance business line's derivative activities given decreased volumes and interest rate volatility as previously discussed. These year-over-year decreases in other noninterest income were heightened by decreases within our fixed income services business line within our taxable and municipal securities trading portfolios as previously discussed. With the expected rise in interest rates through the end of 2022, we anticipate continued volatility and generally lower levels of other noninterest income related to our structured finance and fixed income services business lines.

The changes in noninterest expenses during the three and six months ended June 30, 2022, compared with the same periods in 2021, were primarily due to the impact of respective changes in variable compensation as previously noted.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Total compensation as a % of net revenue ⁽¹⁾	64.3 %	66.2 %	69.8 %	63.2 %
Pre-tax margin ⁽²⁾	9.1 %	7.3 %	0.3 %	12.1 %
FDIC insured program balances at the Bank (end of period)			\$ 758,485	\$ 721,472
Other FDIC insured program balances (end of period)			\$ 1,447,421	\$ 1,627,673
Customer funds on deposit, including short credits (end of period)			\$ 413,229	\$ 454,165
Public finance services:				
Number of issues	282	388	513	619
Aggregate amount of offerings	\$ 11,214,109	\$ 14,712,647	\$ 18,236,389	\$ 30,304,667
Structured finance:				
Lock production/TBA volume	\$ 677,488	\$ 1,784,094	\$ 1,787,396	\$ 3,717,308
Fixed income services:				
Total volumes	\$ 62,551,045	\$ 67,695,308	\$ 125,210,898	\$ 131,025,503
Net inventory (end of period)			\$ 457,205	\$ 549,385
Wealth management (Retail and Clearing services groups):				
Retail employee representatives (end of period)			93	107
Independent registered representatives (end of period)			173	187
Correspondents (end of period)			112	124
Correspondent receivables (end of period)			\$ 145,262	\$ 295,908
Customer margin balances (end of period)			\$ 317,508	\$ 332,414
Wealth management (Securities lending group):				
Interest-earning assets - stock borrowed (end of period)			\$ 1,013,025	\$ 1,336,847
Interest-bearing liabilities - stock loaned (end of period)			\$ 851,192	\$ 1,260,158

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

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

Mortgage Origination Segment

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

	Three Months Ended June 30,		Variance 2022 vs 2021	Six Months Ended June 30,		Variance 2022 vs 2021
	2022	2021		2022	2021	
Net interest income (expense)	\$ (1,291)	\$ (5,953)	\$ 4,662	\$ (3,127)	\$ (13,051)	\$ 9,924
Noninterest income	140,082	241,965	(101,883)	283,276	552,409	(269,133)
Noninterest expense	133,169	186,963	(53,794)	268,027	397,297	(129,270)
Income before income taxes	\$ 5,622	\$ 49,049	\$ (43,427)	\$ 12,122	\$ 142,061	\$ (129,939)

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

Recent trends, as well as typical historical patterns in loan origination volume from purchases of homes or from refinancings because of movements in mortgage interest rates, may not be indicative of future loan origination volumes. During 2022, certain events have adversely impacted origination volumes because of their effect on the economy, including inflation and rising interest rates, the negative residual impact of the COVID-19 pandemic, the Federal Reserve's recent actions and communications, and current geopolitical threats. These events have also adversely impacted the willingness and ability of the mortgage origination segment's customers to conduct mortgage transactions. Specifically, current home inventory shortages and affordability challenges, in addition to supply chain problems, are impacting customers' abilities to purchase homes. The increase in interest rates during the first six months of 2022, which has led to a sharp reduction in national refinancing volume and the reduction of willing and eligible home buyers, has resulted in competitive mortgage pricing pressure, leading to a decline in average loans sales margin. We expect that these trends will persist during the remainder of 2022 and will continue to have a negative impact on the mortgage origination segment's operating results. In addition, these trends could also alter the percentage mix of refinancing and purchase volumes relative to total loan origination volume compared to 2021.

Income before income taxes decreased 88.5% and 91.5% during the three and six months ended June 30, 2022, compared with the same periods in 2021. The decreases during both periods were primarily the result of a decrease in interest rate lock commitments ("IRLCs") related to a decrease in mortgage loan applications and a decrease in the average value of individual IRLCs. The impact of these trends was partially offset by a decrease in noninterest expense during both periods, and during the second quarter of 2022, also an increase in MSR net hedge gains and gains realized on fair value adjustments to the MSR asset.

Since March 2020, the CARES Act has provided borrowers the ability to request forbearance of residential mortgage loan payments. A significant increase in nationwide forbearance requests that began at that time resulted in the reduction of third-party mortgage servicers willing to purchase mortgage servicing rights. Due to this market dynamic, beginning in the second quarter of 2020, we increased the amount of retained servicing on mortgage loan sales, resulting in the retention of almost 90% of servicing on mortgage loan sales during the second and third quarters of 2020. Beginning in the fourth quarter of 2020, PrimeLending began to reduce the amount of servicing it retained as the willingness of third-party mortgage servicers to purchase mortgage servicing rights improved. However, amounts currently retained continue to exceed amounts retained prior to the second quarter of 2020. PrimeLending utilizes a third-party to manage its servicing portfolio. Therefore, we do not expect significant fluctuations in infrastructure costs to manage changes in PrimeLending's servicing portfolio if we experience a significant increase in the amount of retained servicing. However, PrimeLending may be at risk of third-party servicers increasing their pricing to address increased regulatory requirements surrounding servicers. PrimeLending's liquidity has not been, and we do not expect that it will be significantly impacted by forbearance requests resulting from the CARES Act. Government National Mortgage Association ("GNMA"), Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") may impose restrictions on loans the agencies will accept, including loans under a forbearance agreement, which could result in PrimeLending seeking non-agency investors or choosing to retain these loans.

During the three and six months ended June 30, 2022, and the six months ended June 30, 2021, mortgage interest rates increased, while during the three months ended June 30, 2021, mortgage interest rates remained relatively flat. Average

interest rates during the three and six months ended June 30, 2022, exceeded average interest rates during the same periods in 2021, and refinancing volume as a percentage of total origination volume decreased during the three and six months ended June 30, 2022, as compared to the same periods in 2021. Refinancing volume as a percentage of total origination volume during the three months ended June 30, 2022 decreased to 12.3% from 31.9% during the same period in 2021, while refinancing volume during the six months ended June 30, 2022, decreased to 19.5% from 42.7% during the same period in 2021. If current mortgage interest rates remain relatively unchanged during the remainder of 2022, we anticipate a lower percentage of refinancing volume relative to total loan origination volume during 2022, as compared to 2021. However, a higher refinance percentage could be driven by a slowing of purchase volume due to the negative impact on new and existing home sales resulting from existing home inventory shortages, affordability challenges, and supply chain problems related to new home construction, and/or an increase in all-cash buyers.

The mortgage origination segment primarily originates its mortgage loans through a retail channel, with limited lending through its affiliated business arrangements (“ABAs”). For the six months ended June 30, 2022, funded volume through ABAs was approximately 7% of the mortgage origination segment’s total loan volume. As of June 30, 2022, PrimeLending owned a greater than 50% membership interest in five ABAs. We expect total production within the ABA channel to increase slightly to approximately 10% of loan volume of the mortgage origination segment during the remainder of 2022.

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

	Three Months Ended June 30,					Six Months Ended June 30,				
	2022		2021		Variance 2022 vs 2021	2022		2021		Variance 2022 vs 2021
	Amount	% of Total	Amount	% of Total		Amount	% of Total	Amount	% of Total	
Mortgage Loan Originations - units	12,090		19,991		(7,901)	24,309		41,732		(17,423)
Mortgage Loan Originations - volume:										
Conventional	\$ 2,523,426	66.25	\$ 4,055,964	68.75	\$ (1,532,538)	\$ 5,036,525	66.50	\$ 8,538,727	70.66	\$ (3,502,202)
Government	705,741	18.53	873,453	14.80	(167,712)	1,349,055	17.81	1,676,625	13.88	(327,570)
Jumbo	362,810	9.52	731,798	12.40	(368,988)	750,652	9.91	1,439,341	11.91	(688,689)
Other	217,243	5.70	238,828	4.05	(21,585)	437,471	5.78	429,456	3.55	8,015
	<u>\$ 3,809,220</u>	<u>100.00</u>	<u>\$ 5,900,043</u>	<u>100.00</u>	<u>\$ (2,090,823)</u>	<u>\$ 7,573,703</u>	<u>100.00</u>	<u>\$ 12,084,149</u>	<u>100.00</u>	<u>\$ (4,510,446)</u>
Home purchases	\$ 3,342,103	87.74	\$ 4,018,922	68.12	\$ (676,819)	\$ 6,095,134	80.48	\$ 6,921,632	57.28	\$ (826,498)
Refinancings	467,117	12.26	1,881,121	31.88	(1,414,004)	1,478,569	19.52	5,162,517	42.72	(3,683,948)
	<u>\$ 3,809,220</u>	<u>100.00</u>	<u>\$ 5,900,043</u>	<u>100.00</u>	<u>\$ (2,090,823)</u>	<u>\$ 7,573,703</u>	<u>100.00</u>	<u>\$ 12,084,149</u>	<u>100.00</u>	<u>\$ (4,510,446)</u>
Texas	\$ 805,767	21.15	\$ 1,094,085	18.54	\$ (288,318)	\$ 1,594,803	21.06	\$ 2,170,977	17.97	\$ (576,174)
California	320,923	8.42	730,421	12.38	(409,498)	724,692	9.57	1,525,481	12.62	(800,789)
Florida	186,320	4.89	271,973	4.61	(85,653)	383,744	5.07	552,880	4.57	(169,136)
Arizona	167,930	4.41	266,816	4.52	(98,886)	357,335	4.72	557,251	4.61	(199,916)
South Carolina	179,894	4.72	264,222	4.48	(84,328)	342,816	4.52	525,440	4.35	(182,624)
Ohio	172,317	4.52	227,592	3.86	(55,275)	313,261	4.14	450,231	3.73	(136,970)
New York	151,409	3.97	166,857	2.83	(15,448)	293,162	3.87	335,454	2.78	(42,292)
Missouri	121,100	3.18	179,969	3.05	(58,869)	241,260	3.18	368,981	3.05	(127,721)
North Carolina	127,683	3.35	192,436	3.26	(64,753)	235,644	3.11	418,902	3.47	(183,258)
Washington	108,513	2.85	176,333	2.99	(67,820)	201,165	2.65	391,793	3.24	(190,628)
Georgia	93,957	2.47	146,204	2.48	(52,247)	196,810	2.60	301,116	2.49	(104,306)
Maryland	98,902	2.60	194,877	3.30	(95,975)	195,235	2.58	389,990	3.23	(194,755)
All other states	1,274,505	33.47	1,988,258	33.70	(713,753)	2,493,776	32.93	4,095,653	33.89	(1,601,877)
	<u>\$ 3,809,220</u>	<u>100.00</u>	<u>\$ 5,900,043</u>	<u>100.00</u>	<u>\$ (2,090,823)</u>	<u>\$ 7,573,703</u>	<u>100.00</u>	<u>\$ 12,084,149</u>	<u>100.00</u>	<u>\$ (4,510,446)</u>
Mortgage Loan Sales - volume:										
Third parties	\$ 3,768,589	97.31	\$ 5,343,169	96.72	\$ (1,574,580)	\$ 7,528,495	97.25	\$ 11,535,242	97.14	\$ (4,006,747)
Banking segment	104,346	2.69	181,057	3.28	(76,711)	213,036	2.75	339,821	2.86	(126,785)
	<u>\$ 3,872,935</u>	<u>100.00</u>	<u>\$ 5,524,226</u>	<u>100.00</u>	<u>\$ (1,651,291)</u>	<u>\$ 7,741,531</u>	<u>100.00</u>	<u>\$ 11,875,063</u>	<u>100.00</u>	<u>\$ (4,133,532)</u>

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

The mortgage origination segment’s total loan origination volume decreased 35.4% and 37.3% during the three and six months ended June 30, 2022, compared to the same periods in 2021, respectively, while income before income taxes decreased 88.5% and 91.5%, respectively, during those same periods. The decreases in income before income taxes

during the three and six months ended June 30, 2022, were primarily due to a decrease in net gains from sale of loans, partially offset by a decrease in variable compensation, and to a lesser extent, a decrease in non-variable compensation and benefits expense, segment operating costs, and net interest expense.

The information shown in the table below includes certain additional key performance indicators for the mortgage origination segment.

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Net gains from mortgage loan sales (basis points):				
Loans sold to third parties	260	376	291	388
Impact of loans retained by banking segment	(7)	(12)	(8)	(11)
As reported	253	364	283	377
Variable compensation as a percentage of total compensation	56.4 %	66.8 %	55.6 %	68.2 %
Mortgage servicing rights asset (\$000's) (end of period) ⁽¹⁾			\$ 121,688	\$ 124,497

(1) Reported on a consolidated basis and therefore does not include mortgage servicing rights assets related to loans serviced for the banking segment, which are eliminated in consolidation.

Net interest expense was comprised of interest incurred on warehouse lines of credit primarily held with the Bank, and related intercompany financing costs offset by interest income earned on loans held for sale. The year-over-year improvement in net interest expense between both the three and six months ended June 30, 2022 and 2021 reflected the effects of increased net yields on mortgage loans held for sale and a decrease in the average warehouse line balance between each of the periods compared.

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

	<u>Three Months Ended June 30,</u>		<u>Variance</u>	<u>Six Months Ended June 30,</u>		<u>Variance</u>
	<u>2022</u>	<u>2021</u>	<u>2022 vs 2021</u>	<u>2022</u>	<u>2021</u>	<u>2022 vs 2021</u>
Net gains from sale of loans	\$ 98,110	\$ 200,882	\$ (102,772)	\$ 218,934	\$ 447,470	\$ (228,536)
Mortgage loan origination fees and other related income	42,378	42,146	232	74,440	85,301	(10,861)
Other mortgage production income:						
Change in net fair value and related derivative activity:						
IRLCs and loans held for sale	(16,770)	(19,766)	2,996	(37,191)	(24,372)	(12,819)
Mortgage servicing rights asset	7,443	2,553	4,890	9,636	11,685	(2,049)
Servicing fees	8,921	16,150	(7,229)	17,457	32,325	(14,868)
Total noninterest income	\$ 140,082	\$ 241,965	\$ (101,883)	\$ 283,276	\$ 552,409	\$ (269,133)

The decrease in net gains from sale of loans during the three and six months ended June 30, 2022, compared with the same periods in 2021, was primarily the result of decreases of 29.9% and 34.8% in total loan sales volume during those periods, respectively, in addition to a decrease in average loan sales margin during both periods. Since PrimeLending sells substantially all mortgage loans it originates to various investors in the secondary market, the decrease in loan sales volume during the six months ended June 30, 2022, was consistent with the decrease in loan origination volume during the period. The decrease in average loan sales margins during the six months ended June 30, 2022 was primarily attributable to competitive pricing pressure resulting from home inventory shortages and a reduction in national refinancing volume.

The decrease in mortgage loan origination fees during the six months ended June 30, 2022, compared with the same period in 2021, was primarily the result of a decrease in loan origination volume, partially offset by an increase in average mortgage loan origination fees. Fluctuations in mortgage loan origination fees are not always aligned with fluctuations in loan origination volume since customers may opt to pay PrimeLending discount fees on their mortgage loans in exchange for a lower interest rate.

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 and may include loans sold to third parties and loans sold to and retained by the banking segment. For origination services provided, the mortgage origination segment was reimbursed direct origination costs associated with loans retained by the banking segment, 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. Loan volumes to be originated on behalf of and retained by the banking segment are evaluated each quarter. Loans sold to and retained by the banking segment during the second quarter of 2022 were relatively flat when compared to the first quarter of 2022. We anticipate quarterly sales for the remainder of 2022 will increase compared to

the first half of 2022 sales. Loan volumes to be originated on behalf of and retained by the banking segment are expected to 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.

Noninterest income included changes in the net fair value of the mortgage origination segment's IRLCs and loans held for sale and the related activity associated with forward commitments used by the mortgage origination segment to mitigate interest rate risk associated with its IRLCs and mortgage loans held for sale. The decrease in fair value of IRLCs and loans held for sale during the three and six months ended June 30, 2022, was the result of a decrease in the average value of individual IRLCs and loans held for sale, and to a lesser extent a decrease in the total volume of individual IRLCs and loans held for sale.

The mortgage origination segment sells substantially all mortgage loans it originates to various investors in the secondary market, historically with the majority servicing released. In addition, the mortgage origination segment originates loans on behalf of the Bank. The mortgage origination segment's determination of whether to retain or release servicing on mortgage loans it sells is impacted by, among other things, changes in mortgage interest rates, and refinancing and market activity. During the three and six months ended June 30, 2022, PrimeLending retained servicing on approximately 20% and 16%, respectively, of loans sold, compared with approximately 25% and 39% of loans sold during the same periods in 2021, respectively. A recent reduction in third-party mortgage servicers purchasing mortgage servicing rights, while modest, may result in PrimeLending increasing the rate of retained servicing on mortgage loans sold during the remainder of 2022 to as much as 50%. The mortgage origination segment may, from time to time, manage its MSR asset through different strategies, including varying the percentage of mortgage loans sold servicing released and opportunistically selling MSR assets. The mortgage origination segment has also retained servicing on certain loans sold to and retained by the banking segment. Gains and losses associated with such sales to the banking segment and the related MSR asset are eliminated in consolidation. The mortgage origination segment uses derivative financial instruments, including U.S. Treasury bond futures and options, to mitigate interest rate risk associated with its MSR asset. Changes in the net fair value of the MSR asset and the related derivatives associated with normal customer payments, changes in discount rates, prepayment speed assumptions and customer payoffs resulted in net gains (losses) as noted in the table above. During the three and six months ended June 30, 2022, the operating results of the mortgage origination segment were positively impacted by the noted increases of \$7.4 million and \$9.6 million, respectively, in the net fair value of the MSR asset. These increases in the net fair value of the MSR asset during the respective periods were primarily driven by changes in the prepayment and discount rates used as inputs to value the MSR asset to address the impact of increased mortgage rates reducing consumer refinancing activity and recent market trends related to MSR sales. On March 31, 2021 and June 30, 2021, the mortgage origination segment sold MSR assets of \$52.8 million, which represented \$4.9 billion of its serviced loan volume at the time, and \$31.9 million, which represented \$2.6 billion of its serviced loan volume at the time, respectively. There were no MSR assets sold during the six months ended June 30, 2022. On July 20, 2022, the mortgage origination segment had executed a letter of intent for a pending sale of MSR assets with a serviced loan volume totaling \$1.8 billion. The sale of these MSR assets is expected to be completed during the third quarter of 2022 at a total price of approximately \$38 million.

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

	Three Months Ended June 30,		Variance	Six Months Ended June 30,		Variance
	2022	2021	2022 vs 2021	2022	2021	2022 vs 2021
Variable compensation	\$ 56,525	\$ 97,081	\$ (40,556)	\$ 112,767	\$ 212,567	\$ (99,800)
Non-variable compensation and benefits	43,681	48,320	(4,639)	90,187	99,082	(8,895)
Segment operating costs	25,052	29,368	(4,316)	49,027	59,788	(10,761)
Lender paid closing costs	3,809	4,913	(1,104)	7,461	10,381	(2,920)
Servicing expense	4,102	7,281	(3,179)	8,585	15,479	(6,894)
Total noninterest expense	<u>\$ 133,169</u>	<u>\$ 186,963</u>	<u>\$ (53,794)</u>	<u>\$ 268,027</u>	<u>\$ 397,297</u>	<u>\$ (129,270)</u>

Total employees' compensation and benefits accounted for the majority of noninterest expenses incurred during all periods presented. Specifically, variable compensation comprised the majority of total employees' compensation and benefits expenses during the three and six months ended June 30, 2022 and 2021. Variable compensation, which is primarily driven by loan origination volume, tends to fluctuate to a greater degree than loan origination volume, because mortgage loan originator and fulfillment staff incentive compensation plans are structured to pay at increasing rates as higher monthly volume tiers are achieved. However, certain other incentive compensation plans driven by non-mortgage production criteria may alter this trend.

While total loan origination volume decreased 35.4% and 37.3%, during the three and six months ended June 30, 2022, respectively, compared to the same periods in 2021, the aggregate non-variable compensation and benefits of the

mortgage origination segment decreased by 9.6% and 9.0% during the same periods, respectively. This decrease during the three and six months ended June 30, 2022, compared to the same periods in 2021, was primarily due to a decrease in salaries associated with decreased underwriting and loan fulfillment and operations staff given the decrease in loan origination volume starting in the fourth quarter of 2021. PrimeLending is continuing to evaluate staffing levels. Segment operating costs decreased during the three and six months ended June 30, 2022, compared to the same periods in 2021, primarily due to a decrease in business development, professional fees, occupancy and loan related costs.

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

Between January 1, 2013 and June 30, 2022, the mortgage origination segment sold mortgage loans totaling \$146.6 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 2013, it does not anticipate experiencing significant losses in the future on loans originated prior to 2013 as a result of investor claims under these provisions of its sales contracts.

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

Following is a summary of the mortgage origination segment’s claims resolution activity relating to loans sold between January 1, 2013 and June 30, 2022 (dollars in thousands).

	Original Loan Balance		Loss Recognized	
	Amount	% of Loans Sold	Amount	% of Loans Sold
Claims resolved with no payment	\$ 211,668	0.14 %	\$ —	- %
Claims resolved because of a loan repurchase or payment to an investor for losses incurred ⁽¹⁾	227,639	0.16 %	12,030	0.01 %
	<u>\$ 439,307</u>	<u>0.30 %</u>	<u>\$ 12,030</u>	<u>0.01 %</u>

(1) Losses incurred include refunded purchased servicing rights.

For each loan the mortgage origination segment concludes its obligation to a claimant is both probable and reasonably estimable, the mortgage origination segment has established a specific claims indemnification liability reserve. An additional indemnification liability reserve has been established for probable agency, investor or other party losses that may have been incurred, but not yet reported to the mortgage origination segment based upon a reasonable estimate of such losses. In addition to other factors, the mortgage origination segment has considered that GNMA, 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 June 30, 2022 and December 31, 2021, the mortgage origination segment’s total indemnification liability reserve totaled \$23.8 million and \$27.4 million, respectively. The related provision for indemnification losses was \$0.8 million and \$2.5 million during the three months ended June 30, 2022 and 2021, respectively, and \$1.2 million and \$5.5 million during the six months ended June 30, 2022 and 2021, respectively.

Corporate

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

	<u>Three Months Ended June 30,</u>		<u>Variance</u>	<u>Six Months Ended June 30,</u>		<u>Variance</u>
	<u>2022</u>	<u>2021</u>	<u>2022 vs 2021</u>	<u>2022</u>	<u>2021</u>	<u>2022 vs 2021</u>
Net interest income (expense)	\$ (3,190)	\$ (4,687)	\$ 1,497	\$ (6,580)	\$ (9,379)	\$ 2,799
Noninterest income	2,080	6,877	(4,797)	3,846	7,383	(3,537)
Noninterest expense	17,561	12,072	5,489	30,354	21,660	8,694
Income (loss) before income taxes	<u>\$ (18,671)</u>	<u>\$ (9,882)</u>	<u>\$ (8,789)</u>	<u>\$ (33,088)</u>	<u>\$ (23,656)</u>	<u>\$ (9,432)</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. These merchant banking activities currently include investments within various industries, including power generation, consumer services, industrial equipment manufacturing and animal health, with an aggregate carrying value of approximately \$47 million at June 30, 2022.

As a holding company, Hilltop's primary investment objectives are to support capital deployment for organic growth and to preserve capital to be deployed through acquisitions, dividend payments and potential stock repurchases. Investment and interest income earned during the three and six months ended June 30, 2022 was primarily comprised of dividend income from merchant banking investment activities, in addition to interest income earned on intercompany notes.

Interest expense during each period included recurring quarterly interest expense of \$5.0 million incurred on our \$150.0 million aggregate principal amount of 5% senior notes due 2025 ("Senior Notes") and on our \$200 million aggregate principal amount of Subordinated Notes (defined hereafter). Additionally, during the three and six months ended June 30, 2021, we incurred interest expense of \$0.5 million and \$1.1 million, respectively, on junior subordinated debentures of \$67.0 million issued by PCC (the "Debentures"). As discussed in more detail within the section titled "Liquidity and Capital Resources — Junior Subordinated Debentures" below, during the third quarter of 2021, PCC fully redeemed all outstanding Debentures.

Noninterest income during each period included activity related to our investment in a real estate development in Dallas' University Park, which also serves as headquarters for both Hilltop and the Bank, and net noninterest income associated with activity within our merchant bank subsidiary.

Noninterest expenses were primarily comprised of employees' compensation and benefits, occupancy expenses and professional fees, including corporate governance, legal and transaction costs. Noninterest expenses increased during the three and six months ended June 30, 2022, compared to the same periods in 2021, primarily due to increases in expenses associated with employees' compensation and benefits related to both headcount increases and inflationary pressures, as well as professional fees, which included \$4.4 million related to the recently completed tender offer in May 2022.

Financial Condition

The following discussion contains a more detailed analysis of our financial condition at June 30, 2022, as compared with December 31, 2021.

Securities Portfolio

At June 30, 2022, investment securities consisted of securities of the U.S. Treasury, U.S. government and its agencies, obligations of municipalities and other political subdivisions, primarily in the State of Texas, as well as mortgage-backed, corporate debt, and equity securities. We may categorize investments as trading, available for sale, held to maturity and equity securities.

Trading securities are bought and held principally for the purpose of selling them in the near term and are carried at fair value, marked to market through operations and held at the Bank and the Hilltop Broker-Dealers. Securities classified as available for sale may, from time to time, be bought and sold in response to changes in market interest rates, changes in securities' prepayment risk, increases in loan demand, general liquidity needs and to take advantage of market conditions that create more economically attractive returns. Such securities are carried at estimated fair value, with unrealized gains and

losses recorded in accumulated other comprehensive income (loss). Equity investments are carried at fair value, with all changes in fair value recognized in net income. Securities are classified as held to maturity based on the intent and ability of our management, at the time of purchase, to hold such securities to maturity. These securities are carried at amortized cost.

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

	June 30, 2022	December 31, 2021
Trading securities, at fair value		
U.S. Treasury securities	\$ 3,689	\$ 3,728
U.S. government agencies:		
Bonds	17,303	3,410
Residential mortgage-backed securities	133,290	152,093
Collateralized mortgage obligations	124,997	126,389
Corporate debt securities	64,543	60,671
States and political subdivisions	226,986	285,376
Private-label securitized product	16,529	11,377
Other	5,936	4,954
	<u>593,273</u>	<u>647,998</u>
Securities available for sale, at fair value		
U.S. Treasury securities	24,337	14,862
U.S. government agencies:		
Bonds	77,322	44,133
Residential mortgage-backed securities	453,938	898,446
Commercial mortgage-backed securities	166,016	210,699
Collateralized mortgage obligations	802,523	916,866
States and political subdivisions	38,086	45,562
	<u>1,562,222</u>	<u>2,130,568</u>
Securities held to maturity, at amortized cost		
U.S. government agencies:		
Residential mortgage-backed securities	315,666	9,892
Commercial mortgage-backed securities	196,733	145,742
Collateralized mortgage obligations	336,313	43,990
States and political subdivisions	71,871	68,060
	<u>920,583</u>	<u>267,684</u>
Equity securities, at fair value	<u>197</u>	<u>250</u>
Total securities portfolio	<u>\$ 3,076,275</u>	<u>\$ 3,046,500</u>

We had net unrealized losses of \$105.6 million and \$18.1 million at June 30, 2022 and December 31, 2021, respectively, related to the available for sale investment portfolio, and net unrealized losses of \$44.1 million at June 30, 2022, compared with net unrealized gains of \$8.6 million associated with the securities held to maturity portfolio at December 31, 2021. Equity securities included net unrealized gains of \$0.1 million and \$0.2 million at June 30, 2022 and December 31, 2021, respectively. The noted significant change in net unrealized gains (losses) within our available for sale investment portfolio, and recorded in accumulated other comprehensive income (loss), from December 31, 2021 to June 30, 2022 was related to increases in market interest rates since purchase and the resulting decline in associated estimated fair values of such portfolio investments. In future periods, we expect changes in prevailing market interest rates, coupled with changes in the aggregate size of the investment portfolio, to be significant drivers of changes in the unrealized losses or gains in these portfolios, and therefore accumulated other comprehensive income (loss).

We transferred certain agency-issued securities from the available-for-sale to held-to-maturity portfolio on March 31, 2022 having a book value of approximately \$782 million and a market value of approximately \$708 million. As of the date of transfer, the related pre-tax net unrecognized losses of approximately \$74 million within the accumulated other comprehensive loss balance are being amortized over the remaining term of the securities using the effective interest method. This transfer was completed after careful consideration of our intent and ability to hold these securities to maturity. Factors used in assessing the ability to hold these securities to maturity were future liquidity needs and sources of funding.

Banking Segment

The banking segment's securities portfolio plays a role in the management of our interest rate sensitivity and generates additional interest income. In addition, the securities portfolio is used to meet collateral requirements for public and trust

deposits, securities sold under agreements to repurchase and other purposes. The available for sale and equity securities portfolios serve as a source of liquidity. Historically, the Bank's policy has been to invest primarily in securities of the U.S. government and its agencies, obligations of municipalities in the State of Texas and other high grade fixed income securities to minimize credit risk. At June 30, 2022, the banking segment's securities portfolio of \$2.5 billion was comprised of trading securities of \$0.1 million, available for sale securities of \$1.6 billion, equity securities of \$0.2 million and held to maturity securities of \$920.6 million, in addition to \$13.9 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 \$593.2 million at June 30, 2022. 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 \$136.0 million at June 30, 2022.

Corporate

At June 30, 2022, the corporate portfolio included other investments, including those associated with merchant banking, of \$40.0 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 June 30, 2022. In addition, as of June 30, 2022, we had evaluated our held to maturity debt securities, considering the current credit ratings and recognized losses, and determined the potential credit loss to be minimal. With respect to these securities, we considered the risk of credit loss to be negligible, and therefore, no allowance was recognized on the debt securities portfolio at June 30, 2022.

Loan Portfolio

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

	June 30, 2022	December 31, 2021
Commercial real estate	\$ 3,262,628	\$ 3,042,729
Commercial and industrial	1,786,116	1,875,420
Construction and land development	922,047	892,783
1-4 family residential	1,468,962	1,303,430
Consumer	27,862	32,349
Broker-dealer	463,004	733,193
Loans held for investment, gross	7,930,619	7,879,904
Allowance for credit losses	(95,298)	(91,352)
Loans held for investment, net of allowance	<u>\$ 7,835,321</u>	<u>\$ 7,788,552</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 \$8.7 billion and \$8.8 billion at June 30, 2022 and December 31, 2021, respectively. The banking segment's loan portfolio includes warehouse lines of credit extended to PrimeLending of \$2.7 billion, of which \$1.3 billion and \$1.7 billion was drawn at June 30,

2022 and December 31, 2021, 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 approximately \$7 million related to both initial and second round PPP loans at June 30, 2022. While these loans have terms of up to 60 months, borrowers can apply for forgiveness of these loans with the SBA. Through July 15, 2022, the SBA had approved approximately 4,100 PPP forgiveness applications from the Bank totaling approximately \$893 million, with PPP loans of approximately \$2 million pending SBA review and approval. We anticipate a significant amount of these remaining PPP loans pending approval being forgiven during the next quarter. The forgiveness/payoff of the PPP loans would generate an increase in interest income as we would recognize the remaining unamortized origination fee at the time of payoff or forgiveness.

At June 30, 2022, the banking segment had loan concentrations (loans to borrowers engaged in similar activities) that exceeded 10% of total loans in its real estate portfolio. The areas of concentration within our real estate portfolio were non-construction commercial real estate loans, non-construction residential real estate loans, and construction and land development loans, which represented 43.7%, 19.7% and 12.3%, respectively, of the banking segment's total loans held investment at June 30, 2022. The banking segment's loan concentrations were within regulatory guidelines at June 30, 2022.

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

	June 30, 2022				Total
	Due Within One Year	Due From One To Five Years	Due from Five To Fifteen Years	Due After Fifteen Years	
Commercial real estate	\$ 704,910	\$ 1,337,864	\$ 1,096,057	\$ 123,797	\$ 3,262,628
Commercial and industrial	2,634,567	295,469	178,132	—	3,108,168
Construction and land development	685,100	159,356	73,520	4,071	922,047
1-4 family residential	153,059	175,715	290,143	850,045	1,468,962
Consumer	14,052	13,559	232	19	27,862
Total	<u>\$ 4,191,688</u>	<u>\$ 1,981,963</u>	<u>\$ 1,638,084</u>	<u>\$ 977,932</u>	<u>\$ 8,789,667</u>
Fixed rate loans	\$ 2,251,502	\$ 1,749,831	\$ 1,549,344	\$ 977,932	\$ 6,528,609
Floating rate loans	1,940,186	232,132	88,740	—	2,261,058
Total	<u>\$ 4,191,688</u>	<u>\$ 1,981,963</u>	<u>\$ 1,638,084</u>	<u>\$ 977,932</u>	<u>\$ 8,789,667</u>

In the table above, commercial and industrial includes amounts advanced against the warehouse lines of credit extended to PrimeLending. 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 June 30, 2022, floating rate loans totaling \$786 million had reached their applicable rate floor and were expected to reprice, subject to their scheduled repricing timing and frequency terms. An additional \$175 million of floating rate loans would be adjustable if published rates increase by a sufficient amount to move past their floored levels. 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 margin loans to customers and correspondents that are due within one year. The interest rate on margin accounts is computed on the settled margin balance at a fixed rate established by management. 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 \$462.4 million and \$733.0 million at June 30, 2022 and December 31, 2021, respectively. This decrease from December 31, 2021 to June 30, 2022 was primarily attributable to a decrease of \$160.8 million, or 53%, in receivables from correspondents, and a decrease of \$109.1 million, or 26%, in customer margin accounts.

Mortgage Origination Segment

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

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Loans held for sale:		
Unpaid principal balance	\$ 1,354,041	\$ 1,728,255
Fair value adjustment	18,342	54,336
	<u>\$ 1,372,383</u>	<u>\$ 1,782,591</u>
IRLCs:		
Unpaid principal balance	\$ 1,404,328	\$ 1,283,152
Fair value adjustment	15,061	25,489
	<u>\$ 1,419,389</u>	<u>\$ 1,308,641</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 June 30, 2022 and December 31, 2021 were \$2.3 billion and \$2.4 billion, while the related estimated fair values were (\$2.4) million and \$0.4 million, respectively.

Allowance for Credit Losses on Loans

For additional information regarding the allowance for credit losses, refer to the section captioned "Critical Accounting Estimates" set forth in Part II, Item 7 of our 2021 Form 10-K.

Loans Held for Investment

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

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

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

The allowance for credit losses for loans held for investment represents management's best estimate of all expected credit losses over the expected contractual life of our existing portfolio. Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Subsequent evaluations of the then-existing loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for credit losses in those future periods. Such future changes in the allowance for credit losses

are expected to be volatile given dependence upon, among other things, the portfolio composition and quality, as well as the impact of significant drivers, including prepayment assumptions and macroeconomic conditions and forecasts.

The COVID-19 pandemic has adversely impacted financial markets and overall economic conditions, and may continue to have implications on borrowers across our lending portfolios. Significant judgment is required to estimate the severity and duration of the current economic uncertainties, as well as its potential impact on borrower defaults and loss severity. In particular, macroeconomic conditions and forecasts are rapidly changing and remain highly uncertain.

One of the most significant judgments involved in estimating our allowance for credit losses relates to the macroeconomic forecasts used to estimate credit losses over the reasonable and supportable forecast period. To determine the allowance for credit losses as of June 30, 2022, we utilized a single macroeconomic alternative scenario, or S7, published by Moody's Analytics in June 2022.

During our previous quarterly macroeconomic assessment as of March 31, 2022, we also utilized the S7 economic scenario based on our evaluation of the Moody's baseline economic forecast compared to other industry surveys over the reasonable and supportable period and our assessment of the reasonableness of impacts associated with key monetary and fiscal policy assumptions.

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

	As of				
	June 30, 2022	March 31, 2022	December 31, 2021	September 30, 2021	June 30, 2021
GDP growth rates:					
Q2 2021					10.8%
Q3 2021				5.0%	6.6%
Q4 2021			6.7%	7.5%	6.9%
Q1 2022		0.7%	3.6%	4.6%	5.4%
Q2 2022	2.6%	4.7%	3.5%	2.8%	2.8%
Q3 2022	2.0%	2.4%	2.3%	1.3%	2.3%
Q4 2022	0.6%	2.6%	2.7%	1.5%	1.8%
Q1 2023	0.9%	2.9%	3.0%	2.4%	
Q2 2023	1.0%	3.0%	2.4%		
Q3 2023	(1.0)%	3.1%			
Q4 2023	(3.0)%				
Unemployment rates:					
Q2 2021					5.8%
Q3 2021				5.2%	5.2%
Q4 2021			4.3%	4.5%	4.5%
Q1 2022		3.9%	4.3%	3.9%	4.0%
Q2 2022	3.6%	3.7%	4.0%	3.5%	3.7%
Q3 2022	3.5%	3.5%	3.8%	3.4%	3.6%
Q4 2022	3.6%	3.4%	3.6%	3.3%	3.5%
Q1 2023	3.6%	3.4%	3.7%	3.3%	
Q2 2023	3.6%	3.3%	3.7%		
Q3 2023	5.0%	3.2%			
Q4 2023	6.4%				

As of June 30, 2022, our economic forecast was revised lower since March 31, 2022. Real GDP growth decreased at an annualized rate of 1.6% during the first quarter of 2022. Moody's also no longer expects any additional fiscal stimulus from the Build Back Better proposal in its most recent economic forecasts. Both of these reduced real GDP growth expectations during 2022 and the Federal Reserve increased the federal funds rate target to 1.5% to 1.75% during the period. Unemployment rates remained unchanged at 3.6% since March 2022 despite recent news of several layoffs and tight labor market and supply chain conditions. We now expect a mild recession to occur during the second half of 2023 as the Federal Reserve is expected to increase the federal funds rate to 3.5% by the third quarter of 2023 where the unemployment rate is also expected to increase.

As of December 31, 2021, our economic forecast improved from September 30, 2021 based on updated economic data, including November unemployment rates improving faster than the prior quarter's forecast despite tight labor market

conditions and accelerated rates of the Federal Reserve’s taper of monthly asset purchases. We now assume the Federal Reserve continues to support a target range of the federal funds rate near 0% through monetary policy support and assume interest rates begin to rise as early as the second quarter of 2022. Real GDP growth rates were revised lower due to persistently higher inflation data and observed supply-chain impacts on business and consumer spending due to the delta variant. Given the timing of the Moody’s economic forecast release in early December 2021, the forecast utilized also assumed that COVID-19 cases peaked in January 2021, but did not assume a third wave of COVID-19 cases due to the omicron variant into the winter months. The forecast also did not consider uncertainty related to additional fiscal support from the Build Back Better proposal, so our model results were qualitatively adjusted to consider these recent developments as of December 31, 2021.

During the three and six months ended June 30, 2022, the increase in the allowance reflected a deteriorating U.S. economic outlook since the prior quarter, partially offset by decreases in specific reserves and positive risk rating grade migration. The net impact to the allowance of changes associated with individually evaluated loans during the three and six months ended June 30, 2022 included a reversal of credit losses of \$1.3 million and \$1.0 million, respectively, while collectively evaluated loans included a provision for credit losses of \$6.6 million and \$6.4 million, respectively. The changes in the allowance for credit losses during the noted periods were primarily attributable to the Bank and also reflected other factors including, but not limited to, loan mix, changes in loan balances and qualitative factors from the prior quarter. The changes in the allowance during the three and six months ended June 30, 2022 were also impacted by net charge-offs of \$1.2 million and \$1.5 million, respectively.

As discussed under the section titled “Loan Portfolio” earlier in this Item 2, the Bank’s actions beginning in 2020 included supporting our impacted banking clients experiencing an increased level of risk due to the COVID-19 pandemic through loan modifications. This deteriorating economic outlook resulted in a significant build in the allowance and included provision for credit losses through the second quarter of 2020. During 2021, improvement in both economic results and the macroeconomic outlook, coupled with government stimulus and positive risk rating grade migration within the Bank, resulted in aggregate reversals of a significant portion of previously recorded credit losses. During the first half of 2022, the impact of a deteriorating U.S. economic outlook and resulting impact on collectively evaluated loans has resulted in a build in the allowance. As a result, the 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, was 1.33% as of June 30, 2022, down from a high since the initial impacts of the COVID-19 pandemic of 2.63% as of September 30, 2020.

The respective distribution of the 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, are presented in the following table (dollars in thousands).

<u>June 30, 2022</u>	<u>Total Loans Held For Investment</u>	<u>Total Allowance for Credit Losses</u>	<u>Allowance For Credit Losses as a % of Total Loans Held For Investment</u>
Commercial real estate	\$ 3,262,628	\$ 63,719	1.95 %
Commercial and industrial ⁽¹⁾	1,434,438	19,664	1.37 %
Construction and land development	922,047	4,996	0.54 %
1-4 family residential	1,468,962	5,554	0.38 %
Consumer	<u>27,862</u>	<u>542</u>	1.95 %
	7,115,937	94,475	1.33 %
Broker-dealer	463,004	651	0.14 %
Mortgage warehouse lending	344,662	172	0.05 %
Paycheck Protection Program	7,016	—	— %
	<u>\$ 7,930,619</u>	<u>\$ 95,298</u>	1.20 %

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

Allowance Model Sensitivity

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

However, to consider the sensitivity of credit loss estimates to alternative macroeconomic forecasts, we compared the Company's allowance for credit loss estimates as of June 30, 2022, excluding margin loans in the broker-dealer segment, the banking segment mortgage warehouse and PPP lending programs, with modeled results using both upside ("S1") and downside ("S3") economic scenario forecasts published by Moody's Analytics.

Compared to our economic forecast, the upside scenario assumes consumer and business confidence increases as new cases, hospitalizations and deaths from COVID-19, military conflicts between Russia and Ukraine, and global supply chain concerns recede faster than expected. Real GDP is expected to grow 6.7% in the third quarter of 2022, 5.4% in the fourth quarter of 2022, 5.3% in the first quarter of 2023, and 5.4% in the second quarter of 2023. Average unemployment rates are expected to decline to 3.2% by the third quarter of 2022 and 2.9% by the end of 2023. Inflation is expected to trend back toward the Federal Reserve's target sooner than expected and monetary policy increases the federal funds rate at a slower pace to 2.7% by late 2023.

Compared to our economic forecast, the downside scenario assumes consumer and business confidence declines as new cases, hospitalizations and deaths from COVID-19 rise, military conflict between Russia and Ukraine worsens significantly and persists longer than anticipated, and global supply chain issues intensify increasing inflation rates substantially. As a result, consumer confidence and spending erode causing the economy to fall back into recession. Real GDP is expected to decrease 1.0% in the third quarter of 2022, 6.1% in the fourth quarter of 2022, and 1.8% in the first quarter of 2023. Average unemployment rates are expected to increase to 6.4% by the fourth quarter of 2022 and 7.9% by the third quarter of 2023, but improves to 5.8% by year-end 2024 and reverts back to historical average rates over time. The Federal Reserve increases the federal funds rate to 2.9% by the first quarter of 2023 to slow inflation, but proceeds to reduce it to a near 0% target by the fourth quarter of 2024 where it is maintained until late 2025 to support the economy. Disagreements in Congress prevent any additional stimulus from being enacted beyond the American Rescue Plan and Infrastructure Investment and Jobs Acts passed in 2021.

The impact of applying all of the assumptions of the upside economic scenario during the reasonable and supportable forecast period would have resulted in a decrease in the allowance for credit losses of approximately \$27 million or a weighted average expected loss rate of 0.9% 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 \$15 million or a weighted average expected loss rate of 1.5% as a percentage of our total loan portfolio, excluding margin loans in the broker-dealer segment and the banking segment mortgage warehouse lending and PPP lending programs.

This analysis relates only to the modeled credit loss estimates and is not intended to estimate changes in the overall allowance for credit losses as they do not reflect any potential changes in the adjustment to the quantitative calculation, which would also be influenced by the judgment management applies to the modeled lifetime loss estimates to reflect the uncertainty and imprecision of these modeled lifetime loss estimates based on then-current circumstances and conditions.

Our allowance for credit losses reflects our best estimate of current expected credit losses, which is highly dependent on several assumptions, including the COVID-19 pandemic continuing to recede, the Russia-Ukraine conflict and its impact on supply chains, inflation and labor market conditions. Future allowance for credit losses may vary considerably for these reasons.

Allowance Activity

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

Loans Held for Investment	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Balance, beginning of period	\$ 91,185	\$ 144,499	\$ 91,352	\$ 149,044
Provision for (reversal of) credit losses	5,336	(28,720)	5,451	(33,829)
Recoveries of loans previously charged off:				
Commercial real estate	11	220	43	234
Commercial and industrial	727	701	1,634	1,134
Construction and land development	—	—	—	—
1-4 family residential	35	53	48	462
Consumer	28	69	131	145
Broker-dealer	—	—	—	—
Total recoveries	<u>801</u>	<u>1,043</u>	<u>1,856</u>	<u>1,975</u>
Loans charged off:				
Commercial real estate	—	186	—	186
Commercial and industrial	1,892	1,242	3,101	1,421
Construction and land development	—	—	—	—
1-4 family residential	33	51	48	161
Consumer	99	74	212	153
Broker-dealer	—	—	—	—
Total charge-offs	<u>2,024</u>	<u>1,553</u>	<u>3,361</u>	<u>1,921</u>
Net recoveries (charge-offs)	<u>(1,223)</u>	<u>(510)</u>	<u>(1,505)</u>	<u>54</u>
Balance, end of period	<u>\$ 95,298</u>	<u>\$ 115,269</u>	<u>\$ 95,298</u>	<u>\$ 115,269</u>
Average total loans for the period	<u>\$7,838,090</u>	<u>\$ 7,725,906</u>	<u>\$7,838,566</u>	<u>\$7,686,116</u>
Total loans held for investment (end of period)			<u>\$7,930,619</u>	<u>\$7,645,227</u>
Ratios:				
Net recoveries (charge-offs) to average total loans held for investment ⁽¹⁾	<u>(0.06)%</u>	<u>(0.03)%</u>	<u>(0.04)%</u>	<u>0.00 %</u>
Non-accrual loans to total loans held for investment (end of period)			<u>0.40 %</u>	<u>0.81 %</u>
Allowance for credit losses on loans held for investment to:				
Total loans held for investment (end of period)			<u>1.20 %</u>	<u>1.51 %</u>
Non-accrual loans held for investment (end of period)			<u>301.16 %</u>	<u>186.91 %</u>

(1) Net recoveries (charge-offs) to average total loans held for investment ratio presented on a consolidated basis for all periods given relative immateriality of resulting measure by loan portfolio segment.

Total non-accrual loans decreased by \$15.4 million from December 31, 2021 to June 30, 2022. These changes in non-accrual loans were impacted by loans secured by residential real estate within our mortgage origination segment, which were classified as loans held for sale, of \$3.2 million and \$2.9 million at June 30, 2022 and December 31, 2021, respectively.

In addition to changes in non-accrual loans classified as loans held for sale, the decrease in non-accrual loans during 2022 was primarily due to principal paydowns associated with several commercial and industrial and single family residential loan relationships.

As previously discussed in detail within this section, the allowance for credit losses has fluctuated from period to period, which impacted the resulting ratios noted in the table above.

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

<u>Allocation of the Allowance for Credit Losses</u>	<u>June 30, 2022</u>		<u>December 31, 2021</u>	
	<u>Reserve</u>	<u>% of Gross Loans</u>	<u>Reserve</u>	<u>% of Gross Loans</u>
Commercial real estate	\$ 63,719	41.14 %	\$ 59,354	38.61 %
Commercial and industrial	19,836	22.52 %	21,982	23.80 %
Construction and land development	4,996	11.63 %	4,674	11.33 %
1-4 family residential	5,554	18.52 %	4,589	16.54 %
Consumer	542	0.35 %	578	0.41 %
Broker-dealer	651	5.84 %	175	9.31 %
Total	<u>\$ 95,298</u>	<u>100.00 %</u>	<u>\$ 91,352</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).

	<u>June 30, 2022</u>	<u>March 31, 2022</u>	<u>December 31, 2021</u>	<u>September 31, 2021</u>	<u>June 30, 2021</u>
Commercial real estate	\$ 63,719	\$ 60,361	\$ 59,354	\$ 68,535	\$ 77,633
Commercial and industrial	19,836	20,130	21,982	30,545	27,866
Construction and land development	4,996	5,515	4,674	5,100	5,185
1-4 family residential	5,554	4,340	4,589	4,538	3,659
Consumer	542	499	578	504	592
Broker-dealer	651	340	175	290	334
	<u>\$ 95,298</u>	<u>\$ 91,185</u>	<u>\$ 91,352</u>	<u>\$ 109,512</u>	<u>\$ 115,269</u>

Unfunded Loan Commitments

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

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Balance, beginning of period	\$ 6,487	\$ 8,807	\$ 5,880	\$ 8,388
Other noninterest expense	444	(826)	1,051	(407)
Balance, end of period	<u>\$ 6,931</u>	<u>\$ 7,981</u>	<u>\$ 6,931</u>	<u>\$ 7,981</u>

During the three and six months ended June 30, 2022 the increases in the reserve for unfunded commitments were primarily due to increases in both loan expected loss rates and available commitment balances.

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 deferment programs which allow for a deferral of principal and/or interest payments. Within our loan portfolio, we had one credit relationship totaling \$0.1 million of potential problem loans at June 30, 2022, compared with two credit relationships totaling \$3.1 million of potential problem loans at December 31, 2021.

Non-Performing Assets

In response to the COVID-19 pandemic, the CARES Act was passed in March 2020, which among other things, allowed the Bank to suspend the TDR requirements for certain loan modifications to be categorized as a TDR. Subsequent legislation extended such provisions through January 1, 2022. Starting in March 2020, the Bank implemented several actions to better support our impacted banking clients and allow for loan modifications such as principal and/or interest payment deferrals, participation in the PPP as an SBA preferred lender and personal banking assistance including waived fees, increased daily spending limits and suspension of residential foreclosure activities. The COVID-19 payment deferment programs allowed 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 following table presents components of our non-performing assets (dollars in thousands).

	<u>June 30, 2022</u>	<u>December 31, 2021</u>	<u>Variance</u>
Loans accounted for on a non-accrual basis:			
Commercial real estate	\$ 4,947	\$ 6,601	\$ (1,654)
Commercial and industrial	13,315	22,478	(9,163)
Construction and land development	1	2	(1)
1-4 family residential	16,542	21,123	(4,581)
Consumer	19	23	(4)
Broker-dealer	—	—	—
	<u>\$ 34,824</u>	<u>\$ 50,227</u>	<u>\$ (15,403)</u>
Troubled debt restructurings included in accruing loans held for investment	857	922	(65)
Non-performing loans	<u>\$ 35,681</u>	<u>\$ 51,149</u>	<u>\$ (15,468)</u>
Non-performing loans as a percentage of total loans	<u>0.38 %</u>	<u>0.52 %</u>	<u>(0.14)%</u>
Other real estate owned	<u>\$ 1,516</u>	<u>\$ 2,833</u>	<u>\$ (1,317)</u>
Other repossessed assets	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Non-performing assets	<u>\$ 37,197</u>	<u>\$ 53,982</u>	<u>\$ (16,785)</u>
Non-performing assets as a percentage of total assets	<u>0.22 %</u>	<u>0.29 %</u>	<u>(0.07)%</u>
Loans past due 90 days or more and still accruing	<u>\$ 82,410</u>	<u>\$ 60,775</u>	<u>\$ 21,635</u>

At June 30, 2022, non-accrual loans included 39 commercial and industrial relationships with loans secured by accounts receivable, equipment and notes receivable. Non-accrual loans at June 30, 2022 also included \$3.2 million of loans secured by residential real estate which were classified as loans held for sale. At December 31, 2021, non-accrual loans included 45 commercial and industrial relationships with loans secured by accounts receivable, life insurance, oil and gas, livestock and equipment. Non-accrual loans at December 31, 2021 also included \$2.9 million of loans secured by residential real estate which were classified as loans held for sale.

At June 30, 2022, TDRs were comprised of \$0.9 million of loans that are considered to be performing and accruing, and \$7.6 million of loans considered to be non-performing reported in non-accrual loans. At December 31, 2021, TDRs were comprised of \$0.9 million of loans that are considered to be performing and accruing, and \$5.9 million of loans that were considered to be non-performing reported in non-accrual loans.

OREO decreased from December 31, 2021 to June 30, 2022, primarily due to disposals and valuation adjustments totaling \$1.5 million, partially offset by additions totaling \$0.2 million. At both June 30, 2022 and December 31, 2021, OREO was primarily comprised of commercial properties.

Loans past due 90 days or more and still accruing at June 30, 2022 and December 31, 2021, were primarily comprised of loans held for sale and guaranteed by U.S. government agencies, including GNMA related loans subject to repurchase within our mortgage origination segment. As of June 30, 2022, \$36.1 million of loans subject to repurchase were under a forbearance agreement resulting from the COVID-19 pandemic. During May 2020, GNMA announced that it would temporarily exclude any new GNMA lender delinquencies, occurring on or after April 2020, when calculating the delinquency ratios for the purposes of enforcing compliance with its delinquency rate thresholds. This exclusion is extended automatically to GNMA lenders that were compliant with GNMA's delinquency rate thresholds as reflected by their April 2020 investor accounting report. The mortgage origination segment qualified for this exclusion as of June 30, 2022. As of June 30, 2022, \$36.1 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 titled "Liquidity and Capital Resources — Banking Segment" below, is constantly changing due to the banking segment's needs and market conditions. In an effort to assist its customers avoid overdraft-related fees, our banking segment plans to implement certain fee enhancements during the fourth quarter of 2022. Such fee enhancements are not expected to have a material impact on its overall operating results.

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

	Six Months Ended June 30,			
	2022		2021	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
Noninterest-bearing demand deposits	\$ 4,530,166	0.00 %	\$ 3,911,205	0.00 %
Interest-bearing demand deposits	6,698,325	0.22 %	5,829,890	0.22 %
Savings deposits	344,009	0.05 %	279,481	0.07 %
Time deposits	941,768	0.47 %	1,574,263	0.97 %
	<u>\$ 12,514,268</u>	0.16 %	<u>\$ 11,594,839</u>	0.24 %

The following table presents the scheduled maturities of uninsured deposits greater than \$250,000 as of June 30, 2022 (in thousands).

Months to maturity:	
3 months or less	\$ 80,368
3 months to 6 months	121,283
6 months to 12 months	94,018
Over 12 months	109,625
	<u>\$ 405,294</u>

Borrowings

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

	June 30, 2022		December 31, 2021		Variance
	Balance	Average Rate Paid	Balance	Average Rate Paid	
Short-term borrowings	\$ 822,649	1.13 %	\$ 859,444	1.22 %	\$ (36,795)
Notes payable	389,722	4.46 %	387,904	5.79 %	1,818
Junior subordinated debentures	—	— %	—	3.45 %	—
	<u>\$ 1,212,371</u>	2.10 %	<u>\$ 1,247,348</u>	1.32 %	<u>\$ (34,977)</u>

Short-term borrowings consisted of federal funds purchased, securities sold under agreements to repurchase, borrowings at the Federal Home Loan Bank ("FHLB"), short-term bank loans and commercial paper. The decrease in short-term borrowings at June 30, 2022, compared with December 31, 2021, primarily included decreases in short-term bank loans

and commercial paper within the broker-dealer segment, partially offset by an increase in federal funds purchased by the banking segment. Notes payable at June 30, 2022 was comprised of \$149.2 million related to the Senior Notes, net of loan origination fees, Subordinated Notes, net of origination fees, of \$197.2 million and mortgage origination segment borrowings of \$43.3 million. As discussed in more detail within the section titled “Liquidity and Capital Resources — Junior Subordinated Debentures” below, during the third quarter of 2021, PCC fully redeemed all outstanding Debentures.

Liquidity and Capital Resources

Hilltop is a financial holding company whose assets primarily consist of the stock of its subsidiaries and invested assets. Hilltop’s primary investment objectives, as a holding company, are to support capital deployment for organic growth and to preserve capital to be deployed through acquisitions, dividend payments and stock repurchases. At June 30, 2022, Hilltop had \$137.6 million in cash and cash equivalents, a decrease of \$230.3 million from \$367.9 million at December 31, 2021. This decrease in cash and cash equivalents was primarily due to cash outflows of \$442.3 million in stock repurchases related to the tender offer, \$23.8 million in cash dividends declared and other general corporate expenses, partially offset by the receipt of \$265.7 million of dividends from subsidiaries. Subject to regulatory restrictions, Hilltop has received, and may also continue to receive, dividends from its subsidiaries. If necessary or appropriate, we may also finance acquisitions with the proceeds from equity or debt issuances. We believe that Hilltop’s liquidity is sufficient for the foreseeable future, with current short-term liquidity needs including operating expenses, interest on debt obligations, dividend payments to stockholders and potential stock repurchases.

COVID-19

The COVID-19 pandemic has adversely impacted financial markets and overall economic conditions, and may continue to have implications on our business and operations. The extent of the impact of the pandemic on our operational and financial performance for the remainder of 2022 is currently uncertain and will depend on certain developments outside of our control, including, among others, the ongoing distribution and effectiveness of vaccines, emergence of new variants of the virus, government stimulus, the ultimate impact of the pandemic on our customers and clients, and additional, or extended, federal, state and local government orders and regulations that might be imposed in response to the pandemic.

Dividend Declaration

On July 21, 2022, our board of directors declared a quarterly cash dividend of \$0.15 per common share, payable on August 26, 2022 to all common stockholders of record as of the close of business on August 12, 2022.

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 2022, our board of directors authorized a new stock repurchase program through January 2023, pursuant to which we were originally authorized to repurchase, in the aggregate, up to \$100.0 million of our outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation.

Tender Offer

On May 2, 2022, 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 \$400 million, inclusive of the aforementioned stock repurchase program. On May 27, 2022, including the exercise of our right to purchase up to an additional 2% of our outstanding shares, we completed our tender offer, repurchasing 14,868,469 shares of outstanding common stock at a price of \$29.75 per share for a total of \$442.3 million, excluding fees and expenses. We funded the tender offer with cash on hand. As a result of share repurchases during 2022, we have no further available share repurchase capacity associated with our previously authorized stock repurchase program.

Senior Notes due 2025

The Senior Notes bear interest at a rate of 5% per year, payable semi-annually in arrears in cash on April 15 and October 15 of each year, commencing on October 15, 2015. The Senior Notes will mature on April 15, 2025, unless we redeem the Senior Notes, in whole at any time or in part from time to time, on or after January 15, 2025 (three months prior to the maturity date of the Senior Notes) at our election at a redemption price equal to 100% of the principal amount of the Senior Notes to be redeemed plus accrued and unpaid interest to, but excluding, the redemption date. At June 30, 2022, \$150.0 million of our Senior Notes was outstanding.

Subordinated Notes due 2030 and 2035

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

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

The 2030 Subordinated Notes bear interest at a rate of 5.75% per year, payable semi-annually in arrears commencing on November 15, 2020. The interest rate for the 2030 Subordinated Notes will reset quarterly beginning May 15, 2025 to an interest rate, per year, equal to the then-current benchmark rate, which is expected to be three-month term SOFR rate, plus 5.68%, payable quarterly in arrears. The 2035 Subordinated Notes bear interest at a rate of 6.125% per year, payable semi-annually in arrears commencing on November 15, 2020. The interest rate for the 2035 Subordinated Notes will reset quarterly beginning May 15, 2030 to an interest rate, per year, equal to the then-current benchmark rate, which is expected to be three-month term SOFR rate plus 5.80%, payable quarterly in arrears. At June 30, 2022, \$200.0 million of our Subordinated Notes was outstanding.

Junior Subordinated Debentures

Following receipt of regulatory approval, during June, July and August 2021, PCC submitted to the trustees of each of the statutory trusts a notice to redeem in full outstanding Debentures of \$67.0 million issued by PCC, which resulted in the full redemption to the holders of the associated preferred securities and common securities during the third quarter of 2021.

The Debentures, which were held by four statutory trusts created for the sole purpose of issuing and selling preferred securities and common securities used to acquire the Debentures, had an original stated term of 30 years with original maturities ranging from July 2031 to February 2038. The Debentures were callable at PCC's discretion with a minimum of a 45- to 60- day notice. At June 30, 2022, PCC had no remaining borrowings associated with the Debentures. The redemptions noted above were funded from available cash balances held at PCC.

Regulatory Capital

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

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

The following table shows PlainsCapital’s and Hilltop’s actual capital amounts and ratios in accordance with Basel III compared to the regulatory minimum capital requirements including conservation buffer ratio in effect at June 30, 2022 (dollars in thousands). Based on actual capital amounts and ratios shown in the following table, PlainsCapital’s ratios place it in the “well capitalized” (as defined) capital category under regulatory requirements. Actual capital amounts and ratios as of June 30, 2022 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.

	<u>June 30, 2022</u>		<u>Minimum Capital Requirements Including Conservation Buffer Ratio</u>	<u>To Be Well Capitalized Ratio</u>
	<u>Amount</u>	<u>Ratio</u>	<u>Ratio</u>	<u>Ratio</u>
Tier 1 capital (to average assets):				
PlainsCapital	\$ 1,406,640	9.67 %	4.0 %	5.0 %
Hilltop	1,853,729	10.53 %	4.0 %	N/A
Common equity Tier 1 capital (to risk-weighted assets):				
PlainsCapital	1,406,640	14.65 %	7.0 %	6.5 %
Hilltop	1,853,729	17.24 %	7.0 %	N/A
Tier 1 capital (to risk-weighted assets):				
PlainsCapital	1,406,640	14.65 %	8.5 %	8.0 %
Hilltop	1,853,729	17.24 %	8.5 %	N/A
Total capital (to risk-weighted assets):				
PlainsCapital	1,492,639	15.55 %	10.5 %	10.0 %
Hilltop	2,139,683	19.90 %	10.5 %	N/A

We discuss regulatory capital requirements in more detail in Note 16 to our consolidated financial statements, as well as under the caption “Government Supervision and Regulation — Corporate — Capital Adequacy Requirements and BASEL III” set forth in Part I, Item I. of our 2021 Form 10-K.

Banking Segment

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

Given the continued strong cash and liquidity levels at the Bank, the Bank’s borrowing capacity available liquidity position and access to secured funding sources continues to be at a heightened level as summarized in the following table (in millions).

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
FHLB capacity	\$ 4,146	\$ 4,221
Investment portfolio (available)	1,567	1,478
Fed deposits (excess daily requirements)	1,602	2,686
	<u>\$ 7,315</u>	<u>\$ 8,385</u>

As noted in the table above, the Bank's available liquidity position and borrowing capacity at June 30, 2022 continues to be at a heightened level. The Bank is targeting available liquidity of between approximately \$5 billion and \$6 billion during the remainder of 2022 given general economic uncertainties. 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. 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 10.86% of the Bank's total deposits, and the Bank's five largest depositors, excluding Hilltop and Hilltop Securities, collectively accounted for 6.01% of the Bank's total deposits at June 30, 2022. The loss of one or more of our largest Bank customers, or a significant decline in our deposit balances due to ordinary course fluctuations related to these customers' businesses, could adversely affect our liquidity and might require us to raise deposit rates to attract new deposits, purchase federal funds or borrow funds on a short-term basis to replace such deposits.

Broker-Dealer Segment

The Hilltop Broker-Dealers rely on their equity capital, short-term bank borrowings, interest-bearing and noninterest-bearing client credit balances, correspondent deposits, securities lending arrangements, repurchase agreement financing, commercial paper issuances and other payables to finance their assets and operations, subject to their respective compliance with broker-dealer net capital and customer protection rules. At June 30, 2022, Hilltop Securities had credit arrangements with four unaffiliated banks, with maximum aggregate commitments of up to \$600.0 million. These credit arrangements are used to finance securities owned, securities held for correspondent accounts, receivables in customer margin accounts and underwriting activities. These credit arrangements are provided on an "as offered" basis and are not committed lines of credit. In addition, Hilltop Securities has committed revolving credit facilities with three unaffiliated banks, with aggregate availability of up to \$250.0 million. At June 30, 2022, Hilltop Securities had no borrowings under its credit arrangements or its credit facilities.

Hilltop Securities uses the net proceeds (after deducting related issuance expenses) from the sale of two commercial paper programs for general corporate purposes, including working capital and the funding of a portion of its securities inventories. The commercial paper notes ("CP Notes") may be issued with maturities of 14 days to 270 days from the date of issuance. The CP Notes are issued under two separate programs, Series 2019-1 CP Notes and Series 2019-2 CP Notes, in maximum aggregate amounts of \$300 million and \$200 million, respectively. As of June 30, 2022, the weighted average maturity of the CP Notes was 160 days at a rate of 1.80% with a weighted average remaining life of 70 days. At June 30, 2022, the aggregate amount outstanding under these secured arrangements was 289.1 million, which was collateralized by securities held for firm accounts valued at \$315.3 million.

Mortgage Origination Segment

PrimeLending funds the mortgage loans it originates through a warehouse line of credit maintained with the Bank, which has an aggregate commitment of \$2.7 billion, of which \$1.3 billion was drawn at June 30, 2022. PrimeLending sells substantially all mortgage loans it originates to various investors in the secondary market, historically with the majority with servicing released. As these mortgage loans are sold in the secondary market, PrimeLending pays down its warehouse line of credit with the Bank. In addition, PrimeLending has an available line of credit with an unaffiliated bank of up to \$1.0 million, of which no borrowings were drawn at June 30, 2022.

PrimeLending owns a 100% membership interest in PrimeLending Ventures Management, LLC ("Ventures Management") which holds an ownership interest in and is the managing member of certain ABAs. At June 30, 2022, these ABAs had combined available lines of credit totaling \$215.0 million, \$80.0 million of which was with a single unaffiliated bank, and the remaining \$135.0 million of which was with the Bank. At June 30, 2022, Ventures Management had outstanding borrowings of \$84.0 million, \$40.7 million of which was with the Bank.

Other Material Contractual Obligations, Off-Balance Sheet Arrangements, Commitments and Guarantees

Since December 31, 2021, there have been no material changes in other material contractual obligations disclosed within the section captioned “Other Material Contractual Obligations, Off-Balance Sheet Arrangements, Commitments and Guarantees” set forth in Part II, Item 7 of our 2021 Form 10-K.

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

Banking Segment

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

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

In the aggregate, the Bank had outstanding unused commitments to extend credit of \$2.5 billion at June 30, 2022 and outstanding financial and performance standby letters of credit of \$103.6 million at June 30, 2022.

Broker-Dealer Segment

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.

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. Historically, 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.

Critical Accounting Estimates

We have identified certain accounting estimates which involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on our financial condition or results of operations. Our accounting policies are more fully described in Note 1 to the 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 critical accounting estimates, as summarized below, which we

believe to be the most critical in preparing our consolidated financial statements relate to allowance for credit losses, mortgage servicing rights asset, goodwill and identifiable intangible assets, mortgage loan indemnification liability and acquisition accounting. Since December 31, 2021, there have been no changes in critical accounting estimates as further described under “Critical Accounting Estimates” in our 2021 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our assessment of market risk as of June 30, 2022 indicates there are no material changes in the quantitative and qualitative disclosures from those previously reported in our 2021 Form 10-K, except as discussed below.

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

Banking Segment

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

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

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

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. The management of interest rate risk is performed by analyzing the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at specific points in time (“GAP”) and by analyzing the effects of interest rate changes on net interest income over specific periods of time by projecting the performance of the mix of assets and liabilities in varied interest rate environments. Interest rate sensitivity reflects the potential effect on net interest income resulting from a movement in interest rates. A company is considered to be asset sensitive, or have a positive GAP, when the amount of its interest-earning assets maturing or repricing within a given period exceeds the amount of its interest-bearing liabilities also maturing or repricing within that time period. Conversely, a company is considered to be liability sensitive, or have a negative GAP, when the amount of its interest-bearing liabilities maturing or repricing within a given period exceeds the amount of its interest-earning assets also maturing or repricing within that time period. During a period of rising interest rates, a negative GAP would tend to affect net interest income adversely, while a positive GAP would tend to result in an increase in net interest income. During a period of falling interest rates, a negative GAP would tend to result in an increase in net interest income, while a positive GAP would tend to affect net interest income adversely. However, it is our intent to remain relatively balanced so that changes in rates do not have a significant impact on earnings.

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

	June 30, 2022					Total
	3 Months or Less	> 3 Months to 1 Year	> 1 Year to 3 Years	> 3 Years to 5 Years	> 5 Years	
Interest sensitive assets:						
Loans	\$ 4,550,836	\$ 1,295,023	\$ 1,807,716	\$ 736,772	\$ 399,740	\$ 8,790,087
Securities	523,730	238,473	459,174	359,500	1,052,373	2,633,250
Federal funds sold and securities purchased under agreements to resell	39,022	—	—	—	—	39,022
Other interest sensitive assets	1,615,616	—	—	—	29,559	1,645,175
Total interest sensitive assets	6,729,204	1,533,496	2,266,890	1,096,272	1,481,672	13,107,534
Interest sensitive liabilities:						
Interest bearing checking	\$ 5,756,663	\$ —	\$ —	\$ —	\$ —	\$ 5,756,663
Savings	328,619	—	—	—	—	328,619
Time deposits	232,395	482,082	181,811	20,018	—	916,306
Notes payable and other borrowings	353,234	156	493	631	2,468	356,982
Total interest sensitive liabilities	6,670,911	482,238	182,304	20,649	2,468	7,358,570
Interest sensitivity gap	\$ 58,293	\$ 1,051,258	\$ 2,084,586	\$ 1,075,623	\$ 1,479,204	\$ 5,748,964
Cumulative interest sensitivity gap	\$ 58,293	\$ 1,109,551	\$ 3,194,137	\$ 4,269,760	\$ 5,748,964	
Percentage of cumulative gap to total interest sensitive assets	0.44 %	8.46 %	24.37 %	32.57 %	43.86 %	

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

The table below shows the estimated impact of a range of changes in interest rates on net interest income and on economic value of equity for the banking segment at June 30, 2022 (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	\$ 85,287	18.41 %	\$ 237,828	11.05 %
+200	\$ 56,063	12.10 %	\$ 155,782	7.24 %
+100	\$ 28,616	6.18 %	\$ 97,670	4.54 %
-50	\$ (21,803)	(4.71)%	\$ (16,093)	(0.75)%

The projected changes in net interest income and economic value of equity to changes in interest rates at June 30, 2022 were in compliance with established internal policy guidelines. These projected changes are based on numerous assumptions of growth and changes in the mix of assets or liabilities. The projected changes in net interest income are being impacted by the heightened level of cash balances, which represent a significant portion of the Bank's sensitivity given simulation analysis assumptions/limitations. As a result, the timing and magnitude of future changes in interest rates and any runoff of deposits, and related decline in cash, may impact projected changes in net interest income as noted in the table above.

Our portfolio includes loans that periodically reprice or mature prior to the end of an amortized term. Some of our variable-rate loans remain at applicable rate floors, which may delay and/or limit changes in interest income during a

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

Broker-Dealer Segment

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

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

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

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

	June 30, 2022				
	1 Year or Less	> 1 Year to 5 Years	> 5 Years to 10 Years	> 10 Years	Total
Trading securities, at fair value					
Municipal obligations	\$ 423	\$ 24,722	\$ 53,546	\$ 148,295	\$ 226,986
U.S. government and government agency obligations	13,667	(4,208)	(9,866)	224,796	224,389
Corporate obligations	(11,191)	5,297	2,086	17,456	13,648
Total debt securities	<u>2,899</u>	<u>25,811</u>	<u>45,766</u>	<u>390,547</u>	<u>465,023</u>
Corporate equity securities	(13,730)	—	—	—	(13,730)
Other	5,912	—	—	—	5,912
	<u>\$ (4,919)</u>	<u>\$ 25,811</u>	<u>\$ 45,766</u>	<u>\$ 390,547</u>	<u>\$ 457,205</u>
Weighted average yield					
Municipal obligations	4.15 %	3.45 %	3.28 %	4.35 %	4.00 %
U.S. government and government agency obligations	3.13 %	2.86 %	2.87 %	5.40 %	4.69 %
Corporate obligations	3.87 %	4.86 %	4.76 %	4.40 %	4.58 %

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.

Consolidated

At June 30, 2022, total debt obligations on our consolidated balance sheet, excluding short-term borrowings and unamortized debt issuance costs and premiums, were \$393 million, and included \$350 million in debt obligations subject to fixed interest rates, with the remainder of indebtedness subject to variable interest rates. If interest rates 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.

As noted above within the discussion for each business segment, on a consolidated basis, our primary component of market risk is sensitivity to changes in interest rates. Consequently, and in large part due to the significance of our banking segment, our consolidated earnings depend to a significant extent on our net interest income. Refer to the discussion in the “Banking Segment” section above that provides more details regarding sources of interest rate risk and asset/liability management policies and procedures employed 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.

The table below shows the estimated impact of a range of changes in interest rates on net interest income on a consolidated basis at June 30, 2022 (dollars in thousands).

Change in Interest Rates (basis points)	Changes in Net Interest Income	
	Amount	Percent
+300	\$ 120,285	23.77 %
+200	\$ 79,227	15.65 %
+100	\$ 40,141	7.93 %
-50	\$ (33,681)	(6.66)%

The projected changes in net interest income to changes in interest rates at June 30, 2022 were in compliance with established internal policy guidelines. These projected changes are based on numerous assumptions of growth and changes in the mix of assets or liabilities. The projected changes in net interest income are being impacted by the heightened level of cash balances, which represent a significant portion of our asset sensitivity given simulation analysis assumptions/limitations. As a result, the timing and magnitude of future changes in interest rates including runoff of deposits, and related decline in cash, may impact projected changes in net interest income as noted in the table above.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control Over Financial Reporting

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

For a description of material pending legal proceedings, see the discussion set forth under the heading “Legal Matters” in Note 13 to our Consolidated Financial Statements, which is incorporated by reference herein.

Item 1A. Risk Factors.

Except as set forth below, there have been no material changes to the risk factors disclosed under “Item 1A. Risk Factors” of our 2021 Form 10-K. For additional information concerning our risk factors, please refer to “Item 1A. Risk Factors” of our 2021 Form 10-K.

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

The following table details our repurchases of shares of common stock during the three months ended June 30, 2022.

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)</u>
April 1 - April 30, 2022	—	\$ —	—	\$ 100,000,000
May 1 - May 31, 2022	14,868,469	29.75	14,868,469	—
June 1 - June 30, 2022	—	—	—	—
Total	14,868,469	\$ 29.75	14,868,469	

- (1) On January 27, 2022, our board of directors authorized a new stock repurchase program through January 2023, pursuant to which we were originally authorized to repurchase, in the aggregate, up to \$100.0 million of our outstanding common stock, inclusive of repurchases to offset dilution related to grants of stock-based compensation. On May 2, 2022, we announced that we would purchase shares of our common stock up to \$400 million, inclusive of the aforementioned stock repurchase program, through a modified “Dutch auction” tender offer. On May 27, 2022, including the exercise of our right to purchase up to an additional 2% of our outstanding shares, we completed our tender offer, repurchasing 14,868,469 shares of outstanding common stock at a price of \$29.75 per share for a total of \$442.3 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.

Item 6. Exhibits.

Exhibit Number	Description of Exhibit
31.1*	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2*	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1**	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH*	Inline XBRL Taxonomy Extension Schema
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase
104	Cover Page Interactive File (formatted as Inline XBRL and contained in Exhibit 101)

* Filed herewith.

** Furnished herewith.

SIGNATURES

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

HILLTOP HOLDINGS INC.

Date: July 25, 2022

By: /s/ William B. Furr

William B. Furr

Chief Financial Officer

(Principal Financial Officer and duly authorized officer)

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, Jeremy B. Ford, certify that:

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

Date: July 25, 2022

By: /s/ Jeremy B. Ford

Jeremy B. Ford
President and Chief Executive Officer

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, William B. Furr, certify that:

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

Date: July 25, 2022

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

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

In connection with the Quarterly Report on Form 10-Q for the period ended June 30, 2022 (the “Report”) of Hilltop Holdings Inc. (the “Company”), the undersigned hereby certify in their capacities as President and Chief Executive Officer and Chief Financial Officer, respectively, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to their knowledge:

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

Date: July 25, 2022

By: /s/ Jeremy B. Ford

Jeremy B. Ford
President and Chief Executive Officer

Date: July 25, 2022

By: /s/ William B. Furr

William B. Furr
Chief Financial Officer

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