

Hilltop Holdings Inc.
Form 10-K
March 15, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended: December 31, 2012

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

For the transition period from to

Commission file number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

Maryland

84-1477939

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(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

200 Crescent Court, Suite 1330

Dallas, TX

(Address of principal executive offices)

75201

(Zip Code)

(214) 855-2177

(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	New York Stock Exchange

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

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

Aggregate market value of the voting and non-voting common equity held by non-affiliates, computed by reference to the price at which the common stock was last sold on the New York Stock Exchange on June 30, 2012, was approximately \$408 million. For the purposes of this computation, all officers, directors and 10% stockholders are affiliates. The number of shares of the registrant's common stock outstanding at March 14, 2013 was 83,487,340.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant's definitive Proxy Statement pertaining to the 2013 Annual Meeting of Stockholders, filed or to be filed not later than 120 days after the end of the fiscal year pursuant to Regulation 14A, is incorporated herein by reference into Part III.

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MARKET AND INDUSTRY DATA AND FORECASTS

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

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Unless the context otherwise indicates, all references in this Annual Report to the Company, Hilltop, HTH, we, us, our or ours or similar words are to Hilltop Holdings Inc. and its direct and indirect wholly owned subsidiaries, references to PlainsCapital refer to PlainsCapital Corporation (a wholly owned subsidiary of Hilltop), references to the Bank refer to PlainsCapital Bank (a wholly owned subsidiary of PlainsCapital), references to First Southwest refer to First Southwest Holdings, LLC (a wholly owned subsidiary of the Bank) and its subsidiaries as a whole, references to FSC refer to First Southwest Company (a wholly owned subsidiary of First Southwest), references to PrimeLending refer to PrimeLending, a PlainsCapital Company (a wholly owned subsidiary of the Bank) and its subsidiaries as a whole and references to NLASCO refer to NLASCO, Inc. (a wholly owned subsidiary of Hilltop Holdings Inc.) and its subsidiaries as a whole. In addition, unless the context otherwise requires, references to stockholders are to the holders of our voting securities, which consist of our Common Stock, par value \$0.01 per share.

FORWARD-LOOKING STATEMENTS

This Annual Report and the documents incorporated by reference into this report include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act, as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included in this Annual Report that address results or developments that we expect or anticipate will or may occur in the future, where statements are preceded by, followed by or include the words believes, expects, may, would, could, should, seeks, approximately, intends, plans, anticipates or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our financial condition, our litigation, our efforts to make strategic acquisitions, our revenue, our liquidity and sources of funding, our capital expenditures, our products, market trends, operations and business, expectations concerning mortgage loan origination volume, expectations concerning the hiring of additional mortgage bankers, anticipated changes in our revenues or earnings, the effects of government regulation applicable to our operations, expectations concerning deposit insurance premiums, the appropriateness of our allowance for loan losses and provision for loan losses, and the collectability of margin loans are forward-looking statements.

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

- (1) changes in the default rate of our loans and risks associated with concentration in real estate related loans;
- (2) changes in general economic, market and business conditions in areas or markets where we compete;
- (3) changes in the interest rate environment;
- (4) cost and availability of capital;

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(5) 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);

(6) our participation in governmental programs, including the Small Business Lending Fund (SBLF);

(7) severe catastrophic events in our geographic area;

(8) failure of our insurance segment reinsurers to pay obligations under reinsurance contracts;

(9) changes in key management;

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

(11) our ability to use net operating loss carry forwards to reduce future tax payments;

(12) competition for our banking, mortgage origination, financial advisory and insurance segments from other banks and financial institutions as well as insurance companies, mortgage bankers, investment banking and financial advisory firms, asset-based non-bank lenders and government agencies; and

(13) our ability to use excess cash in an effective manner.

For a more detailed discussion of these and other factors that may affect our business and that could cause the actual results to differ materially from those anticipated in these forward-looking statements, see Item 1A, Risk Factors, and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, herein. We caution that the foregoing list of factors is not exhaustive, and new factors may emerge, or changes to the foregoing factors may occur, that could impact our business. All subsequent written and oral forward-looking statements concerning our business attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements above. We do not undertake any obligation to update any forward-looking statement, whether written or oral, relating to the matters discussed in this Annual Report except to the extent required by federal securities laws.

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PART I

Item 1. Business.

General Information

We are a holding company that has endeavored, and continues to endeavor, to make acquisitions or effect business combinations. In connection with this strategy, on May 8, 2012 we entered into a definitive agreement and plan of merger with PlainsCapital Corporation, or the Merger Agreement, pursuant to which we acquired PlainsCapital Corporation on November 30, 2012, or the Merger. Concurrent with the consummation of the Merger, we became a financial holding company registered under the Bank Holding Company Act of 1956 (as amended, the Bank Holding Company Act), as amended by the Gramm-Leach-Bliley Act of 1999 (the Gramm-Leach-Bliley Act).

Prior to the consummation of the Merger with PlainsCapital Corporation, our primary operations were to provide fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States through our wholly owned property and casualty insurance holding company, NLASCO, Inc., or NLASCO. NLASCO operates through its wholly owned subsidiaries, National Lloyds Insurance Company (NLIC) and American Summit Insurance Company (ASIC).

Following the Merger on November 30, 2012, our primary line of business is our wholly owned bank subsidiary, PlainsCapital Bank (the Bank). The Bank provides business and consumer banking services from offices located throughout central, north and west Texas. The Bank's subsidiaries have specialized areas of expertise that allow us to provide an array of financial products and services such as mortgage origination and financial advisory services.

Our common stock is listed on the New York Stock Exchange, or NYSE, under the symbol HTH.

Our principal office is located at 200 Crescent Court, Suite 1330, Dallas, Texas 75201, and our telephone number at that location is (214) 855-2177. Our internet address is www.hilltop-holdings.com.

Company Background

We were formed in 1998 under the name Affordable Residential Communities Inc. as a Maryland corporation that elected to be taxed as a real estate investment trust, or REIT. Until July 2007, we primarily engaged in the acquisition, renovation, repositioning and operation of all-age manufactured home communities, the retail sale and financing of manufactured homes, the rental of manufactured homes and other related businesses, including acting as agent in the sale of homeowners insurance and related products, to residents and prospective residents of those communities. Our primary operations previously were conducted through an operating partnership, in which we owned a general partnership

interest.

On February 18, 2004, we completed our initial public offering. Through the year ended December 31, 2005, we operated as a fully integrated, self-administered and self-managed equity REIT for U.S. federal income tax purposes. In 2006, we revoked our election as a REIT for U.S. federal income tax purposes.

In January 2007, we acquired NLASCO. NLASCO was incorporated in Delaware in 2000, but its origins trace back to 1948 through one of its subsidiaries, NLIC.

On July 31, 2007, we sold substantially all of the operating assets used in our manufactured home communities business and our retail sales and financing business to American Residential Communities LLC. In conjunction with this transaction, we transferred to the buyer the rights to the Affordable Residential Communities name, changed our name to Hilltop Holdings Inc., and moved our headquarters to Dallas, Texas.

On November 30, 2012, we acquired PlainsCapital Corporation through a plan of merger, whereby PlainsCapital Corporation became our wholly owned subsidiary.

We intend to make acquisitions with certain of the remaining proceeds from the American Residential Communities transaction and, if necessary or appropriate, from additional equity or debt financing sources.

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Following the completion of the sale of our manufactured home communities businesses, our operations through November 30, 2012 consisted solely of those of NLASCO and its subsidiaries. Given the significant recent acquisition of PlainsCapital, the remainder of our discussion includes details concerning the banking, mortgage origination and financial advisory operations of PlainsCapital and its subsidiaries, as well as the property and casualty insurance operations of NLASCO and its subsidiaries.

Organizational Structure

Our organizational structure is comprised of two primary operating business units, NLASCO, Inc. (insurance) and PlainsCapital Corporation (financial services and products). Within the PlainsCapital unit are three primary wholly owned subsidiaries: PlainsCapital Bank, PrimeLending and First Southwest. Under U.S. GAAP, our business units are comprised of four reportable business segments: banking, mortgage origination, insurance and financial advisory. Prior to the Merger with PlainsCapital, Hilltop operated as a single segment through its insurance subsidiary, NLASCO, given the integrated monitoring, control and management of its fire and homeowners insurance business lines. The following provides additional details regarding our updated organizational structure at December 31, 2012.

Geographic Dispersion of our Businesses

At December 31, 2012, we had \$4.7 billion in deposits. The following table summarizes the geographic dispersion of our deposit portfolio at December 31, 2012 (dollars in thousands).

	West Texas (1)	DFW (2)	Central/South (3)	Other (4)	Total
Demand deposits	\$ 160,158	\$ 103,241	\$ 53,999	\$ 81,277	\$ 398,675
NOW accounts	57,127	41,162	7,948	325	106,562
Money market deposit accounts	804,240	1,181,915	370,547	407	2,357,109

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Brokered money market deposit accounts				263,193	263,193
Other savings deposits	46,455	52,949	80,635	328	180,367
Time deposits	398,908	689,480	84,251	2,793	1,175,432
Brokered time deposits				219,123	219,123
Total deposits	1,466,888	2,068,747	597,380	567,446	4,700,461
Percentage of total deposits	31.2%	44.0%	12.7%	12.1%	100.0%

-
- (1) West Texas consists of deposits originated in Lubbock, Texas.
 - (2) DFW primarily consists of deposits originated in the Dallas/Fort Worth, Texas metroplex area.
 - (3) Central/South primarily consists of deposits originated in Austin, Texas and San Antonio, Texas.
 - (4) Other consists of deposits that are not managed on a regional basis.

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At December 31, 2012, we had \$3.2 billion in loans held for investment. The following table summarizes the geographic dispersion of our loan portfolio at December 31, 2012 (dollars in thousands).

	West Texas (1)	DFW (2)	Central/South (3)	Other (4)	Total
Commercial and industrial	\$ 319,234	\$ 729,492	\$ 308,686	\$ 302,881	\$ 1,660,293
Real estate	215,553	609,596	359,088		1,184,237
Construction and land development	23,558	156,379	100,537		280,474
Consumer	11,886	10,906	4,600		27,392
Total loans	570,231	1,506,373	772,911	302,881	3,152,396
Percentage of total loans	18.1%	47.8%	24.5%	9.6%	100.0%

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- (1) West Texas consists of loans originated from Lubbock, Texas.
- (2) DFW primarily consists of loans originated in the Dallas/Fort Worth, Texas metroplex area.
- (3) Central/South primarily consists of loans originated from Austin, Texas and San Antonio, Texas.
- (4) Other consists of margin loans held by FSC and lease financing.

For the month of December 2012, approximately 60% of PrimeLending's origination volume was concentrated in seven states (no other state had volume of 4% or more). The following table is a summary of the origination volume by state (in thousands).

	Volume	% of Total
Texas	\$ 275,739	21.4%
California	217,100	16.9%
North Carolina	78,881	6.1%
Virginia	56,387	4.4%
Maryland	55,870	4.3%
Tennessee	53,783	4.2%
Arizona	47,507	3.7%
All other states	501,688	39.0%
	\$ 1,286,955	100.0%

We distribute our insurance products through a broad network of independent agents in 27 states and a select number of managing general agents, referred to as MGAs. The following table sets forth our total gross written premiums by state for the periods shown (in thousands).

	Year Ended December 31,					
	2012	% of Total	2011	% of Total	2010	% of Total
Texas	\$ 118,361	69.5%	\$ 117,046	73.0%	\$ 107,992	74.8%

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Oklahoma	15,398	9.0%	10,804	6.7%	6,777	4.7%
Arizona	13,914	8.2%	12,376	7.7%	11,268	7.8%
Tennessee	10,527	6.2%	9,489	5.9%	8,562	5.9%
Georgia	5,454	3.2%	4,380	2.7%	3,297	2.3%
Louisiana	3,081	1.8%	2,973	1.9%	3,022	2.1%
Missouri	1,244	0.7%	1,170	0.7%	1,230	0.9%
Nevada	991	0.6%	1,015	0.6%	1,015	0.7%
All other states	1,231	0.7%	1,188	0.7%	1,205	0.8%
Total	\$ 170,201	100.0%	\$ 160,441	100.0%	\$ 144,368	100.0%

FSC, a diversified investment banking firm and a registered broker-dealer, competes for business nation-wide. Over 70% of its public finance financial advisory revenues are from entities located in Texas.

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We operate in four business segments: banking, mortgage origination, insurance and financial advisory. For more financial information about each of these business segments, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, herein. See also Note 27 in the notes to our consolidated financial statements included under Item 8, Financial Statements and Supplementary Data.

Banking

The operations of the Bank comprise our banking segment. At December 31, 2012, our banking segment had \$6.2 billion in assets and total deposits of \$4.7 billion. The primary sources of our deposits are residents and businesses located in the Texas markets we serve.

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

The table below sets forth a distribution of the banking segment's business loans, by type, and all other loans at December 31, 2012 (dollars in thousands). The commercial and industrial loans category includes a \$1.6 billion warehouse line of credit extended to PrimeLending, of which \$1.3 billion was drawn at December 31, 2012. Amounts advanced against the warehouse line are included in the table below, but are eliminated from the consolidated balance sheet.

	Amount	% of Total Loans
Loans:		
Commercial and industrial	\$ 2,649,158	64.0%
Real estate	1,184,885	28.5%
Construction and land development	280,474	6.8%
Total business loans	4,114,517	99.3%
All other loans	27,392	0.7%
Total loans	\$ 4,141,909	100.0%

Commercial and industrial loans are primarily made within our market areas in Texas and are underwritten on the basis of the borrower's ability to service the debt from income. In general, commercial and industrial loans involve more credit risk than residential and commercial mortgage loans and, therefore, usually yield a higher return. The increased risk in commercial and industrial loans results primarily from the type of collateral securing these loans, which typically includes commercial real estate, accounts receivable, equipment and inventory. Additionally, increased risk arises from the expectation that commercial and industrial loans generally will be serviced principally from the operations of the business, and those operations may not be successful. Historical trends have shown these types of loans to have higher delinquencies than mortgage loans. As a result of the additional risk and complexity associated with commercial and industrial loans, such loans require more

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thorough underwriting and servicing than loans to individuals. To manage these risks, our policy is to attempt to secure commercial and industrial loans with both the assets of the borrowing business and other additional collateral and guarantees that may be available. In addition, depending on the size of the credit, we actively monitor certain fiscal measures of the borrower, including cash flow, collateral value and other appropriate credit factors. We also have processes in place to analyze and evaluate on a regular basis our exposure to industries, products, market changes and economic trends.

The Bank also offers term financing on commercial real estate properties that include retail, office, multi-family, industrial, warehouse and non-owner occupied single family residences. Commercial mortgage lending can involve high principal loan amounts, and the repayment of these loans is dependent, in large part, on a borrower's on-going business operations or on income generated from the properties that are leased to third parties. As a general practice, the Bank requires its commercial mortgage loans to be secured with first lien positions on the underlying property, to generate adequate equity

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margins, to be serviced by businesses operated by an established management team, and to be guaranteed by the principals of the borrower. The Bank seeks lending opportunities where cash flow from the collateral provides adequate debt service coverage and/or the guarantor's net worth is comprised of assets other than the project being financed.

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

In addition to the real estate lending activities described above, a portion of the Bank's real estate portfolio consists of single family residential mortgage loans typically collateralized by owner occupied properties located in its market areas. These residential mortgage loans are generally secured by a first lien on the underlying property and have maturities of five years or less. Longer term mortgage financing is provided for certain customers within the Bank's private banking group. At December 31, 2012, the Bank had \$199.1 million in one-to-four family residential loans, which represented 4.80% of its total loans held for investment.

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

We loan to individuals for personal, family and household purposes, including lines of credit, home improvement loans, home equity loans, credit cards and loans for purchasing and carrying securities. At December 31, 2012, we had \$27.4 million of loans for these purposes, which are shown in the previous table as All other loans.

Wealth and Investment Management. Our private banking team personally assists high net worth individuals and their families with their banking needs, including depository, credit, asset management, and trust and estate services. We offer trust and asset management services in order to assist these customers in managing, and ultimately transferring, their wealth. Our wealth management services provide personal trust, investment management and employee benefit plan administration services, including estate planning, management and administration, investment portfolio management, employee benefit accounts and individual retirement accounts.

Mortgage Origination

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Our mortgage origination segment operates through a wholly owned subsidiary of the Bank, PrimeLending. Founded in 1986, PrimeLending is a residential mortgage banker licensed to originate and close loans in all 50 states and the District of Columbia. At December 31, 2012, it operated from 280 locations in 42 states, originating approximately 21% of its mortgages from its Texas locations and approximately 17% of its mortgages from locations in California. The mortgage lending business is subject to seasonality, as we typically experience increased loan origination volume from purchases of homes during the spring and summer, when more people tend to move and buy or sell homes, and the overall demand for mortgage loans is driven largely by the applicable interest rates at any given time.

PrimeLending handles loan processing, underwriting and closings in-house. Mortgage loans originated by PrimeLending are funded through a warehouse line of credit maintained with the Bank. PrimeLending sells substantially all mortgage loans it originates to various investors in the secondary market, servicing released, although PrimeLending may retain servicing under certain conditions. As these mortgage loans are sold in the secondary market, PrimeLending pays down its warehouse line of credit with the Bank. Loans sold are subject to certain standard indemnification provisions with investors, including the repurchase of loans sold and the repayment of sales proceeds to investors under certain conditions.

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

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

In addition to its branch office network, PrimeLending, through PrimeLending Ventures, LLC, establishes affiliated business arrangements to originate residential mortgages for customers of referring business partners and for other customers not associated with business partners. At December 31, 2012, PrimeLending Ventures, LLC had two active affiliated business arrangements.

Since its inception in 1986, PrimeLending has grown from originating approximately \$80 million in mortgage loans annually with a staff of 20 individuals to originating \$13.7 billion in loans in 2012 with approximately 2,650 employees. PrimeLending offers a variety of loan products catering to the specific needs of borrowers seeking purchase or refinancing options, including 30-year and 15-year fixed rate conventional mortgages, adjustable rate mortgages, jumbo loans, and Federal Housing Administration (FHA) and Veteran Affairs (VA) loans. Mortgage loans originated by PrimeLending are secured by a first lien on the underlying property. PrimeLending does not currently originate subprime loans (which we define to be loans to borrowers having a Fair Isaac Corporation (FICO) score lower than 620 or that do not comply with applicable agency or investor-specific underwriting guidelines).

Insurance

The operations of NLASCO comprise our insurance segment. NLASCO specializes in providing fire and limited homeowners insurance for low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States. NLASCO's product line also includes enhanced homeowners products offering higher coverage limits with distribution restricted to select agents. NLASCO targets underserved markets through a broad network of independent agents in 27 states and a select number of MGAs, which require underwriting expertise that many larger carriers have been unwilling to develop given the relatively small volume of premiums produced by local agents.

Ratings. Many insurance buyers, agents and brokers use the ratings assigned by A.M. Best and other rating agencies to assist them in assessing the financial strength and overall quality of the companies from which they purchase insurance. The ratings for NLIC and ASIC of A (Excellent) were affirmed by A.M. Best in April 2012. An A rating is the third highest of 16 rating categories used by A.M. Best. In evaluating a company's financial and operating performance, A.M. Best reviews a company's profitability, leverage and liquidity, as well as its book of business, the adequacy and soundness of its reinsurance, the quality and estimated market value of its assets, the adequacy of its liabilities for losses and loss adjustment expenses (LAE), the adequacy of its surplus, its capital structure, the experience and competence of its management and its market presence. This rating assignment is subject to the ability to meet A.M. Best's expectations as to performance and capitalization on an ongoing basis, and is subject to revocation or revision at any time at the sole discretion of A.M. Best. NLASCO cannot ensure that NLIC and ASIC will

maintain their present ratings.

Product Lines. NLASCO's business is conducted in two product lines: personal lines and commercial lines. The personal lines include homeowners, dwelling fire, manufactured home, flood and vacant policies. The commercial lines include commercial, builders risk, builders risk renovation, sports liability and inland marine policies.

The NLASCO companies specialize in writing fire and homeowners insurance coverage for low value dwellings and manufactured homes. The vast majority of NLASCO's property coverage is written on policies that provide actual cash value payments, as opposed to replacement cost. Under actual cash value policies, the insured is entitled to receive only the cost of replacing or repairing damaged or destroyed property with comparable new property, less depreciation. In 2010, NLASCO expanded its homeowners insurance products to include replacement cost coverage, which also includes limited water coverage. These new products are being marketed and sold primarily in Texas. The development and implementation of these new products contributed to the premium growth at NLASCO in 2011 and 2012.

Underwriting and Pricing. NLASCO applies its regional expertise, underwriting discipline and a risk-adjusted, return-on-equity-based approach to capital allocation to primarily offer short-tail insurance products in its target markets. NLASCO's

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underwriting process involves securing an adequate level of underwriting information from its independent agents, identifying and evaluating risk exposures and then pricing the risks it chooses to accept. Management reviews pricing on an ongoing basis to monitor any emerging issues on a specific coverage or geographic territory.

Catastrophe Exposure. NLASCO maintains a comprehensive risk management strategy, which includes actively monitoring its catastrophe prone territories by zip code to ensure a diversified book of risks. NLASCO utilizes software and risk support from its reinsurance brokers to analyze its portfolio and catastrophe exposure. Biannually, NLASCO has its entire portfolio analyzed by its reinsurance broker who utilizes hurricane models to predict risk.

Reinsurance. NLASCO purchases reinsurance to reduce its exposure to liability on individual risks and claims and to protect against catastrophe losses. NLASCO's management believes that less volatile, yet reasonable returns are in the long-term interest of NLASCO.

Reinsurance involves an insurance company transferring, or ceding, a portion of its risk to another insurer, the reinsurer. The reinsurer assumes the exposure in return for a portion of the premium. The ceding of risk to a reinsurer does not legally discharge the primary insurer from its liability for the full amount of the policies on which it obtains reinsurance. Accordingly, the primary insurer remains liable for the entire loss if the reinsurer fails to meet its obligations under the reinsurance agreement, and as a result, the primary insurer is exposed to the risk of non-payment by its reinsurers. In formulating its reinsurance programs, NLASCO believes that it is selective in its choice of reinsurers and considers numerous factors, the most important of which are the financial stability of the reinsurer, its history of responding to claims and its overall reputation.

NLASCO purchases catastrophe excess of loss reinsurance to a limit that exceeds the Hurricane 250-year return time as modeled by RMS Risk Link v.11.0 and exceeds the Hurricane 500-year return time as modeled by AIR Classic v.14.0.

Liabilities for Unpaid Losses and Loss Adjustment Expenses. NLASCO's liabilities for losses and loss adjustment expenses include liabilities for reported losses, liabilities for incurred but not reported, or IBNR, losses and liabilities for LAE, less a reduction for reinsurance recoverables related to those liabilities. The amount of liabilities for reported claims is based primarily on a claim-by-claim evaluation of coverage, liability, injury severity or scope of property damage, and any other information considered relevant to estimating exposure presented by the claim. The amounts of liabilities for IBNR losses and LAE are estimated on the basis of historical trends, adjusted for changes in loss costs, underwriting standards, policy provisions, product mix and other factors. Estimating the liability for unpaid losses and LAE is inherently judgmental and is influenced by factors that are subject to significant variation. Liabilities for LAE are intended to cover the ultimate cost of settling claims, including investigation and defense of lawsuits resulting from such claims. Based upon the contractual terms of the reinsurance agreements, reinsurance recoverables offset, in part, NLASCO's gross liabilities.

Significant periods of time can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer and the insurer's payment of that loss. NLASCO's liabilities for unpaid losses represent the best estimate at a given point in time of what it expects to pay claimants, based on facts, circumstances and historical trends then known. During the loss settlement period, additional facts regarding individual claims may become known and, consequently, it often becomes necessary to refine and adjust the estimates of liability.

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The following tables set forth the annual calendar year-end reserves of NLIC and ASIC since 2003 and the subsequent development of these reserves through December 31, 2012. These tables present accident or policy year development data. The first line of the table shows, for the years indicated, net liability, including IBNR, as originally estimated. The next section of the table sets forth the re-estimates in later years of incurred losses, including payments, for the years indicated. The changes in the original estimate are caused by a combination of factors, including: (1) claims being settled for amounts different than originally estimated; (2) the net liability being increased or decreased for claims remaining open as more information becomes known about those individual claims; and (3) more or fewer claims being reported after December 31, 2003 than had occurred prior to that date. The bottom section of the table shows, by year, the cumulative amounts of net losses and LAE paid as of the end of each succeeding year.

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The net cumulative redundancy (deficiency) represents, as of December 31, 2012, the difference between the latest re-estimated net liability and the net liability as originally estimated for losses and LAE retained by us. A redundancy means the original estimate was higher than the current estimate; and a deficiency means that the original estimate was lower than the current estimate. The following tables are presented net of reinsurance recoverable.

**National Lloyds Insurance Company
Analysis of Loss Reserve Development
(in thousands)**

	Year Ended December 31,									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Original Reserve*	\$ 35,061	\$ 33,951	\$ 41,282	\$ 47,684	\$ 44,613	\$ 65,592	\$ 60,392	\$ 55,482	\$ 81,589	\$ 87,943
1 year later	32,887	28,106	36,332	43,640	44,064	64,864	62,337	54,987	82,065	
2 years later	32,559	27,593	40,391	43,465	44,134	65,070	62,014	54,672		
3 years later	31,614	25,747	41,231	43,394	43,950	64,702	61,759			
4 years later	31,030	25,712	39,735	43,387	43,788	64,569				
5 years later	31,088	25,579	39,699	43,366	43,649					
6 years later	31,072	25,582	39,675	43,365						
7 years later	31,066	25,568	39,674							
8 years later	31,054	25,566								
9 years later	31,048									
Net cumulative redundancy (deficiency)	4,013	8,385	1,608	4,319	964	1,023	(1,367)	810	(476)	
Cumulative amount of net liability paid as of:										
1 year later	30,867	24,747	32,871	42,301	42,478	63,761	59,977	53,387	79,853	
2 years later	30,818	25,149	34,625	42,668	43,245	64,203	60,517	53,872		
3 years later	30,875	25,388	36,157	43,140	43,495	64,391	61,081			
4 years later	30,989	25,462	39,533	43,361	43,563	64,477				
5 years later	31,026	25,521	39,646	43,365	43,648					
6 years later	31,030	25,538	37,674	43,365						
7 years later	31,029	25,564	39,674							
8 years later	31,051	25,565								
9 years later	31,048									

* Including amounts paid in respective year.

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American Summit Insurance Company
Analysis of Loss Reserve Development
(in thousands)

	Year Ended December 31,									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Original Reserve*	\$ 6,235	\$ 8,297	\$ 11,041	\$ 13,003	\$ 9,351	\$ 12,769	\$ 9,773	\$ 12,486	\$ 14,829	\$ 13,547
1 year later	5,322	7,388	9,932	13,014	9,154	12,009	9,423	13,153	14,126	
2 years later	5,512	6,999	9,918	12,998	9,335	11,943	9,088	12,974		
3 years later	5,563	6,859	9,918	13,435	9,235	11,880	9,023			
4 years later	5,401	6,772	9,797	13,216	9,200	12,048				
5 years later	5,396	6,714	9,820	13,195	9,197					
6 years later	5,394	6,787	9,815	13,188						
7 years later	5,396	6,743	9,812							
8 years later	5,417	6,730								
9 years later	5,417									
Net cumulative redundancy (deficiency)	818	1,567	1,229	(185)	154	721	750	(488)	703	
Cumulative amount of net liability paid as of:										
1 year later	4,987	6,566	9,341	12,429	8,732	11,560	8,800	12,390	13,511	
2 years later	5,612	6,610	9,578	12,639	9,095	11,637	8,803	12,632		
3 years later	5,756	6,682	9,679	13,326	9,193	11,726	8,917			
4 years later	5,393	6,699	9,740	13,161	9,196	12,040				
5 years later	5,393	6,714	9,813	13,188	9,196					
6 years later	5,394	6,720	9,813	13,188						
7 years later	5,394	6,723	9,812							
8 years later	5,417	6,730								
9 years later	5,417									

* Including amounts paid in respective year.

Please refer to Note 25 in the notes to consolidated financial statements for a reconciliation of the reserves presented in the tables above to the reserves for losses and loss adjustment expenses set forth in the consolidated balance sheets at December 31, 2012 and 2011.

Current loss reserve development has been favorable with the exception of accident year 2009. In the accident years 2007 and 2008, the developed reserves as of December 31, 2012 were \$1.1 million and \$1.8 million, respectively, less than the initial carried reserve for each year. During accident year 2009, however, loss development was unfavorable by \$0.6 million due to unfavorable development at NLIC of \$1.4 million. The unfavorable development at NLIC in accident year 2009 was due to adverse development on our homeowners product of \$0.6 million. During accident year 2010, the loss development was favorable by \$0.3 million due to favorable development at NLIC of \$0.8 million, offset by unfavorable development at ASIC of \$0.5 million. The unfavorable development at ASIC in accident year 2010 is due to adverse development on homeowners products of \$0.4 million. The favorable development of \$0.2 million during accident year 2011 was due to

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favorable development of \$0.7 million at ASIC, offset by unfavorable development of \$0.5 million at NLIC. For the accident years 2003 through 2007, the reserves were \$22.9 million favorable. Starting in 2002, IBNR loss reserves were strengthened, contributing to the favorable development in accident years 2003, 2004 and 2005. This strengthening of reserves was due to increases in direct premium written and increased net premium written from reductions in quota share reinsurance, a form of pro rata insurance.

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The following table is a reconciliation of the gross liability to net liability for losses and loss adjustment expenses (in thousands).

	December 31, *					
	2007	2008	2009	2010	2011	2012
Gross unpaid losses	\$ 18,091	\$ 34,023	\$ 33,780	\$ 58,882	\$ 44,835	\$ 34,012
Reinsurance recoverable	(2,692)	(14,613)	(21,102)	(43,773)	(25,083)	(10,385)
Net unpaid losses	\$ 15,399	\$ 19,410	\$ 12,678	\$ 15,109	\$ 19,752	\$ 23,627

* Information is not presented for the periods ended prior to January 31, 2007, as that is the date Hilltop Holdings Inc. acquired the insurance operations.

Financial Advisory

Our financial advisory segment operates through First Southwest. FSC, a wholly owned subsidiary of First Southwest, is a diversified investment banking firm and a registered broker-dealer with the Securities and Exchange Commission (the SEC) and the Financial Industry Regulatory Authority (FINRA). First Southwest's primary focus is on providing public finance services.

At December 31, 2012, First Southwest employed approximately 400 people and maintained 26 locations nationwide, nine of which are in Texas. At December 31, 2012, First Southwest maintained \$114.4 million in equity capital and had more than 1,600 public sector clients. At December 31, 2012, it had consolidated assets of \$592.0 million.

First Southwest has five primary lines of business: (i) public finance, (ii) capital markets, (iii) correspondent clearing services, (iv) asset management and (v) corporate finance.

Public Finance. First Southwest's public finance group represents its largest department. This group advises cities, counties, school districts, utility districts, tax increment zones, special districts, state agencies and other governmental entities nationwide. In addition, the group provides specialized advisory and investment banking services for airports, convention centers, healthcare institutions, institutions of higher education, housing, industrial development agencies, toll road authorities, and public power and utility providers.

Capital Markets. Through its capital markets group, First Southwest trades fixed income securities to support sales and other customer activities, underwrites tax-exempt and taxable fixed income securities and trades equities on an agency basis on behalf of its retail and institutional clients. In addition, First Southwest provides asset and liability management advisory services to community banks.

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Correspondent Clearing Services. The correspondent clearing services group offers omnibus and fully disclosed clearing services to FINRA member firms for trade executing, clearing and back office services. Services are provided to approximately 75 correspondent firms.

Asset Management. First Southwest Asset Management is an investment advisor registered under the Investment Advisors Act of 1940 providing state and local governments with advice and assistance with respect to arbitrage rebate compliance, portfolio management and local government investment pool administration. In the area of arbitrage rebate, First Southwest Asset Management advises municipalities with respect to the emerging regulations relating to arbitrage rebates. Further, First Southwest Asset Management assists governmental entities with the complexities of investing public funds in the fixed income markets. As an investment adviser registered with the SEC, First Southwest Asset Management promotes cash management-based investment strategies that seek to adhere to the standards imposed by the fiduciary responsibilities of investment officers of public funds. At December 31, 2012, First Southwest Asset Management served as administrator for local government investment pools totaling \$8.3 billion, investment manager of \$6.2 billion in short-term fixed income portfolios of municipal governments and investment advisor for \$6.2 billion invested by municipal governments.

Corporate Finance. First Southwest's corporate finance group provides focused and tailored investment banking services to institutions and corporations. These services include capital raising, advisory services and corporate restructuring.

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Competition

We face significant competition with respect to the business segments in which we operate and the geographic markets we serve. Our lending and mortgage origination competitors include commercial banks, savings banks, savings and loan associations, credit unions, finance companies, pension trusts, mutual funds, insurance companies, mortgage bankers and brokers, brokerage and investment banking firms, asset-based non-bank lenders, government agencies and certain other non-financial institutions. Competition for deposits and in providing lending and mortgage origination products and services to businesses in our market area is intense and pricing is important. Other factors encountered in competing for savings deposits are convenient office locations, interest rates and fee structures of products offered. Direct competition for savings deposits also comes from other commercial bank and thrift institutions, money market mutual funds and corporate and government securities that may offer more attractive rates than insured depository institutions are willing to pay. Competition for loans includes such additional factors as interest rate, loan origination fees and the range of services offered by the provider. We seek to distinguish ourselves from our competitors through our commitment to personalized customer service and responsiveness to customer needs while providing a range of competitive loan and deposit products and other services.

Our insurance business competes with a large number of other companies in its selected lines of business, including major U.S. and non-U.S. insurers, regional companies, mutual companies, specialty insurance companies, underwriting agencies and diversified financial services companies. The personal lines market in Texas is dominated by a few large carriers and their subsidiaries and affiliates. We seek to distinguish ourselves from our competitors by targeting underserved market segments that provide us with the best opportunity to obtain favorable policy terms, conditions and pricing.

We also face significant competition for financial advisory services on a number of factors such as price, perceived expertise, range of services, and local presence. Our financial advisory business competes directly with numerous other financial advisory and investment banking firms, broker-dealers and banks, including large national and major regional firms and smaller niche companies, some of whom are not broker-dealers and, therefore, are not subject to the broker-dealer regulatory framework. Many of our competitors have substantially greater financial resources, lending limits and larger branch networks than we do, and offer a broader range of products and services. Our financial advisory business competes on the basis of a number of factors, including the quality of advice and service, innovation, reputation and price.

Employees

At December 31, 2012, we employed approximately 3,950 persons, substantially all of which are full-time. None of our employees are represented by any collective bargaining unit or a party to any collective bargaining agreement.

Government Supervision and Regulation

General

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

Recent Regulatory Developments. New regulations and statutes are regularly proposed and/or adopted that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating and doing business in the United States. Certain of these recent proposals and changes are described below.

On July 21, 2010, President Obama signed into law the Dodd-Frank Act. The Dodd-Frank Act aims to restore responsibility and accountability to the financial system by significantly altering the regulation of financial institutions and the financial services industry. Most of the provisions contained in the Dodd-Frank Act have delayed effective dates. Full implementation of the Dodd-Frank Act will require many new rules to be issued by federal regulatory agencies over the next several years, which will profoundly affect how financial institutions will be regulated in the future. The ultimate effect of the Dodd-Frank Act and its implementing regulations on the financial services industry in general, and on us in particular, is uncertain at this time.

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The Dodd-Frank Act, among other things:

- Established the Consumer Financial Protection Bureau (the CFPB), an independent organization within the Federal Reserve which has the authority to promulgate consumer protection regulations applicable to all entities offering consumer financial products or services, including banks and mortgage originators. The CFPB has broad rule-making authority for a wide range of consumer protection laws, including the authority to prohibit unfair, deceptive or abusive acts and practices.
- Established the Financial Stability Oversight Council, tasked with the authority to identify and monitor institutions and systems which pose a systemic risk to the financial system, and to impose standards regarding capital, leverage, liquidity, risk management, and other requirements for financial firms.
- Changed the base for FDIC insurance assessments.
- Increased the minimum reserve ratio for the Deposit Insurance Fund from 1.15% to 1.35% (the FDIC subsequently increased it by regulation to 2.00%).
- Permanently increased the deposit insurance coverage amount from \$100,000 to \$250,000.
- Directed the Federal Reserve to establish interchange fees for debit cards pursuant to a restrictive reasonable and proportional cost per transaction standard.
- Limits the ability of banking organizations to sponsor or invest in private equity and hedge funds and to engage in proprietary trading in a provision known as the Volcker Rule.
- Grants the U.S. government authority to liquidate or take emergency measures with respect to troubled nonbank financial companies that fall outside the existing resolution authority of the FDIC, including the establishment of an orderly liquidation fund.
- Increases regulation of asset-backed securities, including a requirement that issuers of asset-backed securities retain at least 5% of the risk of the asset-backed securities.

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- Increases regulation of consumer protections regarding mortgage originations, including banker compensation, minimum repayment standards, and prepayment consideration.
- Establishes new disclosure and other requirements relating to executive compensation and corporate governance.

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

On April 14, 2011, the Federal Reserve Board and various other federal agencies published a notice of proposed rulemaking implementing provisions of the Dodd-Frank Act that would require reporting of incentive-based compensation arrangements by a covered financial institution and prohibit incentive-based compensation arrangements at a covered financial institution that provide excessive compensation or that could expose the institution to inappropriate risks that could lead to material financial loss. The Dodd-Frank Act defines covered financial institution to include, among other entities, a depository institution or depository institution holding company that has \$1 billion or more in assets. There are

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enhanced requirements for institutions with more than \$50 billion in assets. The proposed rule states that it is consistent with the Incentive Compensation Guidance.

On January 10, 2013, the CFPB issued a final rule to implement the qualified mortgage, or QM provisions of the Dodd-Frank Act requiring mortgage lenders to consider consumers' ability to repay home loans before extending them credit. The final rule describes certain minimum requirements for creditors making ability-to-repay determinations, but does not dictate that they follow particular underwriting models. Lenders will be presumed to have complied with the ability-to-repay rule if they issue qualified mortgages, which are generally defined as mortgage loans prohibiting or limiting certain risky features. Loans that do not meet the ability-to-repay standard can be challenged in court by borrowers who default and the absence of ability-to-repay status can be used against a creditor in foreclosure proceedings. The CFPB's QM rule will take effect on January 10, 2014.

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

Hilltop Holdings Inc.

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

Changes of control. Federal and state laws impose additional notice, approval and ongoing regulatory requirements on any investor that seeks to acquire direct or indirect control of a regulated holding company, such as Hilltop. These laws include the Bank Holding Company Act, the Change in Bank Control Act and the Texas Insurance Code. Among other things, these laws require regulatory filings by an investor that seeks to acquire direct or indirect control of a regulated holding company. The determination whether an investor controls a regulated holding company is based on all of the facts and circumstances surrounding the investment. As a general matter, an investor is deemed to control a depository institution or other company if the investor owns or controls 25% or more of any class of voting stock. Subject to rebuttal, an investor may be presumed to control the regulated holding company if the investor owns or controls 10% or more of any class of voting stock. Accordingly, these laws would apply to a person acquiring 10% or more of Hilltop's common stock. Furthermore, these laws may discourage potential acquisition proposals and may delay, deter or prevent change of control transactions, including those that some or all of our stockholders might consider to be desirable.

Regulatory Restrictions on Dividends; Source of Strength. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries.

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

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

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

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

Safe and Sound Banking Practices. Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board's Regulation Y, for example, generally requires a holding company to give the Federal Reserve Board prior notice of any redemption or repurchase of its equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company's consolidated net worth. In addition, bank holding companies are required to consult with the Federal Reserve Board prior to making any redemption or repurchase, even within the foregoing parameters. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Depending upon the circumstances, the Federal Reserve Board could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries that represent unsafe and unsound banking practices or that constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as \$1.425 million for each day the activity continues. In addition, the Dodd-Frank Act authorizes the Federal Reserve Board to require reports from and examine bank holding companies and their subsidiaries, and to regulate functionally regulated subsidiaries of bank holding companies.

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

Capital Adequacy Requirements. The Federal Reserve Board has adopted a system using risk-based capital guidelines to evaluate the capital adequacy of bank holding companies. Under the guidelines, a risk weight factor of 0% to 100% is assigned to each category of assets based generally on the perceived credit risk of the asset class. The risk weights are then multiplied by the corresponding asset balances to determine a risk-weighted asset base. At least half of the risk-based capital must consist of core (Tier 1) capital, which is comprised of:

- common stockholders' equity (includes common stock and any related surplus, undivided profits, disclosed capital reserves that represent a segregation of undivided profits and foreign currency translation adjustments, excluding changes in other

comprehensive income (loss));

- certain noncumulative perpetual preferred stock and related surplus; and
- minority interests in the equity capital accounts of consolidated subsidiaries (excludes goodwill and various intangible assets).

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The remainder, supplementary (Tier 2) capital, may consist of:

- allowance for loan losses, up to a maximum of 1.25% of risk-weighted assets;
- certain perpetual preferred stock and related surplus;
- hybrid capital instruments;
- perpetual debt;
- mandatory convertible debt securities;
- term subordinated debt;
- intermediate term preferred stock; and
- certain unrealized holding gains on equity securities.

Total capital is the sum of Tier 1 and Tier 2 capital. The guidelines require a minimum ratio of total capital to total risk-weighted assets of 8.0% (of which at least 4.0% is required to consist of Tier 1 capital elements). At December 31, 2012, our ratio of Tier 1 capital to total risk-weighted assets was 17.72% and our ratio of total capital to total risk-weighted assets was 17.81%.

In addition to the risk-based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company's Tier 1 capital divided by its average total consolidated assets. We are required to maintain a leverage ratio of 4.0%, and, at December 31, 2012, our leverage ratio was 13.08%. The Tier 1 Capital (to average assets) ratio was calculated using the average assets for the month of December 2012.

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

The Dodd-Frank Act directs federal banking agencies to establish minimum leverage capital requirements and minimum risk-based capital requirements for insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Federal Reserve Board. These minimum capital requirements may not be less than the generally applicable leverage and risk-based capital requirements applicable to insured depository institutions, in effect applying the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies. The Dodd-Frank Act, for the first time, embeds in the law a leverage capital requirement as opposed to leaving it to the regulators to use a risk-based capital requirement. However, it is left to the discretion of the agencies to set the leverage ratio requirement through the rulemaking process.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take prompt corrective action to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes undercapitalized, it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary's compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution's holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution's assets at the time it became undercapitalized or the amount necessary to cause the institution to be adequately capitalized. The bank regulators have greater power in situations where an institution becomes significantly or critically undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve Board approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Acquisitions by Bank Holding Companies. The Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or

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ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve Board is required to consider, among other things, the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served, and various competitive factors. In addition, the Dodd-Frank Act requires the Federal Reserve Board to consider the risk to the stability of the U.S. banking or financial system when evaluating acquisitions of banks and nonbanks under the Bank Holding Company Act. With respect to interstate acquisitions, the Dodd-Frank Act amends the Bank Holding Company Act by raising the standard by which interstate bank acquisitions are permitted from a standard that the acquiring bank holding company be adequately capitalized and adequately managed, to the higher standard of being well capitalized and well managed.

Control Acquisitions. The Change in Bank Control Act prohibits a person or group of persons from acquiring control of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, would, under the circumstances set forth in the presumption, constitute acquisition of control of such company.

In addition, an entity is required to obtain the approval of the Federal Reserve Board under the Bank Holding Company Act before acquiring 25% (5% in the case of an acquiror that is a bank holding company) or more of any class of our outstanding common stock, or otherwise obtaining control or a controlling influence over us.

Emergency Economic Stabilization Act of 2008 and the Small Business Jobs Act of 2010. The U.S. Congress, the U.S. Department of the Treasury (U.S. Treasury) and the federal banking regulators have taken broad action since early September 2008 to address volatility in the U.S. banking system. The Emergency Economic Stabilization Act of 2008 (EESA) authorized the U.S. Treasury to purchase from financial institutions and their holding companies up to \$700 billion in mortgage loans, mortgage-backed securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in the Troubled Asset Relief Program (TARP). The Dodd-Frank Act reduced the TARP authorization contained in the EESA to \$475 billion.

The stated purpose of TARP was to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. The U.S. Treasury allocated \$250 billion towards the TARP Capital Purchase Program. Under the Capital Purchase Program, the U.S. Treasury purchased debt or equity securities from eligible participating institutions. The TARP also provided for the direct purchases or guarantees of troubled assets of financial institutions.

On December 19, 2008, PlainsCapital sold 87,631 shares of its Fixed Rate Cumulative Perpetual Stock, Series A and a warrant to purchase, upon net exercise, 4,382 shares of its Fixed Rate Cumulative Perpetual Stock, Series B to the U.S. Treasury for \$87.6 million pursuant to the Capital Purchase Program. The U.S. Treasury immediately exercised its warrant on December 19, 2008, and PlainsCapital issued the underlying shares of its Series B Preferred Stock to the U.S. Treasury. On September 27, 2011, PlainsCapital entered into a Securities Purchase Agreement with the Secretary of the Treasury (the Purchase Agreement) pursuant to which PlainsCapital issued 114,068 shares of its newly designated Non-Cumulative Perpetual Preferred Stock, Series C for a total purchase price of \$114,068,000. The proceeds from the sale of PlainsCapital's Series C Preferred Stock were used to redeem and repurchase PlainsCapital's Series A and Series B Preferred Stock. PlainsCapital's Series C Preferred Stock was issued pursuant to the Small Business Lending Fund program, a \$30 billion fund established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets of less than \$10 billion. In connection with the Merger, Hilltop assumed PlainsCapital's obligations under the Purchase Agreement and redeemed PlainsCapital's outstanding Series C Preferred Stock in exchange for the Hilltop Series B Preferred Stock.

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On November 29, 2012, Hilltop filed with the State Department of Assessments and Taxation of the State of Maryland articles supplementary for the Hilltop Series B Preferred Stock, setting forth its terms. Holders of the Hilltop Series B Preferred Stock are entitled to noncumulative cash dividends at a fluctuating dividend rate based on the Bank's level of qualified small business lending. The Hilltop Series B Preferred Stock is non-voting, except in limited circumstances, and ranks senior to Hilltop's common stock with respect to the payment of dividends and distribution of assets upon any liquidation, dissolution or winding up of Hilltop.

The terms of the Hilltop Series B Preferred Stock restrict Hilltop's ability to pay dividends on, make distributions with respect to, or redeem, purchase or acquire, or make a liquidation payment on its common stock and other Hilltop capital stock ranking junior to the Hilltop Series B Preferred Stock, and on other preferred stock and other stock ranking on a

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parity with the Hilltop Series B Preferred Stock, in the event that Hilltop does not declare dividends on the Hilltop Series B Preferred Stock during any dividend period.

The Series B Preferred Stock qualifies as Tier 1 capital and is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1. The dividend rate, as a percentage of the liquidation amount, fluctuates on a quarterly basis during the first 10 quarters from its original issuance by PlainsCapital is outstanding, based upon changes in the level of Qualified Small Business Lending (QSBL) at the Bank. Until December 31, 2013, the dividend rate we pay on any outstanding shares of Series B Preferred Stock will fluctuate on a quarterly basis between one percent (1%) and five percent (5%) per annum, based upon changes in the level of qualified small business lending by the Bank measured against the Baseline. From January 1, 2014 through March 26, 2016, if we have not sufficiently increased our small business lending we may become subject to a dividend rate as high as seven percent (7%) per annum, and may be required to pay a dividend rate penalty of 0.5% per quarter. Beginning March 27, 2016, the dividend rate on any outstanding shares of Series B Preferred Stock will be fixed at nine percent (9%) per annum.

Except as noted in the next sentence, the Series B Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100 percent of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to approval of the Federal Reserve Board. In the Merger Agreement, Hilltop agreed not to redeem or otherwise acquire the Company's Series B Preferred prior to the second anniversary of the closing date of the Merger, or November 30, 2014. For more information, see Risk Factors. The Treasury's investment in us imposes restrictions and obligations upon us that could adversely affect the rights of our common stockholders.

Governmental Monetary Policies. Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the U.S. government and its agencies. The monetary policies of the Federal Reserve Board have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve Board affect the levels of bank loans, investments and deposits through its influence over the issuance of U.S. government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

PlainsCapital Bank

The Bank is subject to various requirements and restrictions under the laws of the United States, and to regulation, supervision and regular examination by the Texas Department of Banking. The Bank, as a state member bank, is also subject to regulation and examination by the Federal Reserve Board. As a bank with less than \$10 billion in assets, the Bank became subject to the regulations issued by the CFPB on July 21, 2011, although the Federal Reserve Board continues to examine the Bank for compliance with federal consumer protection laws. The Bank is also an insured depository institution and, therefore, subject to regulation by the FDIC, although the Federal Reserve Board is the Bank's primary federal regulator. The Federal Reserve Board, the Texas Department of Banking, the CFPB and the FDIC have the power to enforce compliance with applicable banking statutes and regulations. Such requirements and restrictions include requirements to maintain reserves against deposits, restrictions on the nature and amount of loans that may be made and the interest that may be charged thereon and restrictions relating to investments and other activities of the Bank. In July 2010, the FDIC voted to revise its Memorandum of Understanding with the primary federal regulators to enhance the FDIC's existing backup authorities over insured depository institutions that the FDIC does not directly supervise. As a result, the Bank may be subject to increased supervision by the FDIC.

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

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act, which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The Federal Reserve

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has also issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

Loans to Insiders. The restrictions on loans to directors, executive officers, principal stockholders and their related interests (collectively referred to herein as "insiders") contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests. These loans cannot exceed the institution's total unimpaired capital and surplus, and the Federal Reserve Board may determine that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions. The Dodd-Frank Act amends the statutes placing limitations on loans to insiders by including credit exposures to the person arising from a derivatives transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between the member bank and the person within the definition of an extension of credit.

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

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

Branching. The establishment of a branch must be approved by the Texas Department of Banking and the Federal Reserve Board, which consider a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate powers. The regulators will also consider the applicant's CRA record.

Interstate Branching. Effective June 1, 1997, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 amended the Federal Deposit Insurance Act and certain other statutes to permit state and national banks with different home states to merge across state lines, with approval of the appropriate federal banking agency, unless the home state of a participating bank had passed legislation prior to May 31, 1997 expressly prohibiting interstate mergers. Under the Riegle-Neal Act amendments, once a state or national bank has established branches in a state, that bank may establish and acquire additional branches at any location in the state at which any bank involved in the interstate merger transaction could have established or acquired branches under applicable federal or state law. If a state opted out of interstate branching within the specified time period, no bank in any other state may establish a branch in the state which has opted out, whether through an acquisition or de novo. Under the Dodd-Frank Act, de novo interstate branching by national banks is permitted if, under the laws of the state where the branch is to be located, a state bank chartered in that state would have been permitted to establish a branch.

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

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

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

In 2009, the FDIC adopted a final rule requiring a special assessment on insured institutions as part of its effort to rebuild the FDIC deposit insurance fund (DIF). The FDIC administers the DIF, and all insured depository institutions are required to pay assessments to the FDIC that fund the DIF. The Dodd-Frank Act broadens the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution during the assessment period. On February 7, 2011, the FDIC issued a final rule implementing revisions to the assessment system mandated by the Dodd-Frank Act. The new regulation was effective April 1, 2011 and was reflected in the June 30, 2011 FDIC DIF balance and the invoices for assessments due September 30, 2011. Accruals for DIF assessments were \$0.2 million for the month ended December 31, 2012.

The FDIC is required to maintain a designated reserve ratio of the DIF to insured deposits in the United States. The Dodd-Frank Act requires the FDIC to assess insured depository institutions to achieve a DIF ratio of at least 1.35 percent by September 30, 2020. Pursuant to its authority in the Dodd-Frank Act, the FDIC on December 20, 2010, published a final rule establishing a higher long-term target DIF ratio of greater than 2%. Deposit insurance assessment rates are subject to change by the FDIC and will be impacted by the overall economy and the stability of the banking industry as a whole. The FDIC will notify the Bank concerning an assessment rate that we will be charged for the assessment period. As a result of the new regulations, we expect to incur higher annual deposit insurance assessments, which could have a significant adverse impact on our financial condition and results of operations.

The Dodd-Frank Act permanently increased the standard maximum deposit insurance amount from \$100,000 to \$250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category.

The Dodd-Frank Act instituted, for all insured depository institutions, unlimited deposit insurance on noninterest-bearing transaction accounts for the period from December 31, 2010 through December 31, 2012 for all depositors, including consumers, businesses and government entities. This unlimited insurance coverage, which expired on December 31, 2012, was separate from, and in addition to, the insurance coverage provided to a depositor's other deposit accounts held at an FDIC-insured institution up to the permissible limit of \$250,000.

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

During the fourth quarter of 2011, the Bank received a satisfactory CRA rating in connection with its most-recent CRA Performance Evaluation. A CRA rating of less than satisfactory adversely affects a bank's ability to establish new

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branches and impairs a bank's ability to commence new activities that are financial in nature or acquire companies engaged in these activities. See Risk factors We are subject to extensive supervision and regulation that could restrict our activities and impose financial requirements or limitations on the conduct of our business and limit our ability to generate income.

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

Federal Laws Applicable to Credit Transactions. The loan operations of the Bank are also subject to federal laws applicable to credit transactions, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies and preventing identity theft;

- Fair Debt Collection Practices Act, governing the manner in which consumer debts may be collected by collection agencies;

- Service Members Civil Relief Act, which amended the Soldiers and Sailors Civil Relief Act of 1940, governing the repayment terms of, and property rights underlying, secured obligations of persons in military service;

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- The Dodd-Frank Act, which establishes the CFPB, an independent entity within the Federal Reserve, dedicated to promulgating and enforcing consumer protection laws applicable to all entities offering consumer financial services or products; and
- The rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates.

Federal Laws Applicable to Deposit Operations. The deposit operations of the Bank are subject to:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Truth in Savings Act, which requires the Bank to disclose the terms and conditions on which interest is paid and fees are assessed in connection with deposit accounts; and
- Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board and the CFPB to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of ATMs and other electronic banking services. The Dodd-Frank Act amends the Electronic Funds Transfer Act to, among other things, give the Federal Reserve Board the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

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

Under the regulatory capital guidelines, the Bank must maintain a total risk-based capital to risk-weighted assets ratio of at least 8.0%, a Tier 1 capital to risk-weighted assets ratio of at least 4.0%, and a Tier 1 capital to average total assets ratio of at least 4.0% (3.0% for banks receiving the highest examination rating) to be considered adequately capitalized. See the discussion herein under "The FDIC Improvement Act." At December 31, 2012, the Bank's ratio of total risk-based capital to risk-weighted assets was 11.93%, the Bank's ratio of Tier 1 capital to risk-weighted assets was 11.83% and the Bank's ratio of Tier 1 capital to average total assets was 8.84%. The Tier 1 Capital (to average assets) ratio was calculated using the average assets for the month of December 2012.

BASEL III. In December 2010 and January 2011, the Basel Committee on Banking Supervision (BCBS) published the final texts of reforms on capital and liquidity generally referred to as Basel III. Although Basel III is intended to be implemented by participating countries for large, internationally active banks, its provisions are likely to be considered by the U.S. banking regulators in developing new regulations applicable to other banks in the United States. For banks in the United States, among the most significant provisions of Basel III concerning capital are the following:

- a minimum ratio of common equity to risk-weighted assets reaching 4.5%, plus an additional 2.5% as a capital conservation buffer, after a phase-in period;
- a minimum ratio of Tier 1 capital to risk-weighted assets reaching 6.0% after a phase-in period;
- a minimum ratio of total capital to risk-weighted assets of 8.0%, plus the additional 2.5% capital conservation buffer, reaching 10.5% after a phase-in period;
- a minimum Tier 1 leverage ratio of 4.0%;
- an additional countercyclical capital buffer to be imposed by applicable banking regulators periodically at their discretion, with advance notice;
- restrictions on capital distributions and discretionary bonuses applicable when capital ratios fall within the buffer zone;
- deduction from common equity of deferred tax assets that depend on future profitability to be realized;

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- increased capital requirements for counterparty credit risk relating to over-the-counter derivatives, repos and securities financing activities;
- for capital instruments issued on or after January 13, 2013 (other than common equity), a loss-absorbency requirement such that the instrument must be written off or converted to common equity if a trigger event occurs, either pursuant to applicable law or at the direction of the banking regulator. A trigger event is an event under which the banking entity would become nonviable without the write-off or conversion, or without an injection of capital from the public sector. The issuer must maintain authorization to issue the requisite shares of common equity if conversion were required;
- increased capital requirements for holding 1 to 4 family residential mortgages; and
- increased capital requirements for the representations and warranties associated with originating and selling 1 to 4 family residential mortgages.

The Basel III provisions on liquidity include complex criteria establishing: (i) a method to ensure that a bank maintains adequate unencumbered, high quality liquid assets to meet its liquidity needs for 30 days under a severe liquidity stress scenario; and (ii) a method to promote more medium and long-term funding of assets and activities, using a one-year horizon.

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Although Basel III is described as a final text, it is subject to the resolution of certain issues and to further guidance and modification, as well as to adoption by United States banking regulators, including decisions as to whether and to what extent it will apply to United States banks that are not large, internationally active banks. On June 7, 2012, the Federal Reserve Board released notices of proposed rulemaking to implement the capital reforms of Basel III and to implement certain aspects of the standardized approach in the BCBS's final text on risk-based capital generally referred to as Basel II. Although the Basel III notice of proposed rulemaking did not specify an effective date or implementation schedule, it was originally contemplated that implementation would coincide with the Basel III implementation schedule, which commenced on January 1, 2013. However, in light of the volume of comments received and the wide range of issues expressed during the comment period, the Federal Reserve issued a press release on November 9, 2012 clarifying that it did not expect that any of the proposed rules would become effective on January 1, 2013 and will take operational and other considerations into account when determining appropriate implementation dates and associated transition periods. On January 6, 2013, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee, met and unanimously endorsed a 4 year delay in the Basel Committee's rules establishing a liquidity coverage ratio (LCR). Under the revised liquidity requirements, banks would be required to meet 60 percent of the LCR obligations by 2015, and the full rule would be phased in annually through 2019. At this time, it is unclear how these provisions will be implemented in the United States and what impact these delays in the effective dates will have on the capital proposals. We continue to monitor all developments related to Basel III.

FIRREA. The Financial Institutions Reform, Recovery and Enforcement Act of 1989, or FIRREA, includes various provisions that affect or may affect the Bank. Among other matters, FIRREA generally permits bank holding companies to acquire healthy thrifts as well as failed or failing thrifts. FIRREA removed certain cross marketing prohibitions previously applicable to thrift and bank subsidiaries of a common holding company. Furthermore, a multi-bank holding company may now be required to indemnify the DIF against losses it incurs with respect to such company's affiliated banks, which in effect makes a bank holding company's equity investments in healthy bank subsidiaries available to the FDIC to assist such company's failing or failed bank subsidiaries.

In addition, pursuant to FIRREA, any depository institution that has been chartered less than two years, is not in compliance with the minimum capital requirements of its primary federal banking regulator, or is otherwise in a troubled condition must notify its primary federal banking regulator of the proposed addition of any person to its board of directors or the employment of any person as a senior executive officer of the institution at least 30 days before such addition or employment becomes effective. During such 30 day period, the applicable federal banking regulatory agency may disapprove of the addition of or employment of such director or officer. The Bank is not subject to any such requirements. FIRREA also expanded and increased civil and criminal penalties available for use by the appropriate regulatory agency against certain institution affiliated parties primarily including: (i) management, employees and agents of a financial institution; (ii) independent contractors such as attorneys and accountants and others who participate in the conduct of the financial institution's affairs and who caused or are likely to cause more than minimum financial loss to or a significant adverse effect on the institution, who knowingly or recklessly violate a law or regulation, breach a fiduciary duty or engage in unsafe or unsound practices. Such practices can include the failure of an institution to timely file required reports or the submission of inaccurate reports. Furthermore, FIRREA authorizes the appropriate banking agency to issue cease and desist orders that may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets or take other action as determined by the ordering agency to be appropriate.

The FDIC Improvement Act. The Federal Deposit Insurance Corporation Improvement Act of 1991, or FDICIA, made a number of reforms addressing the safety and soundness of the deposit insurance system, supervision of domestic and foreign depository institutions, and improvement of accounting standards. This statute also limited deposit insurance coverage, implemented changes in consumer protection laws and provided for least-cost resolution and prompt regulatory action with regard to troubled institutions.

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

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FDICIA also places certain restrictions on activities of banks depending on their level of capital. FDICIA divides banks into five different categories, depending on their level of capital. Under regulations adopted by the FDIC:

- a bank is deemed to be well capitalized if it has a total Risk-Based Capital Ratio of 10.0% or more, a Tier 1 Capital Ratio of 6.0% or more, a Leverage Ratio of 5.0% or more, and the bank is not subject to an order or capital directive to meet and maintain a certain capital level;
- a bank is deemed to be adequately capitalized if it has a total Risk-Based Capital Ratio of 8.0% or more, a Tier 1 Capital Ratio of 4.0% or more and a Leverage Ratio of 4.0% or more (unless it receives the highest composite rating at its most recent examination and is not experiencing or anticipating significant growth, in which instance it must maintain a Leverage Ratio of 3.0% or more);
- a bank is deemed to be undercapitalized if it has a total Risk-Based Capital Ratio of less than 8.0%, a Tier 1 Capital Ratio of less than 4.0% or a Leverage Ratio of less than 4.0%;
- a bank is deemed to be significantly undercapitalized if it has a Risk-Based Capital Ratio of less than 6.0%, a Tier 1 Capital Ratio of less than 3.0% and a Leverage Ratio of less than 3.0%; and
- a bank is deemed to be critically undercapitalized if it has a Leverage Ratio of less than or equal to 2.0%.

In addition, the FDIC has the ability to downgrade a bank's classification (but not to critically undercapitalized) based on other considerations even if the bank meets the capital guidelines. According to these guidelines, the Bank was classified as well capitalized at December 31, 2012.

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

Furthermore, if a bank is classified as undercapitalized, the federal banking regulators may take certain actions to correct the capital position of the bank; if a bank is classified as significantly undercapitalized or critically undercapitalized, the federal banking regulators would be required to take one or more prompt corrective actions. These actions would include, among other things, requiring: sales of new securities to bolster capital, improvements in management, limits on interest rates paid, prohibitions on transactions with affiliates, termination of certain risky activities and restrictions on compensation paid to executive officers. If a bank is classified as critically undercapitalized, FDICIA requires the bank to be placed into conservatorship or receivership within 90 days, unless the federal banking regulators determines that other action would better achieve the purposes of FDICIA regarding prompt corrective action with respect to undercapitalized banks.

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The capital classification of a bank affects the frequency of examinations of the bank and impacts the ability of the bank to engage in certain activities and affects the deposit insurance premiums paid by such bank. Under FDICIA, the federal banking regulators are required to conduct a full-scope, on-site examination of every bank at least once every 12 months. An exception to this rule is made, however, that provides that banks (i) with assets of less than \$100 million, (ii) that are categorized as well capitalized, (iii) that were found to be well managed and composite rating was outstanding and (iv) have not been subject to a change in control during the last 12 months, need only be examined once every 18 months.

Brokered Deposits. Under FDICIA, banks may be restricted in their ability to accept brokered deposits, depending on their capital classification.

Well capitalized banks are permitted to accept brokered deposits, but banks that are not well capitalized are not permitted to accept such deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized to accept brokered deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank. At December 31, 2012, the Bank was well capitalized and therefore not subject to any limitations with respect to its brokered deposits. Brokered deposits are the subject of a study under the Dodd-Frank Act.

Federal limitations on activities and investments. The equity investments and activities, as a principle of FDIC-insured state-chartered banks, are generally limited to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank.

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

Federal Home Loan Bank System. The Federal Home Loan Bank, or FHLB, system, of which the Bank is a member, consists of 12 regional FHLBs governed and regulated by the Federal Housing Finance Board. The FHLBs serve as reserve or credit facilities for member institutions within their assigned regions. The reserves are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system. The FHLBs make loans (i.e., advances) to members in accordance with policies and procedures established by the FHLB and the boards of directors of each regional FHLB.

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

Anti-terrorism and Money Laundering Legislation. The Bank is subject to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism of 2001 (the USA PATRIOT Act), the Bank Secrecy Act and rules and regulations of the Office of Foreign Assets Control. These statutes and related rules and regulations impose requirements and limitations on specific financial transactions and account relationships intended to guard against money laundering and terrorism financing. The Bank has established a customer identification program pursuant to Section 326 of the USA PATRIOT Act and the Bank Secrecy Act, and otherwise has implemented policies and procedures intended to comply with the foregoing rules.

PrimeLending

PrimeLending and the Bank are subject to the rules and regulations of the CFPB, FHA, VA, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and Government National Mortgage Association with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines which include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts, and, with respect to VA loans, fix maximum interest rates. Mortgage origination activities are subject to, among others, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act, Secure and Fair Enforcement of Mortgage Licensing Act, Home Mortgage Disclosure Act, Fair Credit Reporting Act and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder which, among other things, prohibit discrimination and require the disclosure of certain basic information to borrowers concerning credit terms and settlement costs. PrimeLending and the Bank are also subject to regulation by the Texas Department of Banking with respect to, among other things, the establishment of maximum origination fees on certain types of mortgage loan products. PrimeLending and the Bank are also subject to the provisions of the Dodd-Frank Act. Among other things, the Dodd-Frank Act established the CFPB and provides mortgage reform provisions regarding a customer's ability to repay, restrictions on variable-rate lending, loan officers compensation, risk retention, and new disclosure requirements. The Dodd-Frank Act also clarifies that applicable state laws, rules and regulations related to the origination, processing, selling and servicing of mortgage loans continue to apply to PrimeLending. The additional regulatory requirements affecting our mortgage origination operations will result in increased compliance costs and may impact revenue.

On August 16, 2010, the Federal Reserve Board published a final rule on loan banker compensation, pursuant to the Dodd-Frank Act, which prohibits certain compensation payments to loan bankers and the practice of steering consumers to loans not in their interest when it will result

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in greater compensation for a loan banker. This final rule became effective on April 1, 2011, however, the Federal Reserve Board noted in the final rule that the CFPB may clarify the rule in the future pursuant to the CFPB's authority granted under the Dodd-Frank Act. In addition, the Dodd-Frank Act directed the Federal Reserve Board to promulgate regulations requiring lenders and securitizers to retain an economic interest in the credit risk relating to loans the lender sells and other asset-backed securities that the securitizer issues if the loans have not complied with the ability to repay standards spelled out in the Dodd-Frank Act and its implementing regulations. The risk retention requirement has not become effective to date but is expected to be 5%, subject to increase or decrease by regulation. Final regulations have not yet been issued.

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On March 2, 2011, the Federal Reserve Board published a final rule implementing a provision in the Dodd-Frank Act that provides a separate, higher rate threshold for determining when the escrow requirements apply to higher-priced mortgage loans that exceed the maximum principal obligation eligible for purchase by Freddie Mac.

In January 2013, the CFPB published a series of very detailed and complex final rules that will impact mortgage origination and servicing once they become effective, generally in January 2014 unless noted below. Had these final rules not been published, many of the statutory requirements in Title XIV of the Dodd-Frank Act would have become effective on January 21, 2013 without any implementing regulations.

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

Ability to Repay. This final rule implements the Dodd-Frank Act provisions requiring that for residential mortgages, creditors must make a reasonable and good faith determination based on verified and documented information that the consumer has a reasonable ability to repay the loan according to its terms. The final rule also establishes a presumption of compliance with the ability to repay determination for a certain category of mortgages called qualified mortgages meeting a series of detailed requirements. The final rule also provides a rebuttable presumption for higher-priced mortgage loans.

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

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

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

Escrow Requirements. This final rule implements Dodd-Frank Act changes that generally extend the required duration of an escrow account on certain higher-priced mortgage loans from a minimum of one year to a minimum of five years, subject to certain exemptions for loans made by certain creditors that operate predominantly in rural or underserved areas, as long as certain other criteria are met. This final rule is effective on June 1, 2013.

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Servicing. Two final rules were published to implement laws to protect consumers from detrimental actions by mortgage servicers and to provide consumers with better tools and information when dealing with mortgage servicers. One final rule amends Regulation Z, which implements the Truth in Lending Act, and a second final rule amends Regulation X, which implements the Real Estate Settlement Procedures Act. The rules cover nine major topics implementing the Dodd-Frank Act provisions related to mortgage servicing. The final rules include a number of exemptions and other adjustments for small servicers, defined as servicers that service 5,000 or fewer mortgage loans and service only mortgage loans that they or an affiliate originated or own.

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

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Additional rules and regulations are expected including risk retention rules which would require lenders and securitizers to retain an economic interest in the credit risk relating to loans the lender sells and other asset-backed securities that the securitizer issues if the loans have not complied with the ability to repay standards spelled out in the Dodd-Frank Act and its implementing regulations. The risk retention requirement has not become effective to date but is expected to be 5%, subject to increase or decrease by regulation. Any additional regulatory requirements affecting PrimeLending mortgage origination operations will result in increased compliance costs and may impact revenue.

NLASCO

NLASCO's insurance subsidiaries, NLIC and ASIC, are subject to regulation and supervision in each state where they are licensed to do business. This regulation and supervision is vested in state agencies having broad administrative power over the various aspects of the business of NLIC and ASIC.

State insurance holding company regulation. NLASCO controls two operating insurance companies, NLIC and ASIC, and is subject to the insurance holding company laws of Texas, the state in which those insurance companies are domiciled. These laws generally require NLASCO to register with the Texas Department of Insurance and periodically to furnish financial and other information about the operations of companies within its holding company structure. Generally under these laws, all transactions between an insurer and an affiliated company in its holding company structure, including sales, loans, reinsurance agreements and service agreements, must be fair and reasonable and, if satisfying a specified threshold amount or of a specified category, require prior notice and approval or non-objection by the Texas Department of Insurance.

National Association of Insurance Commissioners. The National Association of Insurance Commissioners, or NAIC, is a group consisting of state insurance commissioners that discuss issues and formulate policy with respect to regulation, reporting and accounting for insurance companies. Although the NAIC has no legislative authority and insurance companies are at all times subject to the laws of their respective domiciliary states and, to a lesser extent, other states in which they conduct business, the NAIC is influential in determining the form in which such laws are enacted. Certain Model Insurance Laws, Regulations and Guidelines, or Model Laws, have been promulgated by the NAIC as a minimum standard by which state regulatory systems and regulations are measured. Adoption of state laws that provide for substantially similar regulations to those described in the Model Laws is a requirement for accreditation by the NAIC.

The NAIC provides authoritative guidance to insurance regulators on current statutory accounting issues by promulgating and updating a codified set of statutory accounting practices in its Accounting Practices and Procedures Manual. The Texas Department of Insurance has generally adopted these codified statutory accounting practices.

Texas also has adopted laws substantially similar to the NAIC's risk based capital, or RBC laws, which require insurers to maintain minimum levels of capital based on their investments and operations. Domestic property and casualty insurers are required to report their RBC based on a formula that attempts to measure statutory capital and surplus needs based on the risks in the insurer's mix of products and investment portfolio. The formula is designed to allow the Texas Department of Insurance to identify potential inadequately capitalized companies. Under the formula, a company determines its RBC by taking into account certain risks related to its assets (including risks related to its investment portfolio and ceded reinsurance) and its liabilities (including underwriting risks related to the nature and experience of its insurance business). Among other requirements, an insurance company must maintain capital and surplus of at least 200% of the RBC computed by the NAIC's RBC model (known as the Authorized Control Level of RBC). At December 31, 2012, NLIC and ASIC capital and surplus levels exceeded the minimum RBC requirements that would trigger regulatory attention. In their 2012 statutory financial statements, both NLIC and ASIC complied with the NAIC's RBC reporting requirements.

The NAIC's Insurance Regulatory Information System, or IRIS, was developed to assist state insurance departments in executing their statutory mandates to oversee the financial condition of insurance companies. IRIS identifies twelve industry ratios and specifies a range of usual values for each ratio. Departure from the usual values on four or more of these ratios can lead to inquiries from state insurance commissioners as to certain aspects of an insurer's business. For 2012, all ratios for both NLIC and ASIC were within the usual values, with two exceptions. Both companies fell below the indicated minimum investment yield range of 3%, with NLIC at 2.8% and ASIC at 1.9%, due to the concentration in cash at each company. We expect improvement in the yields at both companies as appropriate investment opportunities are identified. Additionally, NLIC's two-year operating ratio was calculated at 101%, which is above the threshold of 100%, primarily due to the weather events experienced over the past two year period.

The NAIC adopted an amendment to its Model Audit Rule in response to the passage of the Sarbanes-Oxley Act of 2002, or SOX. The amendment is effective for financial statements for accounting periods after January 1, 2010. This amendment addresses auditor independence, corporate governance and, most notably, the application of certain provisions of Section 404 of SOX regarding internal control reporting. The rules relating to internal controls apply to insurers with gross direct and assumed written premiums of \$500 million or more, measured at the legal entity level (rather than at the insurance holding company level), and to insurers that the domiciliary commissioner selects from among those identified as in hazardous condition, but exempts SOX compliant entities. Neither NLIC nor ASIC currently has direct and assumed written premiums of at least \$500 million, but it is conceivable that this may change in the future; however, NLASCO must be SOX compliant because it is wholly owned by HTH, a public company subject to SOX.

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Legislative changes. From time to time, various regulatory and legislative changes have been, or are, proposed that would adversely affect the insurance industry. Among the proposals that have been, or are being, considered are the possible introduction of Federal regulation in addition to, or in lieu of, the current system of state regulation of insurers and proposals in various state legislatures (some of which proposals have been enacted) to conform portions of their insurance laws and regulations to various Model Laws adopted by the NAIC. NLASCO is unable to predict whether any of these laws and regulations will be adopted, the form in which any such laws and regulations would be adopted, or the effect, if any, these developments would have on its financial condition or results of operations.

In November 2002, in response to the tightening supply in certain insurance and reinsurance markets resulting from, among other things, the September 11, 2001 terrorist attacks, the Terrorism Risk Insurance Act, or TRIA, was enacted. TRIA was modified and extended by the Terrorism Risk Insurance Extension Act of 2005 and extended again by the Terrorism Risk Insurance Program Reauthorization Act of 2007. These Acts created a Federal Program designed to ensure the availability of commercial insurance coverage for terrorist acts in the United States. This Program helped the commercial property and casualty insurance industry cover claims related to terrorism-related losses and requires such companies to offer coverage for certain acts of terrorism. As a result, NLASCO is prohibited from adding certain terrorism exclusions to the policies written by its insurance company subsidiaries. The 2005 Act extended the Program through 2007, but eliminated commercial auto, farm-owners and certain other commercial coverages from its scope. The Reauthorization Act further extended the Program through December 31, 2014 and fixed the reimbursement percentage at 85% and the deductible at 20%. Although NLASCO is protected by federally funded terrorism reinsurance as provided for in the TRIA, there is a substantial deductible that must be met, the payment of which could have an adverse effect on its financial condition and results of operations. NLASCO's deductible under the Program was \$1.6 million for 2012 and is estimated to be \$1.7 million in 2013. Potential future changes to the TRIA could also adversely affect NLASCO by causing its reinsurers to increase prices or withdraw from certain markets where terrorism coverage is required. NLASCO had no terrorism-related losses in 2012.

State insurance regulations. State insurance authorities have broad powers to regulate U.S. insurance companies. The primary purposes of these powers are to promote insurer solvency and to protect individual policyholders. The extent of regulation varies, but generally has its source in statutes that delegate regulatory, supervisory and administrative power to state insurance departments. These powers relate to, among other things, licensing to transact business, accreditation of reinsurers, admittance of assets to statutory surplus, regulating unfair trade and claims practices, establishing actuarial requirements and solvency standards, regulating investments and dividends, and regulating policy forms, related materials and premium rates. State insurance laws and regulations require insurance companies to file financial statements prepared in accordance with accounting principles prescribed by insurance departments in states in which they conduct insurance business, and their operations are subject to examination by those departments.

As part of the broad authority that state insurance commissioners hold, they may impose periodic rules or regulations related to local issues or events. An example is the State of Louisiana's prohibition on the cancellation of policies for nonpayment of premium in the wake of Hurricane Katrina. Due to the extent of damage and displacement of people, inability of mail to reach policyholders and inaccessibility of entire neighborhoods, the State of Louisiana prohibited insurance companies from canceling policies for a period of time following that named storm.

Periodic financial and market conduct examinations. The insurance departments in every state in which NLASCO's insurance companies do business may conduct on-site visits and examinations of its insurance companies at any time to review the insurance companies' financial condition, market conduct and relationships and transactions with affiliates. In addition, the Texas Department of Insurance will conduct comprehensive examinations of insurance companies domiciled in Texas every three to five years. Examinations are generally carried out in cooperation with the insurance departments of other licensing states under guidelines promulgated by the NAIC.

The Texas Department of Insurance completed their last examinations of NLIC and ASIC through December 31, 2010 in an examination report dated May 12, 2012. This examination report contained no information of any significant compliance issues and there is no indication of any

significant changes to our financial statements as a result of the examination by the domiciliary state.

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State dividend limitations. The Texas Department of Insurance must approve any dividend declared or paid by an insurance company domiciled in the state if the dividend, together with all dividends declared or distributed by that insurance company during the preceding twelve months, exceeds the greater of (1) 10% of its policyholders' surplus as of December 31 of the preceding year or (2) 100% of its net income for the preceding calendar year. The greater number is known as the insurer's extraordinary dividend limit. At December 31, 2012, the extraordinary dividend limit for NLIC and ASIC is \$9.5 million and \$2.6 million, respectively. In addition, NLASCO's insurance companies may only pay dividends out of their earned surplus.

Statutory accounting principles. Statutory accounting principles, or SAP, are a comprehensive basis of accounting developed to assist insurance regulators in monitoring and regulating the solvency of insurance companies. SAP rules are different from GAAP, and are intended to reflect a more conservative view of the insurer. SAP is primarily concerned with measuring an insurer's surplus to policyholders. Accordingly, SAP focuses on valuing assets and liabilities of insurers at financial reporting dates in accordance with insurance laws and regulatory provisions applicable in each insurer's domiciliary state.

While GAAP is concerned with a company's solvency, it also stresses other financial measurements, such as income and cash flows. Accordingly, GAAP gives more consideration to appropriate matching of revenues and expenses and accounting for management's stewardship of assets than does SAP. As a direct result, different amounts of assets and liabilities will be reflected in financial statements prepared in accordance with GAAP as opposed to SAP. SAP, as established by the NAIC and adopted by Texas regulators, determines the statutory surplus and statutory net income of the NLASCO insurance companies and, thus, determines the amount they have available to pay dividends.

Guaranty associations. In Texas, and in all of the jurisdictions in which NLIC and ASIC are, or in the future may be, licensed to transact business, there is a requirement that property and casualty insurers doing business within the jurisdiction must participate in guaranty associations, which are organized to pay limited covered benefits owed pursuant to insurance policies issued by impaired, insolvent or failed insurers. These associations levy assessments, up to prescribed limits, on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the lines of business in which the impaired, insolvent or failed insurer was engaged. States generally permit member insurers to recover assessments paid through full or partial premium tax offsets.

NLASCO did not incur any levies in 2012, 2011 or 2010. Property and casualty insurance company insolvencies or failures may, however, result in additional guaranty fund assessments at some future date. At this time NLASCO is unable to determine the impact, if any, that these assessments may have on its financial condition or results of operations. NLASCO has established liabilities for guaranty fund assessments with respect to insurers that are currently subject to insolvency proceedings.

National Flood Insurance Program. NLASCO voluntarily participates as a Write Your Own carrier in the National Flood Insurance Program, or NFIP. The NFIP is administered and regulated by the Federal Emergency Management Agency (FEMA). NLASCO operates as a fiscal agent of the Federal government in the selling and administering of the Standard Flood Insurance Policy. This involves writing the policy, the collection of premiums and the paying of covered claims. All pricing is set by FEMA and all collections are made by the Company.

The Company cedes 100% of the policies written by the Company on the Standard Flood Insurance Policy to FEMA; however, if FEMA were unable to perform, the Company would have a legal obligation to the policyholders. The terms of the reinsurance agreement are standard terms, which require the Company to maintain its rating criteria, determine policyholder eligibility, issue policies on the Company's paper, endorse and cancel policies, collect from insureds and process claims. NLASCO receives ceding commissions from NFIP for underwriting administration, claims management, commission and adjuster fees.

Participation in involuntary risk plans. NLASCO's insurance companies are required to participate in residual market or involuntary risk plans in various states where they are licensed that provide insurance to individuals or entities that otherwise would be unable to purchase coverage from private insurers. If these plans experience losses in excess of their capitalization, they may assess participating insurers for proportionate shares of their financial deficit. These plans include the Georgia Underwriting Association, Texas FAIR Plan Association, Texas Windstorm Insurance Agency, or TWIA, the Louisiana Citizens Property Insurance Corporation, the Mississippi Residential Property Insurance Underwriting Association and the Mississippi Windstorm Underwriting Association. For example in 2005, following Hurricanes Katrina and Rita, the above plans levied collective assessments totaling \$10.4 million on NLASCO's insurance subsidiaries. Additional assessments, including emergency assessments, may follow. In some of these instances, NLASCO's insurance companies should be able to recover these assessments through policyholder surcharges, higher rates or reinsurance. The ultimate impact hurricanes have on the Texas and Louisiana facilities is currently uncertain and future assessments can occur whenever the involuntary facilities experience financial deficits.

Other. Insurance activities are subject to state insurance laws and regulations as determined by the particular insurance commissioner for each state in accordance with the McCarran-Ferguson Act, as well as subject to the Gramm-Leach-Bliley Act and the privacy regulations promulgated by the Federal Trade Commission.

Changes in any of the laws governing our conduct could have an adverse impact on our ability to conduct our business or could materially affect our financial position, operating income, expense or cash flow.

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First Southwest

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

The regulations to which broker-dealers are subject cover all aspects of the securities business, including sales and trade practices, capital structure, record keeping and the conduct of registered persons, directors, officers and employees. Broker-dealers are also subject to the privacy and anti-money laundering laws and regulations discussed previously. Additional legislation, changes in rules promulgated by the SEC and by self-regulatory organizations or changes in the interpretation or enforcement of existing laws and rules often directly affect the method of operation and profitability of broker-dealers. The SEC, the self-regulatory organizations and states may conduct administrative and enforcement proceedings that can result in censure, fine, suspension or expulsion of a broker-dealer, its registered persons, officers or employees. The principal purpose of regulation and discipline of broker-dealers is the protection of customers and the securities markets rather than protection of creditors and stockholders of broker-dealers.

Limitation on Businesses. The businesses that FSC may conduct are limited by its agreements with, and its oversight by, FINRA and by federal and state law. Participation in new business lines, including trading of new products or participation on new exchanges or in new countries often requires governmental and/or exchange approvals, which may take significant time and resources. In addition, FSC is an operating subsidiary of the Bank, which means its activities are further limited by those that are permissible for the Bank. As a result, FSC may be prevented from entering new businesses that may be profitable in a timely manner, if at all.

Net Capital Requirements. The SEC, FINRA and various other regulatory authorities have stringent rules and regulations with respect to the maintenance of specific levels of net capital by regulated entities. Rule 15c3-1 of the Exchange Act (the "Net Capital Rule") requires that a broker-dealer maintain minimum net capital. Generally, a broker-dealer's net capital is net worth plus qualified subordinated debt less deductions for non-allowable (or non-liquid) assets and other adjustments and operational charges. At December 31, 2012, FSC was in compliance with applicable net capital requirements.

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

Securities Investor Protection Corporation. FSC is required by federal law to belong to the SIPC, whose primary function is to provide financial protection for the customers of failing brokerage firms. SIPC provides protection for clients up to \$500,000, of which a maximum of \$250,000 may be in cash.

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

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Item 1A. Risk Factors.

Risks Related to our Business

We may fail to realize all of the anticipated benefits of our recent Merger with PlainsCapital.

On November 30, 2012, we acquired PlainsCapital pursuant to the Merger. The success of the Merger will depend, in part, on our ability to successfully combine PlainsCapital Corporation's business with our own. We expect to incur substantial expenses in connection with the integration of the business, operations, networks, systems, technologies, policies and procedures of the two previously independent companies. Achieving the anticipated cost savings and financial benefits of the Merger will depend in part on whether we integrate PlainsCapital Corporation's businesses in an efficient and effective manner. It is possible that the integration process could result in the loss of key employees, the disruption of ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients, customers, depositors and employees. In addition, the integration of certain operations will require the dedication of significant management resources, which may temporarily distract management's attention from our day-to-day business. Any inability to realize the full extent, or any, of the anticipated cost savings and financial benefits of the Merger, as well as any delays encountered in the integration process, could have an adverse effect on our business and results of operations, which could affect our financial condition and cause a decrease in our earnings per share or decrease or delay the expected accretive effect of the Merger and contribute to a decrease in the price of our common stock.

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

At December 31, 2012, approximately 29% of the loan portfolio of our banking segment was comprised of loans with real estate as the primary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A decline in real estate values generally and in Texas specifically could impair the value of our collateral and our ability to sell the collateral upon any foreclosure. In the event of a default with respect to any of these loans, the amounts we receive upon sale of the collateral may be insufficient to recover the outstanding principal and interest on the loan. As a result, our profitability and financial condition may be adversely affected by a decrease in real estate market values.

If our allowance for loan losses is insufficient to cover actual loan losses, our banking segment earnings will be adversely affected.

As a lender, we are exposed to the risk that we could sustain losses because our borrowers may not repay their loans in accordance with the terms of their loans. We have historically accounted for this risk by maintaining an allowance for loan losses in an amount intended to cover Bank management's estimate of losses inherent in the loan portfolio. As a result of the Merger, we were required under GAAP to estimate the fair value of the loan portfolio after the consummation of the Merger and write-down the recorded value of the portfolio to that estimate. For most loans, this process was accomplished by computing the net present value of estimated cash flows to be received from borrowers of these loans. PlainsCapital's allowance for loan losses that had been maintained prior to the Merger was eliminated in this accounting process. A new allowance for loan losses has been established for loans made subsequent to consummation of the Merger and for any subsequent decrease in the estimate of cash flows to be received from the loans held at the time of the Merger.

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

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

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

We conduct our banking operations primarily in Texas. Substantially all of the real estate loans in our loan portfolio are secured by properties located in Texas, with more than 82% secured by properties located in the Dallas/Fort Worth and Austin/San Antonio markets at December 31, 2012. Adverse economic conditions in Texas may result in a reduction in the value of the collateral securing these loans. Likewise, substantially all of the real estate loans in our loan portfolio are made to borrowers who live and conduct business in Texas. In addition, mortgage origination fee income is dependent to a significant degree on economic conditions in Texas and California. During 2012, approximately 21% and 17% by dollar volume of our mortgage loans originated were collateralized by properties located in Texas and California, respectively. Texas insureds accounted for approximately 70% and 73% of our insurance segment's gross premiums written in 2012 and 2011, respectively. Any regional or local economic downturn that affects Texas or, to a lesser extent, California, may affect us and our profitability more significantly and more adversely than our competitors that are less geographically concentrated.

Our geographic concentration may also exacerbate the adverse effects on our insurance segment of inherently unpredictable catastrophic events.

Our insurance segment expects to have large aggregate exposures to inherently unpredictable natural and man-made disasters of great severity, such as hurricanes, hail, tornados, windstorms, wildfires and acts of terrorism. Hurricanes Ike, Katrina and Rita highlighted the challenges inherent in predicting the impact of catastrophic events. The catastrophe models utilized by our insurance segment to assess its probable maximum insurance losses generally failed to adequately project the financial impact of these hurricanes. Although our insurance segment may attempt to exclude certain losses, such as terrorism and other similar risks, from some coverage that our insurance segment writes, it may be prohibited from, or may not be successful in, doing so. The occurrence of losses from catastrophic events may have a material adverse effect on our insurance segment's ability to write new business and on its financial condition and results of operations. Increases in the values and geographic concentrations of policyholder property and the effects of inflation have resulted in increased severity of industry losses in recent years, and our insurance segment expects that these factors will increase the severity of losses in the future. Factors that may influence our insurance segment's exposure to losses from these types of events, in addition to the routine adjustment of losses, include, among others:

- exhaustion of reinsurance coverage;
- increases in reinsurance rates;
- unanticipated litigation expenses;
- unrecoverability of ceded losses;
- impact on independent agent operations and future premium income in areas affected by catastrophic events;
- unanticipated expansion of policy coverage or reduction of premium due to regulatory, legislative and/or judicial action following a catastrophic event; and
- unanticipated demand surge related to other recent catastrophic events.

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Our insurance segment writes insurance primarily in the states of Texas, Arizona, Tennessee, Oklahoma, Georgia and Louisiana. In 2012, Texas accounted for 69.5%, Arizona accounted for 8.2%, Oklahoma accounted for 9.0%, Tennessee accounted for 6.2%, Georgia accounted for 3.2%, and Louisiana accounted for 1.8% of our premiums. As a result, a single catastrophe, destructive weather pattern, wildfire, terrorist attack, regulatory development or other condition or general economic trend affecting these regions or significant portions of these regions could adversely affect our insurance segment's financial condition and results of operations more significantly than other insurance companies that conduct business across a broader geographic area. Although our insurance segment purchases catastrophe reinsurance to limit its exposure to these types of catastrophes, in the event of one or more major catastrophes resulting in losses to it in excess of \$170.0 million, our insurance segment's losses would exceed the limits of its reinsurance coverage.

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

The majority of our assets are monetary in nature and, as a result, we are subject to significant risk from changes in interest rates. Changes in interest rates may impact our net interest income in our banking segment as well as the valuation of our

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assets and liabilities in each of our segments. Earnings in our banking segment are significantly dependent on our net interest income, which is the difference between interest income on interest-earning assets, such as loans and securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. We expect to periodically experience gaps in the interest rate sensitivities of our banking segment's assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to our position, this gap may work against us, and our earnings may be adversely affected.

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

Our insurance segment invested over 91% of its invested assets in fixed maturity assets such as bonds and mortgage-backed securities during the year ended December 31, 2012. Because bond trading prices decrease as interest rates rise, a significant increase in interest rates could have a material adverse effect on our insurance segment's financial condition and results of operations. On the other hand, decreases in interest rates could have an adverse effect on our insurance segment's investment income and results of operations. For example, if interest rates decline, investment of new premiums received and funds reinvested will earn less. Additionally, mortgage-backed securities typically are prepaid more quickly when interest rates fall and the holder must reinvest the proceeds at lower interest rates. In periods of increasing interest rates, mortgage-backed securities typically are prepaid more slowly, which may require our insurance segment to receive interest payments that are below the then prevailing interest rates for longer time periods than expected.

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

The investment performance of our insurance segment has suffered, and may further suffer, as a result of adverse capital market developments and other factors, which affect its financial results.

Our insurance segment invests the premiums it receives from policyholders until they are needed to pay policyholder claims or other expenses. At December 31, 2012, our insurance segment's invested assets consisted of \$134.1 million in fixed maturity securities and \$12.6 million in equity securities. During the year ended December 31, 2012, our insurance segment realized \$6.3 million of net investment income, representing 3.9% of our insurance segment's total revenues. Although our insurance segment's investment policies stress diversification of risks, conservation of principal and liquidity, its investments are subject to a variety of investment risks, including those relating to general economic conditions, market volatility, interest rate fluctuations, liquidity risk and credit and default risk. In particular, the volatility of our insurance segment's claims may force it to liquidate securities, which may cause it to incur capital losses. If our insurance segment's investment portfolio is not appropriately matched with its insurance liabilities, it may be forced to liquidate investments prior to maturity at a significant loss to cover these liabilities. In addition, if we experience market disruption and volatility, such as that experienced in 2009 and 2010, we may experience additional losses on our investments and reductions in our earnings. Investment losses could significantly decrease the asset base and statutory surplus of our insurance segment, thereby adversely affecting its ability to conduct business and potentially its A.M. Best financial strength rating.

Our banking segment is subject to funding risks associated with its high deposit concentration and reliance on brokered deposits.

At December 31, 2012, our fifteen largest depositors, excluding First Southwest, our indirect wholly owned subsidiary, accounted for 19.2% of our total deposits, and our five largest depositors, excluding First Southwest, accounted for 11.2% of our total deposits. Brokered deposits at December 31, 2012 accounted for 10.3% of our total deposits. The loss of one or more of our largest Bank customers, a significant decline in our deposit balances due to ordinary course fluctuations related to these customers' businesses, or the loss of a significant amount of our brokered deposits could adversely affect our liquidity. Additionally, such circumstances could require us to raise deposit rates in an attempt to attract new deposits, or purchase federal funds or borrow funds on a short-term basis at higher rates, which would adversely affect our results of operations. Under applicable regulations, if the Bank were no longer well capitalized, the Bank would not be able to accept brokered deposits without the approval of the FDIC.

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We are heavily dependent on dividends from our subsidiaries.

We are a financial holding company engaged in the business of managing, controlling and operating our subsidiaries, including NLASCO and its two insurance company subsidiaries, NLIC and ASIC, as well as the Bank and the Bank's subsidiaries, PrimeLending and First Southwest. We conduct no material business or other activity other than activities incidental to holding stock in NLASCO and the Bank. As a result, we rely substantially on the profitability of, and dividends from, these subsidiaries to pay our operating expenses, to satisfy our obligations and to pay dividends on our preferred stock. As with most financial institutions, the profitability of the Bank is subject to the fluctuating cost and availability of money, changes in interest rates and in economic conditions in general. PrimeLending and First Southwest contribute to the Bank's profitability and, in turn, on its ability to pay dividends to us. If the Bank, however, is unable to make cash distributions to us, then we may also be unable to obtain funds from PrimeLending and First Southwest, and we may be unable to satisfy our obligations or make distributions on our preferred stock.

Likewise, our insurance segment also operates as a holding company. Dividends and other permitted payments from its operating subsidiaries are expected to be its primary source of funds to meet ongoing cash requirements, including any future debt service payments and other expenses, and to pay dividends, if any, to us. NLIC and ASIC are subject to significant regulatory restrictions and limitations under debt agreements limiting their ability to declare and pay dividends, including the indenture governing NLASCO's LIBOR plus 3.40% notes due 2035 and the surplus indentures governing NLIC's two LIBOR plus 4.10% and 4.05% notes due 2033 and ASIC's LIBOR plus 4.05% notes due 2034. Together these restrictions could, in turn, limit NLASCO's ability to pay dividends.

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

We are subject to extensive federal and state regulation and supervision, including that of the Federal Reserve Board, the Texas Department of Banking, the Texas Department of Insurance, the FDIC, the CFPB, the SEC and FINRA. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not stockholders. Insurance regulations promulgated by state insurance departments are primarily intended to protect policyholders rather than stockholders. Likewise, regulations promulgated by FINRA are primarily intended to protect customers of broker-dealer businesses rather than stockholders.

These regulations affect our lending practices, capital structure, capital requirements, investment practices, dividend policy and growth, among other things. Failure to comply with laws, regulations or policies could result in damages, civil money penalties or reputational damage, as well as sanctions and supervisory actions by regulatory agencies that could subject us to significant restrictions on our business and our ability to expand through acquisitions or branching. While we have implemented policies and procedures designed to prevent any such violations of laws and regulations, such violations may occur from time to time, which could have a material adverse effect on our financial condition and results of operations.

The U.S. Congress and federal regulatory agencies frequently revise banking and securities laws, regulations and policies. On July 21, 2010, President Obama signed into law the Dodd-Frank Act, which significantly alters the regulation of financial institutions and the financial services industry. The Dodd-Frank Act establishes the CFPB and requires the CFPB and other federal agencies to implement many provisions of the Dodd-Frank Act. We expect that several aspects of the Dodd-Frank Act may affect our business, including, without limitation, increased capital requirements, increased mortgage regulation, restrictions on proprietary trading in securities, restrictions on investments in hedge funds and private equity funds, executive compensation restrictions and disclosure and reporting requirements. At this time, it is difficult to predict the extent to which the Dodd-Frank Act or the resulting rules and regulations will affect our business. Compliance with these new laws and

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regulations likely will result in additional costs, which could be significant and may adversely impact our results of operations, financial condition, and liquidity.

During the fourth quarter of 2011, the Bank received a satisfactory CRA rating in connection with its most-recent CRA Performance Evaluation. A CRA rating of less than satisfactory adversely affects a bank's ability to establish new branches and impairs a bank's ability to commence new activities that are financial in nature or acquire companies engaged in these activities. Other regulatory exam ratings or findings also may otherwise impact our ability to branch, commence new activities or make acquisitions.

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We cannot predict whether or in what form any other proposed regulations or statutes will be adopted or the extent to which our business may be affected by any new regulation or statute. Such changes could subject our business to additional costs, limit the types of financial services and products we may offer and increase the ability of non-banks to offer competing financial services and products, among other things.

We may be unable to increase or maintain our level of qualified small business lending from our banking segment, which could subject us to higher dividend rates on our outstanding preferred stock.

We sold \$114.1 million of our Series B Preferred Stock to the Secretary of the United States Treasury Department (Treasury) pursuant to the SBLF. The SBLF encourages participant banks to increase their lending to small businesses by offering banks reduced dividend rates on the senior preferred shares they issued to the Secretary of the Treasury if they meet certain thresholds of increased small business lending. We could become subject to higher dividend rates and penalties in the future depending upon our future level of qualified lending to small businesses relative to our defined baseline level. Until December 31, 2013, the dividend rate we pay on any outstanding shares of Series B Preferred Stock will fluctuate on a quarterly basis between one percent (1%) and five percent (5%) per annum, based upon changes in the level of qualified small business lending by the Bank measured against the Baseline. From January 1, 2014 through March 26, 2016, if we have not sufficiently increased our small business lending we may become subject to a dividend rate as high as seven percent (7%) per annum, and may be required to pay a dividend rate penalty of 0.5% per quarter. Beginning March 27, 2016, the dividend rate on any outstanding shares of Series B Preferred Stock will be fixed at nine percent (9%) per annum. The future demands for additional lending are unclear and uncertain, and our ability to make qualifying small business loans depends on a number of factors, many of which may be outside of our control. These factors include, among other things, general economic conditions, demand for loans, the effectiveness of our marketing efforts, the ability of borrowers to meet our lending standards, competition from other lenders, the lending policies of our competitors and regulatory restrictions. If we fail to maintain or increase our level of qualified small business lending from our Baseline, the resulting increase in the dividend rate on the Series B Preferred Stock could increase our cost of capital and adversely affect our results of operations and financial condition.

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

We intend to sell, and not hold for investment, substantially all residential mortgage loans that we originate through PrimeLending. At times, however, we may originate a loan or execute an interest rate lock commitment (IRLC) with a customer pursuant to which we agree to originate a mortgage loan on a future date at an agreed-upon interest rate without having identified a purchaser for such loan or the loan underlying such IRLC. An identified purchaser may also decline to purchase a loan for a variety of reasons. In these instances, we will bear interest rate risk on an IRLC until, and unless, we are able to find a buyer for the loan underlying such IRLC and the risk of investment on a loan until, and unless, we are able to find a buyer for such loan. In addition, if a customer defaults on a mortgage payment shortly after the loan is originated, the purchaser of the loan may have a put right, whereby the purchaser can require us to repurchase the loan at the full amount that it paid. During periods of market downturn, we have at times chosen to hold mortgage loans when the identified purchasers have declined to purchase such loans because we could not obtain an acceptable substitute bid price for such loan. The failure of mortgage loans that we hold on our books to perform adequately could have a material adverse effect on our financial condition, liquidity and results of operations.

Our financial advisory business is subject to various risks associated with the securities industry, particularly those impacting the public finance industry.

Our financial advisory business is subject to uncertainties that are common in the securities industry. These uncertainties include:

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- intense competition in the public finance and other sectors of the securities industry;
- the volatility of domestic and international financial, bond and stock markets;
- extensive governmental regulation;
- litigation; and
- substantial fluctuations in the volume and price level of securities.

As a result, the revenues and operating results of our financial advisory segment may vary significantly from quarter to quarter and from year to year. Unfavorable financial or economic conditions could reduce the number and size of transactions in which we provide financial advisory, underwriting and other services. Disruptions in fixed income and equity markets could lead to a decline in the volume of transactions executed for customers and therefore, to declines in revenues from commissions and clearing services. First Southwest is much smaller and has much less capital than many competitors in the securities industry. In addition, First Southwest is an operating subsidiary of the Bank, which means that its activities are limited to those that are permissible for the Bank.

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We ultimately may write-off goodwill and other intangible assets resulting from our acquisitions of NLASCO and PlainsCapital.

As a result of purchase accounting for our acquisitions of NLASCO and PlainsCapital, our consolidated balance sheet at December 31, 2012, contained goodwill and other intangible assets aggregating \$331.5 million. On an ongoing basis, we evaluate whether facts and circumstances indicate any impairment of value of intangible assets. As circumstances change, the value of these intangible assets may not be realized by us. If we determine that a material impairment has occurred, we will be required to write-off the impaired portion of intangible assets, which could have a material adverse effect on our results of operations in the period in which the write-off occurs.

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

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

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

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

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

Our financial advisory segment has historically earned a significant portion of its revenues from advisory fees paid to it by its clients, in large part upon the successful completion of the client's transaction. Financial advisory revenues from the public finance group of First Southwest represented the largest component of our financial advisory segment's net revenues for the year ended December 31, 2012. Unlike other investment banks, First Southwest earns most of its revenues from its advisory fees and, to a lesser extent, from other business activities such as commissions and underwriting. New issuances in the municipal market by cities, counties, school districts, state and other governmental agencies, airports, healthcare institutions, institutions of higher education and other clients that First Southwest's public finance group serves can be subject to significant fluctuations based on by factors such as changes in interest rates, property tax bases, budget pressures on certain issuers

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caused by uncertain economic times and other factors. We expect that the reliance of our financial advisory segment on advisory fees will continue for the foreseeable future, and a decline in public finance advisory engagements or the market for advisory services generally would have an adverse effect on our business and results of operations.

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

Our ability to attract and retain customers and conduct our business could be adversely affected to the extent our reputation is damaged. Reputational risk, or the risk to our business, earnings and capital from negative public opinion regarding our company, or financial institutions in general, is inherent in our business. Adverse perceptions concerning our reputation could lead to difficulties in generating and maintaining accounts as well as in financing them. In particular, negative perceptions concerning our reputation could lead to decreases in the level of deposits that consumer and commercial

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customers and potential customers choose to maintain with us. Negative public opinion could result from actual or alleged conduct in any number of activities or circumstances, including lending or foreclosure practices; sales practices; corporate governance and potential conflicts of interest; ethical failures or fraud, including alleged deceptive or unfair lending or pricing practices; regulatory compliance; protection of customer information; cyber-attacks, whether actual, threatened, or perceived; negative news about us or the financial institutions industry generally; general company performance; or from actions taken by government regulators and community organizations in response to such activities or circumstances. Furthermore, our failure to address, or the perception that we have failed to address, these issues appropriately could impact our ability to keep and attract customers and/or employees and could expose us to litigation and/or regulatory action, which could have an adverse effect on our business and results of operations.

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

We rely heavily on communications and information systems to conduct our business and maintain the security of confidential information and complex transactions, which subjects us to an increasing risk of cyber incidents from these activities due to a combination of new technologies and the increasing use of the Internet to conduct financial transactions, as well as a potential failure of interruption or breach in the security of these systems, including those that could result from attacks or planned changes, upgrades and maintenance of these systems. Such cyber incidents could result in failures or disruptions in our customer relationship management, securities trading, general ledger, deposits, computer systems, electronic underwriting servicing or loan origination systems. Third parties with which we do business may also be sources of cybersecurity or other technological risks.

Although we devote significant resources to maintain and regularly upgrade our systems and networks with measures such as intrusion and detection prevention systems and monitoring firewalls to safeguard critical business applications, there is no guarantee that these measures or any other measures can provide absolute security. Our computer systems, software and networks may be adversely affected by cyber incidents such as unauthorized access; loss or destruction of data (including confidential client information); account takeovers; unavailability of service; computer viruses or other malicious code; cyber attacks; and other events. These threats may derive from human error, fraud or malice on the part of employees or third parties, or may result from accidental technological failure. Additional challenges are posed by external extremist parties, including foreign state actors, in some circumstances, as a means to promote political ends. If one or more of these events occurs, it could result in the disclosure of confidential client information, damage to our reputation with our clients and the market, customer dissatisfaction, additional costs such as repairing systems or adding new personnel or protection technologies, regulatory penalties, exposure to litigation and other financial losses to both us and our clients and customers. Such events could also cause interruptions or malfunctions in our operations.

We have been the subject of denial of services attacks from external sources that have limited or interrupted the availability of our online banking services. Although to date we are not aware of any material losses relating to cyber attacks or other information security breaches, we may suffer such losses in the future. We have taken steps to improve and upgrade the security of our systems in response to such threats, such incidents could occur again, but they could occur more frequently or on a more significant scale.

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

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Our banking and mortgage origination businesses face vigorous competition from banks and other financial institutions, including savings and loan associations, savings banks, finance companies and credit unions. A number of these banks and other financial institutions have substantially greater resources and lending limits, larger branch systems and a wider array of banking services than we do. We also compete with other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies, insurance companies and governmental organizations, each of which may offer more favorable financing than we are able to provide. In addition, some of our non-bank competitors are not subject to the same extensive regulations that govern us. The banking business in Texas, particularly in the Austin, Dallas/Fort Worth, Lubbock and San Antonio metropolitan and surrounding areas, has become increasingly competitive over the past several years, and we expect the level of competition we face to further increase. Our profitability depends on our ability to compete effectively in these markets. This competition may reduce or limit our margins on banking services, reduce our market share and adversely affect our results of operations and financial condition.

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The insurance industry also is highly competitive and has, historically, been characterized by periods of significant price competition, alternating with periods of greater pricing discipline during which competitors focus on other factors. In the current market environment, competition in our insurance business industry is based primarily on products offered, service, experience, the strength of agent and policyholder relationships, reputation, speed and accuracy of claims payment, perceived financial strength, ratings, scope of business, commissions paid and policy and contract terms and conditions. Our insurance business competes with many other insurers, including large national companies who have greater financial, marketing and management resources than our insurance segment. Many of these competitors also have better ratings and market recognition than our insurance business. Our insurance segment seeks to distinguish itself from its competitors by providing a broad product line and targeting those market segments that provide the best opportunity to earn an underwriting profit.

In addition, a number of new, proposed or potential industry developments also could increase competition in our insurance business industry. These developments include changes in practices and other effects caused by the Internet (including direct marketing campaigns by our insurance segment's competitors in established and new geographic markets), which have led to greater competition in the insurance business and increased expectations for customer service. These developments could prevent our insurance business from expanding its book of business. Our insurance business also faces competition from new entrants into the insurance market. New entrants do not have historic claims or losses to address and, therefore, may be able to price policies on a basis that is not favorable to our insurance business. New competition could reduce the demand for our insurance segment's insurance products, which could have a material adverse effect on its financial condition and results of operations.

The financial advisory and investment banking industries also are intensely competitive industries and will likely remain competitive. Our financial advisory business competes directly with numerous other financial advisory and investment banking firms, broker-dealers and banks, including large national and major regional firms and smaller niche companies, some of whom are not broker-dealers and, therefore, not subject to the broker-dealer regulatory framework. In addition to competition from firms currently in the industry, there has been increasing competition from others offering financial services, including automated trading and other services based on technological innovations. Our financial advisory business competes on the basis of a number of factors, including the quality of advice and service, innovation, reputation and price. Many of our financial advisory segment's competitors in the investment banking industry have a greater range of products and services, greater financial and marketing resources, larger customer bases, greater name recognition, more managing directors to serve their clients' needs, greater global reach and more established relationships with their customers than our financial advisory business. Additionally, certain competitors of our financial advisory business have reorganized or plan to reorganize from investment banks into bank holding companies which may provide them with a competitive advantage. These larger and better capitalized competitors may be more capable of responding to changes in the investment banking market, to compete for skilled professionals, to finance acquisitions, to fund internal growth and to compete for market share generally. Increased pressure created by any current or future competitors, or by competitors of our financial advisory business collectively, could materially and adversely affect our business and results of operations. Increased competition may result in reduced revenue and loss of market share. Further, as a strategic response to changes in the competitive environment, our financial advisory business may from time to time make certain pricing, service or marketing decisions that also could materially and adversely affect our business and results of operations.

Our mortgage origination and insurance businesses are subject to seasonal fluctuations and, as a result, our results of operations for any given quarter may not be indicative of the results that may be achieved for the full fiscal year.

Our mortgage origination business is subject to several variables that can impact loan origination volume, including seasonal and interest rate fluctuations. We typically experience increased loan origination volume from purchases of homes during the second and third quarters, when more people tend to move and buy or sell homes. In addition, an increase in the general level of interest rates may, among other things, adversely affect the demand for mortgage loans and our ability to originate mortgage loans. In particular, if mortgage interest rates increase, the demand for residential mortgage loans and the refinancing of residential mortgage loans will likely decrease, which will have an adverse effect on our mortgage origination activities. Conversely, a decrease in the general level of interest rates, among other things, may lead to increased competition for mortgage loan origination business. As a result of these variables, our results of operations for any single quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

Generally, our insurance segment's insured risks exhibit higher losses in the second and third quarters due to a seasonal concentration of weather-related events in its primary geographic markets. Although weather-related losses (including hail, high winds, tornadoes and hurricanes) can occur in any calendar quarter, the second calendar quarter, historically, has experienced the highest frequency of losses associated with these events. Hurricanes, however, are more likely to occur in the third calendar quarter of the year.

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If the actual losses and loss adjustment expenses of our insurance segment exceed its loss and expense estimates, its financial condition and results of operations could be materially adversely affected.

The financial condition and results of operations of our insurance segment depend upon its ability to assess accurately the potential losses associated with the risks that it insures. Our insurance segment establishes reserve liabilities to cover the payment of all losses and loss adjustment expenses incurred under the policies that it writes. These liability estimates include case estimates, which are established for specific claims that have been reported to our insurance segment, and liabilities for claims that have been incurred but not reported (IBNR). Loss adjustment expenses represent expenses incurred to investigate and settle claims. To the extent that losses and loss adjustment expenses exceed estimates, NLIC and ASIC will be required to increase their reserve liabilities and reduce their income in the period in which the deficiency is identified. In addition, increasing reserves causes a reduction in policyholders' surplus and could cause a downgrade in the ratings of NLIC and ASIC. This, in turn, could diminish our ability to sell insurance policies.

The liability estimation process for our insurance segment's casualty insurance coverage possesses characteristics that make case and IBNR reserving inherently less susceptible to accurate actuarial estimation than is the case with property coverages. Unlike property losses, casualty losses are claims made by third-parties of which the policyholder may not be aware and, therefore, may be reported a significant time after the occurrence, including sometimes years later. As casualty claims most often involve claims of bodily injury, assessment of the proper case estimates is a far more subjective process than claims involving property damage. In addition, in determining the case estimate for a casualty claim, information develops slowly over the life of the claim and can subject the case estimation to substantial modification well after the claim was first reported. Numerous factors impact the casualty case reserving process, such as venue, the amount of monetary damage, legislative activity, the permanence of the injury and the age of the claimant.

The effects of inflation could cause the severity of claims from catastrophes or other events to rise in the future. Increases in the values and geographic concentrations of policyholder property and the effects of inflation have resulted in increased severity of industry losses in recent years, and our insurance segment expects that these factors will increase the severity of losses in the future. As NLASCO observed in 2008, the severity of some catastrophic weather events, including the scope and extent of damage and the inability to gain access to damaged properties, and the ensuing shortages of labor and materials and resulting demand surge, provide additional challenges to estimating ultimate losses. Our insurance segment's liabilities for losses and loss adjustment expenses include assumptions about future payments for settlement of claims and claims handling expenses, such as medical treatments and litigation costs. To the extent inflation causes these costs to increase above liabilities established for these costs, our insurance segment expects to be required to increase its liabilities, together with a corresponding reduction in its net income in the period in which the deficiency is identified.

Estimating an appropriate level of liabilities for losses and loss adjustment expense is an inherently uncertain process. Accordingly, actual loss and loss adjustment expenses paid will likely deviate, perhaps substantially, from the liability estimates reflected in our insurance segment's consolidated financial statements. Claims could exceed our insurance segment's estimate for liabilities for losses and loss adjustment expenses, which could have a material adverse effect on its financial condition and results of operations.

If our insurance segment cannot obtain adequate reinsurance protection for the risks it underwrites or its reinsurers do not pay losses in a timely fashion, or at all, our insurance segment will suffer greater losses from these risks or may reduce the amount of business it underwrites, which may materially adversely affect its financial condition and results of operations.

Our insurance segment purchases reinsurance to protect itself from certain risks and to share certain risks it underwrites. During 2012 and 2011, our insurance segment's personal lines ceded 12.1% and 12.0%, respectively, of its direct insurance premiums written (primarily through excess

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of loss, quota share and catastrophe reinsurance treaties) and its commercial lines ceded 4.9% and 4.9%, respectively, of its direct insurance premiums written (primarily through excess of loss and catastrophe reinsurance treaties). The total cost of reinsurance, inclusive of per risk excess and catastrophe, increased 9.0% in the year ended December 31, 2012, which is partially attributable to higher reinstatement premiums in 2012 of \$0.4 million. Reinsurance cost generally increases as a result of hurricanes or any diminished capacity in the reinsurance market.

From time to time, market conditions have limited, and in some cases have prevented, insurers from obtaining the types and amounts of reinsurance that they have considered adequate for their business needs. Accordingly, our insurance segment may not be able to obtain desired amounts of reinsurance. Even if our insurance segment is able to obtain adequate reinsurance, it may not be able to obtain it from entities with satisfactory creditworthiness or negotiate terms that it deems appropriate or acceptable. Although the cost of reinsurance is, in some cases, reflected in our insurance segment's premium

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rates, our insurance segment may have guaranteed certain premium rates to its policyholders. Under these circumstances, if the cost of reinsurance were to increase with respect to policies for which our insurance segment guaranteed the rates, our insurance segment would be adversely affected. In addition, if our insurance segment cannot obtain adequate reinsurance protection for the risks it underwrites, it may be exposed to greater losses from these risks or it may be forced to reduce the amount of business that it underwrites for such risks, which will reduce our insurance segment's revenue and may have a material adverse effect on its results of operations and financial condition.

At December 31, 2012, our insurance segment had \$18.6 million in reinsurance recoverables, including ceded paid loss recoverables, ceded losses and loss adjustment expense recoverables and ceded unearned insurance premiums. Our insurance segment expects to continue to purchase substantial reinsurance coverage in the foreseeable future. Because our insurance segment remains primarily liable to its policyholders for the payment of their claims, regardless of the reinsurance it has purchased relating to those claims, in the event that one of its reinsurers becomes insolvent or otherwise refuses to reimburse our insurance segment for losses paid, or delays in reimbursing our insurance segment for losses paid, its liability for these claims could materially and adversely affect its financial condition and results of operations.

We are subject to legal claims and litigation that could have a material adverse effect on our business.

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

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

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

If we fail to maintain an effective system of internal controls over financial reporting, the accuracy and timing of our financial reporting may be adversely affected.

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Effective internal controls are necessary for us to provide timely and reliable financial reports and effectively prevent fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. If we fail to maintain the adequacy of our internal controls, our financial statements may not accurately reflect our financial condition. Inadequate internal controls over financial reporting could impact the reliability and timeliness of our financial reports and could cause investors to lose confidence in our reported financial information, which could have a negative effect on our business and the value of our securities.

The debt agreements of our insurance segment and its controlled affiliates contain financial covenants and impose restrictions on its business.

The indenture governing NLASCO's LIBOR plus 3.40% notes due 2035 contains restrictions on its ability to, among other things, declare and pay dividends and merge or consolidate. In addition, this indenture contains a change of control provision, which provides that (i) if a person or group becomes the beneficial owner, directly or indirectly, of 50% or more of NLASCO's equity securities and (ii) if NLASCO's ratings are downgraded by a nationally recognized statistical rating organization (as defined in the Exchange Act), then each holder of the notes governed by such indenture has the right to require that NLASCO purchase such holder's notes, in whole or in part, at a price equal to 100% of the then outstanding principal amount.

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Likewise, the surplus indentures governing NLIC's two LIBOR plus 4.10% and 4.05% notes due 2033 and ASIC's LIBOR plus 4.05% notes due 2034 contain restrictions on dividends and mergers and consolidations. In addition, NLASCO has other credit arrangements with its affiliates and other third-parties.

NLASCO's ability to comply with these covenants may be affected by events beyond its control, including prevailing economic, financial and industry conditions. The breach of any of these restrictions could result in a default under the loan agreements or indentures governing the notes or under its other debt agreements. An event of default under its debt agreements would permit some of its lenders to declare all amounts borrowed from them to be due and payable, together with accrued and unpaid interest. If NLASCO were unable to repay debt to its secured lenders, these lenders could proceed against the collateral securing that debt. In addition, acceleration of its other indebtedness may cause NLASCO to be unable to make interest payments on the notes. Other agreements that NLASCO or its insurance company subsidiaries may enter into in the future may contain covenants imposing significant restrictions on their respective businesses that are similar to, or in addition to, the covenants under their respective existing agreements. These restrictions may affect NLASCO's ability to operate its business and may limit its ability to take advantage of potential business opportunities as they arise.

Risks Related to our Substantial Cash Position and Related Strategies for its Use

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

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

The success of any acquisition or business combination will depend upon, among other things, the ability of management and our employees to integrate personnel, operations, products and technologies effectively, to retain and motivate key personnel and to retain customers and clients of targets. In addition, any acquisition or business combination we undertake may consume available cash resources, result in potentially dilutive issuances of equity securities and divert management's attention from other business concerns. Even if we conduct extensive due diligence on a target business that we acquire or with which we merge, our diligence may not surface all material issues that may adversely affect a particular target business, and we may be forced to later write-down or write-off assets, restructure our operations or incur impairment or other charges that could result in our reporting losses. Consequently, we also may need to make further investments to support the acquired or combined company and may have difficulty identifying and acquiring the appropriate resources.

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

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

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

Difficult market conditions have adversely affected the yield on our available cash.

Our primary objective is to preserve and maintain the liquidity of our available cash, while at the same time maximizing yields without significantly increasing risk. The capital and credit markets have been experiencing volatility and disruption for a prolonged period. This volatility and disruption reached unprecedented levels, resulting in dramatic declines in interest

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rates and other yields relative to risk. This downward pressure has negatively affected the yields we receive on our available cash. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will receive any significant yield on our available cash. Further, given current market conditions, no assurance can be given that we will be able to preserve our available cash.

If regulators determine that we control SWS Group, Inc., we will be required to file appropriate reports with the Federal Reserve Board and potentially provide financial support.

As a general matter, an investor is deemed to control a depository institution or other company if the investor owns or controls 25% or more of any class of voting stock. Subject to rebuttal, an investor may be presumed to control a depository institution or other company if the investor owns or controls ten percent or more of any class of voting stock. At December 31, 2012, we beneficially owned 24.6% of the outstanding common stock of SWS Group, Inc. (SWS). In connection with the transactions entered into with SWS, we filed a Rebuttal of Control, which the Office of Thrift Supervision, now a part of the Office of the Comptroller of the Currency, accepted based upon the facts represented by us. The transaction documents also provide for mechanisms to prevent us from being deemed to control SWS through our ownership of voting securities. Notwithstanding this finding by the Office of Thrift Supervision, in the event that we were determined to control SWS, we would be required to file appropriate reports as a financial holding company regulated by the Federal Reserve Board reflecting our controlling interest in SWS. In connection with our transaction with PlainsCapital, we provided certain passivity commitments to the Federal Reserve Board related to SWS. These passivity commitments provide that we cannot take certain actions, namely exercising any controlling influence over management or policies, without the prior approval of the Federal Reserve Bank.

In addition, it is a policy of the Federal Reserve Board that a bank holding company should serve as a source of financial and managerial strength to the depository institutions that it controls. The Dodd-Frank Act requires by statute that all holding companies serve as a source of financial strength for any subsidiary of the holding company. The Federal Reserve Board and the other banking agencies have not published a proposed rule implementing these source of strength requirements. Given that the Federal Reserve Board became the primary federal regulator of savings and loan holding companies (SLHCs), such as SWS, the policy for SLHCs on this subject likely will be altered to align more closely with those for bank holding companies. The regulators may require certain financial and other action by a regulated holding company in support of controlled depository institutions even if such action is not in the best interests of the regulated holding company or its stockholders.

Risks Related to Our Common Stock

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

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

- may significantly dilute the equity interest of our stockholders;
- may subordinate the rights of holders of common stock if preferred stock is issued with rights senior to those afforded our common stock;

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- could cause a change in control if a substantial number of shares of common stock are issued, which may affect, among other things, our ability to use our net operating loss carry forwards; and
- may adversely affect prevailing market prices for our common stock.

Our authorized capital stock includes ten million shares of preferred stock, and we currently have 114,068 shares of Series B Preferred Stock issued and outstanding, liquidation preference \$1,000 per share, to the Secretary of the Treasury pursuant to the SBLF. Our board of directors, in its sole discretion, may designate and issue one or more additional series of preferred stock from the authorized and unissued shares of preferred stock. Subject to limitations imposed by law or our articles of incorporation, our board of directors is empowered to determine the designation and number of shares constituting each series of preferred stock, as well as any designations, qualifications, privileges, limitations, restrictions or special or relative rights of additional series. The rights of preferred stockholders may supersede the rights of common stockholders. Preferred stock could be issued with voting and conversion rights that could adversely affect the voting power of the shares of our common stock. The issuance of preferred stock could also result in a series of securities outstanding that would have preferences over the common stock with respect to dividends and in liquidation.

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

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

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

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

The Treasury's investment in us imposes restrictions and obligations upon us that could adversely affect the rights of our common stockholders.

We have sold 114,068 shares of our Series B Preferred Stock, liquidation preference \$1,000 per share, for \$114.1 million, to the Secretary of the Treasury pursuant to the SBLF. The shares of Series B Preferred Stock are senior to shares of our common stock with respect to dividends and liquidation preference. The terms of the Series B Preferred Stock provided for the payment of non-cumulative dividends on a quarterly basis. The dividend rate, as a percentage of the liquidation amount, fluctuates while the Series B Preferred Stock is outstanding based upon changes in the level of qualified small business lending by the Bank from its Baseline. As long as shares of Series B Preferred Stock remain outstanding, we may not pay dividends to our common stockholders (nor may we repurchase or redeem any shares of our common stock) during any quarter in which we fail to declare and pay dividends on the Series B Preferred Stock and for the next three quarters following such failure. In addition, under the terms of the Series B Preferred Stock, we may only declare and pay dividends on our common stock (or repurchase shares of our common stock), if, after payment of such dividend, the dollar amount of our Tier 1 capital would be at least ninety percent (90%) of Tier 1 capital as of September 27, 2011, excluding any charge-offs and redemptions of the Series B Preferred Stock (the Tier 1 Dividend Threshold). The Tier 1 Dividend Threshold is subject to reduction, beginning January 1, 2014, based upon the extent by which, if at all, the Bank's qualified small business lending at September 30, 2013 has increased over the Baseline.

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

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Authority to Issue Additional Shares. Under our charter, our board of directors may issue up to an aggregate of ten million shares of preferred stock without stockholder action. The preferred stock may be issued, in one or more series, with the preferences and other terms designated by our board of directors that may delay or prevent a change in control of us, even if the change is in the best interests of stockholders. At December 31, 2012, 114,068 shares of preferred stock were designated or outstanding.

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

Insurance Laws. NLIC and ASIC are domiciled in the State of Texas. Before a person can acquire control of an insurance company domiciled in Texas, prior written approval must be obtained from the Texas Department of Insurance. Acquisition of control would be presumed on the acquisition, directly or indirectly, of ten percent or more of our outstanding voting

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stock, unless the regulators determine otherwise. Prior to granting approval of an application to acquire control of a domestic insurer, the Texas Department of Insurance will consider several factors, such as:

- the financial strength of the acquirer;
- the integrity and management experience of the acquirer's board of directors and executive officers;
- the acquirer's plans for the management of the insurer;
- the acquirer's plans to declare dividends, sell assets or incur debt;
- the acquirer's plans for the future operations of the domestic insurer;
- the impact of the acquisition on continued licensure of the domestic insurer;
- the impact on the interests of Texas policyholders; and
- any anti-competitive results that may arise from the consummation of the acquisition of control.

These laws may discourage potential acquisition proposals for us and may delay, deter or prevent a change of control of us, including transactions that some or all of our stockholders might consider desirable.

Restrictions on Calling Special Meeting, Cumulative Voting and Director Removal. Our bylaws includes a provision prohibiting the holders of less than a majority of the voting power represented by all of our shares issued, outstanding and entitled to be voted at a proposed meeting, from calling a special meeting of stockholders. Our charter does not provide for the cumulative voting in the election of directors. In addition, our charter provides that our directors may only be removed for cause and then only by an affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors. Any amendment to our charter relating to the removal of directors requires the affirmative vote of two-thirds of all of the votes entitled to be cast on the matter. These provisions of our bylaws and charter may delay, discourage or prevent an attempted acquisition or change in control of us.

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

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

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

We lease office space for our principle executive offices in Dallas, Texas. In addition to our principal office, our various business segments conduct business at various locations.

Banking. At December 31, 2012, our banking segment conducted business at 36 locations, including two operations centers. Our banking segment's principal executive offices are located in Dallas, Texas, in space leased by PlainsCapital. In addition to the principal office, we operate the following banking locations. We have options to renew leases at most locations.

	Owned	Leased	Total
Lubbock market	7	7	14
Dallas/Fort Worth market		14	14
Austin market		5	5
San Antonio market		3	3
Total	7	29	36

Mortgage Origination. Our mortgage origination segment is headquartered in Dallas, Texas and at December 31, 2012 conducted business at 280 locations in 42 states. Each of these locations is leased by PrimeLending.

Insurance. At December 31, 2012, NLASCO leases office space in Waco, Texas for all corporate, claims, customer service and data center operations.

Financial Advisory. Our financial advisory segment is headquartered in Dallas, Texas and at December 31, 2012 conducted business at 26 locations in 14 states and the District of Columbia. Each of these offices is leased by First Southwest.

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Item 3. Legal Proceedings.

We are a party to various legal actions resulting from our operating activities. These actions consist of litigation and administrative proceedings arising in the ordinary course of business, some of which are covered by liability insurance, and none of which is expected to have a material adverse effect on our consolidated financial condition, results of operations or cash flows taken as a whole.

In November 2006, FSC received subpoenas from the SEC and the U.S. Department of Justice (the DOJ) in connection with an investigation of possible antitrust and securities law violations, including bid-rigging, in the procurement of guaranteed investment contracts and other investment products for the reinvestment of bond proceeds by municipalities. The investigation is industry-wide and includes approximately 30 or more firms, including some of the largest U.S. investment firms.

As a result of these SEC and DOJ investigations into industry-wide practices, FSC was initially named as a co-defendant in cases filed in several different federal courts by various state and local governmental entities suing on behalf of themselves and a purported class of similarly situated governmental entities and a similar set of lawsuits filed by various California local governmental entities suing on behalf of themselves and a purported class of similarly situated governmental entities. All claims asserted against FSC in these purported class actions were subsequently dismissed. However, the plaintiffs in these purported class actions have filed amended complaints against other entities, and FSC is identified in these complaints not as a defendant, but as an alleged co-conspirator with the named defendants.

Additionally, as a result of these SEC and DOJ investigations into industry-wide practices, FSC has been named as a defendant in 20 individual lawsuits. These lawsuits have been brought by several California public entities and two New York non-profit corporations that do not seek to certify a class. The Judicial Panel on Multidistrict Litigation has transferred these cases to the United States District Court, Southern District of New York. The California plaintiffs allege violations of Section 1 of the Sherman Act and the California Cartwright Act. The New York plaintiffs allege violations of Section 1 of the Sherman Act and the New York Donnelly Act. The allegations against FSC are very limited in scope. FSC has filed answers in each of the twenty lawsuits denying the allegations and asserting several affirmative defenses. FSC intends to defend itself vigorously in these individual actions. The relief sought is unspecified monetary damages.

Like other financial institutions, we are subject to various federal, state and local laws and regulations relating to environmental matters. Under these laws and regulations, we could be held liable for costs relating to environmental contamination at or from properties that secure our loan portfolio. With respect to our borrower's properties, the potential liabilities may far exceed the original amount of the loan made by us and secured by the property. Currently, we are not a defendant in any environmental legal proceeding.

Item 4. Mine Safety Disclosures.

Not applicable.

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PART II

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

Securities, Stockholder and Dividend Information

Our common stock is listed on the New York Stock Exchange under the symbol HTH . Our common stock has no public trading history prior to February 12, 2004. Our common stock closed at \$13.03 on March 14, 2013. At March 14, 2013, there were 83,487,340 shares of our common stock outstanding with 644 stockholders of record.

On November 29, 2012, we filed with the State Department of Assessments and Taxation of the State of Maryland articles supplementary for Series B Preferred Stock, setting forth its terms. Holders of the Series B Preferred Stock are entitled to noncumulative cash dividends at a fluctuating dividend rate based on the Bank's level of qualified small business lending. The Series B Preferred Stock is non-voting, except in limited circumstances, and ranks senior to our common stock with respect to the payment of dividends and distribution of assets upon any liquidation, dissolution or winding up of Hilltop.

Subject to the restrictions discussed below, our stockholders are entitled to receive dividends when, as, and if declared by our Board of Directors out of funds legally available for that purpose. Our Board of Directors exercises discretion with respect to whether we will pay dividends and the amount of such dividend, if any. Factors that affect our ability to pay dividends on our common stock in the future include, without limitation, 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 deemed relevant by our Board of Directors. Hilltop has not declared or paid any dividends over the past two completed fiscal years.

As a holding company, we are ultimately dependent upon our subsidiaries to provide funding for our operating expenses, debt service and dividends. Various laws limit the payment of dividends and other distributions by our subsidiaries to us, and may therefore limit our ability to pay dividends on our common stock. In addition, as long as shares of Series B Preferred Stock remain outstanding, we may not pay dividends to our common stockholders (nor may we repurchase or redeem any shares of our common stock) during any quarter in which we fail to declare and pay dividends on the Series B Preferred Stock and for the next three quarters following such failure. In addition, under the terms of the Series B Preferred Stock, we may only declare and pay dividends on our common stock (or repurchase shares of our common stock), if, after payment of such dividend, the dollar amount of our Tier 1 capital would be at least ninety percent (90%) of Tier 1 capital as of September 27, 2011, excluding any charge-offs and redemptions of the Series B Preferred Stock. The Tier 1 Dividend Threshold is subject to reduction, beginning January 1, 2014, based upon the extent by which, if at all, the our qualified small business lending at September 30, 2013 has increased over the Baseline.

If required payments on our outstanding junior subordinated debentures held by our unconsolidated subsidiary trusts are not made or suspended, we may be prohibited from paying dividends on our common stock. Regulatory authorities could impose administratively stricter limitations on the ability of our subsidiaries to pay dividends to us if such limits were deemed appropriate to preserve certain capital adequacy requirements. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Restrictions on Dividends and Distributions.

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The following table discloses the high and low sales prices per quarter for our common stock during 2012 and 2011. Quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

	Price Range	
	High	Low
Year Ended December 31, 2012		
First Quarter	\$ 9.10	\$ 7.87
Second Quarter	\$ 10.89	\$ 7.75
Third Quarter	\$ 12.80	\$ 10.21
Fourth Quarter	\$ 14.49	\$ 12.57
Year Ended December 31, 2011		
First Quarter	\$ 10.13	\$ 9.01
Second Quarter	\$ 10.09	\$ 8.60
Third Quarter	\$ 9.01	\$ 7.12
Fourth Quarter	\$ 8.60	\$ 6.88

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The following table sets forth information at December 31, 2012 with respect to compensation plans under which shares of our common stock may be issued. Additional information concerning our stock-based compensation plans is presented in Note 18, Stock-Based Compensation, in the notes to our consolidated financial statements.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column)
Equity compensation plans approved by security holders*	600,000	\$ 7.70	4,000,000
Total	600,000	\$ 7.70	4,000,000

*Excludes shares of restricted stock granted under the 2003 equity incentive plan, as all of these shares are vested. No exercise price is required to be paid upon the vesting of the restricted shares of common stock granted. All shares issued as of December 31, 2012 were issued under our 2003 equity incentive plan. In September 2012, the stockholders approved the 2012 equity incentive plan, which allows for the granting of nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards, dividend equivalent rights and other awards to employees of Hilltop, its subsidiaries and outside directors of Hilltop. Upon the effectiveness of the 2012 equity incentive plan, no additional awards are permissible under the 2003 equity incentive plan. In the aggregate, 4,000,000 shares of common stock may be delivered pursuant to awards granted under the 2012 equity incentive plan. At December 31, 2012, no awards had been granted pursuant to the 2012 equity incentive plan. All shares outstanding, whether vested or unvested, are entitled to receive dividends and to vote, unless forfeited. No participant in our 2012 equity incentive plan may be granted awards in any fiscal year covering more than 1,250,000 shares of our common stock.

Issuer Repurchases of Equity Securities

The following table details our repurchases of shares of common stock during the three months ended December 31, 2012.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 1 - October 31, 2012	10,134(2)	\$ 13.42	\$	\$ 98,837,692
November 1 - November 30, 2012				

December 1 December 31, 2012

(1) On November 2, 2011, our Board of Directors approved a share repurchase plan that authorized us to purchase up to \$100 million of our outstanding shares of common stock. This repurchase plan permitted the purchase of shares of common stock from time to time in open market purchases in accordance with Rule 10b-18 promulgated by the SEC under the Exchange Act or pursuant to privately negotiated transactions. This repurchase plan expired pursuant to its terms on November 1, 2012.

(2) Represents 10,134 shares of common stock surrendered to the Company upon the net exercise of options in addition to the number of shares necessary to pay taxes or satisfy the exercise price thereof.

Recent Sales of Unregistered Securities

All issuances of unregistered securities have previously been reported.

Item 6. Selected Financial Data.

Our historical consolidated balance sheet data at December 31, 2012 and 2011 and our consolidated statements of operations data for the years ended December 31, 2012, 2011 and 2010 have been derived from our audited historical consolidated financial statements included elsewhere in this Annual Report. The following table shows our selected historical financial data for the periods indicated. You should read our selected historical financial data, together with the notes thereto, in conjunction with the more detailed information contained in our consolidated financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Annual Report. The operating results of PlainsCapital are included in the tables below for the month of December 2012 and the balance sheet reflects the combined company at December 31, 2012, respectively (in thousands, except per share data and weighted average shares outstanding).

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	2012	2011	2010	2009	2008
Statement of Operations Data:					
Total interest income	\$ 39,038	\$ 11,049	\$ 8,154	\$ 6,866	\$ 27,553
Total interest expense	10,196	8,985	8,971	9,668	10,528
Net interest income (loss)	28,842	2,064	(817)	(2,802)	17,025
Provision for loan losses	3,800				
Net interest income (loss) after provision for loan losses	25,042	2,064	(817)	(2,802)	17,025
Total noninterest income	224,232	141,650	124,073	122,377	75,402
Total noninterest expense	255,517	155,254	124,811	123,036	134,571
Loss before income taxes	(6,243)	(11,540)	(1,555)	(3,461)	(42,144)
Income tax benefit	(1,145)	(5,009)	(1,007)	(1,349)	(19,559)
Net loss	(5,098)	(6,531)	(548)	(2,112)	(22,585)
Less: Net income attributable to noncontrolling interest	494				
Net loss attributable to Hilltop Holdings	(5,592)	(6,531)	(548)	(2,112)	(22,585)
Dividends on preferred stock and other (1)	259		12,939	10,313	10,313
Loss applicable to Hilltop Holdings common stockholders	\$ (5,851)	\$ (6,531)	\$ (13,487)	\$ (12,425)	\$ (32,898)
Per Share Data:					
Net loss - basic	\$ (0.10)	\$ (0.12)	\$ (0.24)	\$ (0.22)	\$ (0.58)
Weighted average shares outstanding - basic	58,754	56,499	56,492	56,474	56,453
Net loss - diluted	\$ (0.10)	\$ (0.12)	\$ (0.24)	\$ (0.22)	\$ (0.58)
Weighted average shares outstanding - diluted	58,754	56,499	56,492	56,474	56,453
Book value per common share	\$ 12.34	\$ 11.60	\$ 11.56	\$ 11.77	\$ 11.91
Tangible book value per common share	\$ 8.35	\$ 11.01	\$ 10.95	\$ 11.13	\$ 11.24
Balance Sheet Data:					
Total assets	\$ 7,286,865	\$ 925,425	\$ 939,641	\$ 1,040,752	\$ 1,048,770
Cash and due from banks	720,741	578,520	649,439	790,013	767,876
Securities	1,081,066	224,200	148,965	129,968	138,568
Loans held for sale	1,399,944				
Loans, net of unearned income	3,152,396				
Allowance for loan losses	(3,409)				
Goodwill and other intangible assets, net	331,508	33,062	34,587	36,229	37,990
Total deposits	4,700,461				
Notes payable	141,539	131,450	138,350	138,350	138,368
Junior subordinated debentures	67,012				
Total stockholders equity	1,146,550	655,383	653,055	783,777	791,455
Performance Ratios (2):					
Return on average stockholders equity	-0.62%				
Return on average assets	-0.08%				
Net interest margin (taxable equivalent) (3)	2.35%				
Efficiency ratio (4)(5)	NM				
Asset Quality Ratios (2):					
Total nonperforming assets to total loans and other real estate (5)	NM				
Allowance for loan losses to nonperforming loans (5)	NM				
Allowance for loan losses to total loans (5)	NM				
	NM				

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Net charge-offs to average loans
outstanding (5)

Capital Ratios:

Equity to assets ratio	15.73%	70.82%	69.50%	75.31%	75.47%
Tangible common equity to tangible assets	10.02%	69.74%	68.33%	62.56%	62.76%

Regulatory Capital Ratios (2):

Hilltop - Leverage ratio (6)	13.08%
Hilltop - Tier 1 risk-based capital ratio	17.72%
Hilltop - Total risk-based capital ratio	17.81%
Bank - Leverage ratio (6)	8.84%
Bank - Tier 1 risk-based capital ratio	11.83%
Bank - Total risk-based capital ratio	11.93%

Other Data (7):

Net loss and LAE ratio	74.4%	72.2%	60.5%	61.0%	69.8%
Expense ratio	34.4%	34.0%	36.0%	35.7%	35.6%
GAAP combined ratio	108.8%	106.2%	96.5%	96.8%	105.4%
Statutory surplus (8)	\$ 120,319	\$ 118,708	\$ 119,297	\$ 117,063	\$ 108,478
Statutory premiums to surplus ratio	125.0%	119.4%	102.0%	98.0%	104.4%

-
- (1) Series A preferred stock was redeemed in September 2010.
 - (2) Noted measures are typically used for measuring the performance of banking and financial institutions. Our operations prior to the acquisition of PlainsCapital are limited to our insurance operations. Therefore, noted measures for periods prior to 2012 are not a useful measure and have been excluded.
 - (3) Taxable equivalent net interest income divided by average interest-earning assets.
 - (4) Noninterest expenses divided by the sum of total noninterest income and net interest income for the year.
 - (5) Noted measures are typically used for measuring the performance of banking and financial institutions. Our operations prior to the acquisition of PlainsCapital are limited to our insurance operations. Additionally, noted measure is not meaningful (NM) in 2012.
 - (6) Ratio was calculated using the average assets for the month of December.
 - (7) Only considers operations of insurance segment.
 - (8) Statutory surplus includes combined surplus of NLIC and ASIC.

Table of Contents**GAAP Reconciliation and Management's Explanation of Non-GAAP Financial Measures**

We present two measures in our selected financial data that are not measures of financial performance recognized by GAAP.

Tangible book value per common share is defined as our total stockholders' equity, excluding preferred stock, reduced by goodwill and other intangible assets, divided by total common shares outstanding. Tangible common stockholders' equity to tangible assets is defined as our total stockholders' equity, excluding preferred stock, reduced by goodwill and other intangible assets divided by total assets reduced by goodwill and other intangible assets.

These measures are important to investors interested in changes from period to period in tangible common equity per share exclusive of changes in intangible assets. For companies such as ours that have engaged in business combinations, purchase accounting can result in the recording of significant amounts of goodwill and other intangible assets related to those transactions.

You should not view this disclosure as a substitute for results determined in accordance with GAAP, and our disclosure is not necessarily comparable to that of other companies that use non-GAAP measures. The following table reconciles these non-GAAP financial measures to the most comparable GAAP financial measures, book value per common share and Hilltop Holdings stockholders' equity to total assets (in thousands, except per share data).

	2012	2011	December 31, 2010	2009	2008
Book value per common share	\$ 12.34	\$ 11.60	\$ 11.56	\$ 11.77	\$ 11.91
Effect of goodwill and intangible assets per share	\$ (3.99)	\$ (0.59)	\$ (0.61)	\$ (0.64)	\$ (0.67)
Tangible book value per common share	\$ 8.35	\$ 11.01	\$ 10.95	\$ 11.13	\$ 11.24
Hilltop Holdings stockholders' equity	\$ 1,144,496	\$ 655,383	\$ 653,055	\$ 783,777	\$ 791,455
Less: preferred stock	114,068			119,108	119,108
Less: goodwill and intangible assets, net	331,508	33,062	34,587	36,229	37,990
Tangible common equity	698,920	622,321	618,468	628,440	634,357
Total assets	7,286,865	925,425	939,641	1,040,752	1,048,770
Less: goodwill and intangible assets, net	331,508	33,062	34,587	36,229	37,990
Tangible assets	6,955,357	892,363	905,054	1,004,523	1,010,780
Equity to assets	15.71%	70.82%	69.50%	75.31%	75.47%
Tangible common equity to tangible assets	10.05%	69.74%	68.33%	62.56%	62.76%

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

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

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, Hilltop, HTH, we, us, our or ours or similar words are to Hilltop Holdings Inc. and its direct and indirect wholly owned subsidiaries, references to PlainsCapital refer to PlainsCapital Corporation (a wholly owned subsidiary of Hilltop), references to the Bank refer to PlainsCapital Bank (a wholly owned subsidiary of PlainsCapital), references to First Southwest refer to First Southwest Holdings, LLC (a wholly owned subsidiary of the Bank) and its subsidiaries as a whole, references to FSC refer to First Southwest Company (a wholly owned subsidiary of First Southwest), references to PrimeLending refer to PrimeLending, a PlainsCapital Company (a wholly owned subsidiary of the Bank) and its subsidiaries as a whole and references to NLASCO refer to NLASCO, Inc. (a wholly owned subsidiary of Hilltop Holdings Inc.) and its subsidiaries as a whole.

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OUR GENERAL STRUCTURE

Beginning in 1995, we were founded as several companies under the name Affordable Residential Communities or ARC, now known as Hilltop Holdings Inc., for the purpose of engaging in the business of acquiring, renovating, repositioning and operating manufactured home communities, as well as certain related businesses. In 1998 we formed a Maryland corporation for the purpose of acting as the investment vehicle for, and a co-general partner of, our operating partnership, HTH Operating Partnership LP, formerly known as Affordable Residential Communities LP. In May 2002, we completed a reorganization in which we acquired substantially all the other real property partnerships and other related businesses we had previously organized and operated.

Through the year ended December 31, 2005, we were organized as a fully-integrated, self-administered and self-managed equity real estate investment trust, or REIT, for U.S. Federal income tax purposes. In 2006, we revoked our election as a REIT for U. S. Federal income tax purposes.

In January 2007, we acquired NLASCO. NLASCO, in turn, owns National Lloyds Insurance Company, or NLIC, and American Summit Insurance Company, or ASIC, both of which are licensed property and casualty insurers operating in multiple states. In addition, NLASCO also owns the NALICO GA, a general agency that operates in Texas. NLIC commenced business in 1949 and currently operates in 14 states, with its largest market being the state of Texas. NLIC carries a financial strength rating of A (Excellent) by A.M. Best. ASIC was formed in 1955 and currently operates in 13 states, its largest market being the state of Arizona. ASIC carries a financial strength rating of A (Excellent) by A.M. Best. Both of these companies are regulated by the Texas Department of Insurance.

On July 31, 2007, we sold substantially all of the operating assets used in our manufactured home communities business and our retail sales and financing business to American Residential Communities LLC. We received gross proceeds of approximately \$890 million in cash, which represents the aggregate purchase price of \$1.8 billion, less the indebtedness assumed by the buyer. After giving effect to expenses, taxes and our continued outstanding preferred stock and senior notes, our net cash balance was approximately \$550 million.

In connection with our strategy to make acquisitions or effect business combinations, on May 8, 2012 we entered into a definitive agreement and plan of merger with PlainsCapital Corporation, a diversified financial institution which provides an array of financial products and services through its business and consumer banking, lending and financial advisory subsidiaries. On November 30, 2012, concurrent with the consummation of the Merger, we became a financial holding company registered under the Bank Holding Company Act of 1956, as amended by the Gramm-Leach-Bliley Act of 1999.

OVERVIEW

On November 30, 2012, Hilltop acquired PlainsCapital Corporation in a stock and cash transaction, whereby PlainsCapital Corporation merged with and into Meadow Corporation, a wholly owned subsidiary of Hilltop Holdings Inc., with Meadow Corporation continuing as the surviving entity under the name PlainsCapital Corporation (the Merger). Based on Hilltop's closing stock price on November 30, 2012, the total purchase price was \$813.5 million, consisting of 27.1 million shares of common stock, \$311.8 million in cash and the issuance of 114,068 shares of Series B Preferred Stock. The fair market value of assets acquired, excluding goodwill, totaled \$6.5 billion, including \$3.2 billion of loans, \$730.8 million of investment securities and \$70.7 million of identifiable intangibles. The fair market value of the liabilities assumed was \$5.9

billion, including \$4.5 billion of deposits.

As a result of the Merger, the operating results of Hilltop for the year ended December 31, 2012 include the results from the operations acquired in the PlainsCapital Corporation transaction since December 1, 2012. Accordingly, our operating results and financial condition will not be comparable between 2012 and prior years. Additionally, the presentation of Hilltop's historical consolidated financial statements have been modified and certain items have been reclassified to conform to 2012 presentation which is more consistent with that of a financial institution that provides an array of financial products and services. Prior to the Merger with PlainsCapital Corporation, Hilltop's primary operations were to provide fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States.

At December 31, 2012, on a consolidated basis, we had total assets of \$7.3 billion, total deposits of \$4.7 billion, total loans, including loans held for sale, of \$4.6 billion and stockholders' equity of \$1.1 billion. The Bank, one of our wholly owned subsidiaries, provides a broad array of financial products and services, including commercial banking, personal banking, wealth management and treasury management, from offices located throughout central, north and west Texas. In addition to

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the Bank, we have various subsidiaries with specialized areas of expertise that also offer an array of financial products and services such as mortgage origination, insurance and financial advisory services.

Historically, we have derived our revenue from a single insurance segment. The Merger with PlainsCapital Corporation on November 30, 2012 has resulted in an increase to four reportable segments that are organized primarily by the core products offered to the segments' respective customers. We anticipate that future revenues will be driven primarily from the banking and mortgage origination segments, with the remainder being generated by our insurance and financial advisory segments. Based on historical results of PlainsCapital Corporation, the relative share of total revenue provided by our banking and mortgage origination segments fluctuates depending on market conditions, and operating results for the mortgage origination segment tend to be more volatile than operating results for the banking segment.

The banking segment includes the operations of the Bank. The banking segment primarily provides business banking and personal banking products and services and generates revenue from its portfolio of earning assets. The Bank's results of operations are primarily dependent on net interest income, while also deriving revenue from other sources, including service charges on customer deposit accounts and trust fees. The operations of PrimeLending comprise the mortgage origination segment, which offers a variety of loan products from offices in 42 states and generates revenue predominantly from fees charged on the origination of loans and from selling these loans in the secondary market. The insurance segment includes the operations of NLASCO, which operates through its wholly owned subsidiaries, National Lloyds Insurance Company, (NLIC), and American Summit Insurance Company, (ASIC). Insurance segment revenues are primarily generated from net insurance premiums earned, less loss and loss adjustment expenses (LAE) and policy acquisition and other underwriting expenses in Texas and other areas of the south, southeastern and southwestern United States. The financial advisory segment generates a majority of its revenues from fees and commissions earned from investment advisory and securities brokerage services at First Southwest. The principal subsidiaries of First Southwest are FSC, a broker-dealer registered with the Securities and Exchange Commission and Financial Industry Regulatory Authority, and First Southwest Asset Management, Inc., a registered investment advisor under the Investment Advisors Act of 1940. Additional information concerning our reportable segments is presented in Note 27, Segment and Related Information, in the notes to our consolidated financial statements.

We generate revenue from net interest income and from noninterest income. Net interest income represents the difference between the income earned on our assets, including our loans and investment securities, and our cost of funds, including the interest paid on the deposits and borrowings that are used to support our assets. Net interest income is a significant contributor to our operating results. Fluctuations in interest rates, as well as the amounts and types of interest-earning assets and interest-bearing liabilities we hold, affect net interest income. We generated \$28.8 million in net interest income during the year ended December 31, 2012, compared with net interest income of \$2.1 million in 2011 and net interest expense of \$0.8 million in 2010. The significant increase in net interest income during 2012 was primarily due to \$25.0 million in net interest income for the month ended December 31, 2012 from our banking segment that we acquired as a part of the Merger.

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

(i) *Net gains from sale of loans and mortgage loan origination fees.* Through our wholly owned subsidiary, PrimeLending, we generate noninterest income by originating and selling mortgage loans. During the month ended December 31, 2012, we generated \$57.6 million in net gains from sale of loans and mortgage loan origination fees.

(ii) *Investment advisory fees and commissions and securities brokerage fees and commissions.* Through our wholly owned subsidiary, First Southwest, we provide public finance advisory and various investment banking and brokerage services. We generated \$11.2

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million in investment advisory fees and commissions and securities brokerage fees and commissions during the month ended December 31, 2012.

(iii) *Net insurance premiums earned.* Through our wholly owned insurance subsidiary, NLASCO, we provide fire and limited homeowners insurance for low value dwellings and manufactured homes. We generated \$146.7 million, \$134.0 million and \$117.2 million in net insurance premiums earned during the years ended December 31, 2012, 2011 and 2010, respectively.

In the aggregate, we generated \$224.2 million, \$141.7 million and \$124.1 million in noninterest income during the years ended December 31, 2012, 2011 and 2010, respectively. The significant increase in noninterest income during 2012 was primarily due to the mortgage operations that we acquired as a part of the Merger.

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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.

Operating Results

The net loss applicable to common stockholders for the year ended December 31, 2012 was \$5.9 million, or \$0.10 per diluted share, compared to net losses applicable to common stockholders of \$6.5 million, or \$0.12 per diluted share, for the year ended December 31, 2011, and \$13.5 million, or \$0.24 per diluted share, for the year ended December 31, 2010. As a result of the Merger on November 30, 2012, the net income of PlainsCapital for the month ended December 31, 2012 is included in the operating results of Hilltop for the year ended December 31, 2012.

Certain items included in net loss for 2012 resulted from purchase accounting, compensation expense related to retention agreements with two PlainsCapital executive officers and specific merger related expenses associated with the PlainsCapital transaction. The pre-tax effects of these items include net accretion on acquired earning assets and liabilities of \$6.1 million, amortization of identifiable intangibles of \$0.8 million, compensation expense of \$8.9 million and the specific merger related expenses of \$6.6 million. The after tax impact of these items was to increase the net loss by \$7.7 million.

Our insurance segment's underwriting gain or loss consists of net insurance premiums earned, less loss, LAE and policy acquisition and other underwriting expenses. Underwriting performance is one of the most important factors in evaluating the overall results of our insurance operations given the fluctuations that can occur in loss and LAE due to weather related events, as well as the uncertainties involved in the process of estimating reserves for losses and LAE. The underwriting results and fluctuations in other noninterest income and expense line items specific to our insurance operations are discussed in greater detail below. The following table shows the underwriting gain or loss, as well as other income and expense line items specific to the financial results of NLASCO (in thousands).

Summary of Insurance Operations

	Year Ended December 31,			Variance	
	2012	2011	2010	2012 vs 2011	2011 vs 2010
Underwriting gain (loss):					
Homeowners	\$ (9,137)	\$ (123)	\$ (2,564)	\$ (9,014)	\$ 2,441
Fire	(4,517)	(2,057)	1,844	(2,460)	(3,901)
Mobile Home	(1,637)	(5,811)	845	4,174	(6,656)
Commercial	60	(2,305)	1,779	2,365	(4,084)
Other	187	185	188	2	(3)
Total underwriting loss	\$ (15,044)	\$ (10,111)	\$ 2,092	\$ (4,933)	\$ (12,203)
Other revenue (expense) items:					
Net investment income	6,308	6,306	5,873	2	433
Net realized gains on investments	112	817	137	(705)	680
Other income	7,334	6,785	6,744	549	41
Depreciation and amortization	(1,361)	(1,714)	(1,788)	353	74
Interest expense	(2,057)	(1,904)	(1,961)	(153)	57
Total other revenue (expense) items	10,336	10,290	9,005	46	1,285

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Operating income (loss) before federal income taxes	(4,708)	179	11,097	(4,887)	(10,918)
Federal income tax expense (benefit) on operating income (loss)	(2,385)	129	3,934	(2,514)	(3,805)
Net income (loss) from continuing operations of NLASCO	\$ (2,323)	\$ 50	\$ 7,163	\$ (2,373)	\$ (7,113)

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The insurance segment's underwriting gain or loss consists of net insurance premiums earned, less loss, LAE and policy acquisition and other underwriting expenses. As presented in this exhibit, policy acquisition and other underwriting expenses encompass all expenses incurred relative to insurance segment operations, and include elements of multiple categories of expense otherwise reported as noninterest expense in the consolidated statements of operations. The insurance underwriting results are presented in the table below (in thousands).

	Year Ended December 31,			Variance	
	2012	2011	2010	2012 vs 2011	2011 vs 2010
Direct insurance premiums written	\$ 163,780	\$ 155,054	\$ 139,290	\$ 8,726	\$ 15,764
Net insurance premiums written	\$ 150,451	\$ 141,737	\$ 121,691	\$ 8,714	\$ 20,046
Net insurance premiums earned	\$ 146,701	\$ 134,048	\$ 117,192	\$ 12,653	\$ 16,856
Loss and LAE	109,159	96,734	70,943	12,425	25,791
Policy acquisition and other underwriting expenses	52,586	47,425	44,157	5,161	3,268
Underwriting income (loss)	\$ (15,044)	\$ (10,111)	\$ 2,092	\$ (4,933)	\$ (12,203)
Agency expenses	\$ (2,073)	\$ (1,789)	\$ (1,966)	\$ (284)	\$ 177
Loss and LAE ratio	74.4%	72.2%	60.5%	2.2%	11.7%
Policy acquisition and other underwriting less agency expense ratio	34.4%	34.0%	36.0%	0.4%	-2.0%
Combined ratio	108.8%	106.2%	96.5%	2.6%	9.7%

The loss and LAE ratio is loss and LAE divided by net insurance premiums earned for the same period. The underwriting expense ratio is policy acquisition and other underwriting expense less agency expenses, divided by net insurance premiums earned for the same period. The combined ratio is the sum of the loss and LAE ratio and the underwriting expense ratio.

Loss and LAE increased \$12.4 million for the year ended December 31, 2012, as compared to the same period in 2011. This increase is primarily due to the increased frequency and severity of current accident year wind and hail losses. Wind and hail losses increased \$12.8 million during the year ended December 31, 2012 as compared to the same period in 2011. Net insurance premiums earned increased 9.4% in the year ended December 31, 2012, as compared to the same period in 2011, due to an \$8.7 million increase in volume of written premiums over the last twelve months. Loss and LAE expenses increased 12.8% in the year ended December 31, 2012, as compared to 2011, due to higher incurred losses associated with wind and hail storms that occurred in Texas and Oklahoma and additional losses associated with a 9.4% increase in earned premiums. Policy acquisition and other underwriting expenses increased 10.9% for the year ended December 31, 2012, as compared to 2011, primarily due to increased direct written premiums.

The Company seeks to generate underwriting profitability. Management evaluates NLASCO's loss and LAE ratio by bifurcating the losses to derive catastrophic and non-catastrophic loss ratios. The non-catastrophic loss ratio excludes Property Claims Services events that exceed \$1.0 million of losses to NLASCO. Catastrophic events, including those that do not exceed our reinsurance retention, affect the Company's loss ratios. For the year ended December 31, 2012, catastrophic events that did not exceed our reinsurance retention accounted for \$23.3 million of the total loss and loss adjustment expense, as compared to \$20.3 million and \$12.3 million for the same periods in 2011 and 2010, respectively. Excluding catastrophic events, our combined ratios for the year ended December 31, 2012, 2011 and 2010 would have been 93.0%, 91.0% and 86.0%, respectively.

For the year ended December 31, 2012, the Company had net unfavorable development in losses related to two 2008 catastrophes, Hurricane Ike and Hurricane Dolly. The Company also incurred losses in 2012 related to a catastrophic wind and hail storm in Arizona from October of 2010. Gross losses incurred from these prior storms was \$0.8 million for the year ended December 31, 2012, compared to favorable development of

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\$7.0 million for the same period in 2011. These losses have no effect on net loss and LAE incurred because the catastrophic events exceeded our retention and are fully recoverable. In 2012, NLIC incurred an \$8.3 million loss from a Texas hail storm. The \$8 million retention for catastrophic losses applied to the Texas hailstorm, and affected 2012 loss and LAE. The primary financial effect beyond the reinsurance retention is additional reinstatement premium payable to the affected reinsurers. For the year ended December 31, 2012 and 2011, the Company recorded reinstatement premiums of \$0.5 million and \$0.1 million, respectively.

Our combined ratio for the year ended December 31, 2012 is 108.8%, as compared to 106.2% and 96.5% for the same periods in 2011 and 2010, respectively. The 2.6% increase in combined ratio from 2011 to 2012 is primarily due to the 2.2% increase in loss and LAE ratio for the year ended December 31, 2012. Net insurance premiums earned increased 9.4% in the year ended December 31, 2012, as compared to the same period in 2011, due to an \$8.7 million increase in the volume of written premiums over the last 12 months. Loss and LAE expenses increased 12.8% in the year ended December 31, 2012, as compared to 2011, due to higher incurred losses associated with wind and hail losses and storms that occurred

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in Texas and additional losses associated with a 9.4% increase in earned premiums. Policy acquisition and other underwriting expenses increased 10.9% for the twelve months ended December 31, 2012, as compared to 2011, which is a result of increased direct written premiums in Texas and the write-off of the policy administration system.

The 9.7% increase in combined ratio in 2011 compared to 2010, was primarily due to the 11.7% increase in loss and LAE ratio for the year ended December 31, 2011. Loss and LAE expenses increased 36.4% in 2011, as compared to 2010, due to higher incurred losses associated with wind and hail storms in Texas and additional losses associated with a 14.4% increase in earned premiums. Texas typically experiences seasonal tornado and hail storms; however, NLASCO suffered a dramatic increase in losses from five storms in April and May 2011 that created \$19.3 million in incurred losses. Additionally, there were fifteen days of widely dispersed, exceptional weather related losses experienced during the three months ended June 30, 2011, which resulted in losses of \$8.1 million. NLASCO also experienced an increase in the frequency and severity of fire losses, which resulted in \$7.1 million in incurred losses above prior year. Policy acquisition and other underwriting expenses increased 7.4% for the year ended December 31, 2011, as compared to 2010, which is a direct result of an 11.3% increase in direct written premiums.

Net Interest Income

On a consolidated basis, net interest income increased \$26.8 million in 2012 compared with 2011 primarily due to the PlainsCapital acquisition on November 30, 2012. Net interest income increased \$2.9 million in 2011 compared with 2010, primarily due to higher investment income at the parent of \$2.5 million and \$0.4 million within our insurance segment.

The taxable equivalent net interest margin for the banking segment was 5.83% for the month of December 2012. The taxable equivalent net interest margin was impacted by accretion of discount on loans of \$6.3 million, amortization of premium on acquired securities of \$0.7 million and amortization of premium on acquired time deposits of \$0.4 million. As a result of these items, the taxable equivalent interest margin increased by 140 basis points.

We consider our banking segment to be the primary generator of our net interest income. The banking segment provides business banking and personal banking products and services and generates revenue from its portfolio of interest earning assets. The banking segment's results are primarily dependent on net interest income.

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The table below provides additional details regarding our banking segment's net interest income for the month ended December 31, 2012 (dollars in thousands).

	Average Balance	Month Ended December 31, 2012 Interest Earned or Paid	Yield or Rate
Assets			
Interest-earning assets			
Loans, gross (1)	\$ 4,148,317	\$ 25,212	7.29%
Investment securities - taxable	494,285	444	1.08%
Investment securities - non-taxable (2)	175,850	479	3.27%
Federal funds sold and securities purchased under agreements to resell	33,180	48	1.74%
Interest-bearing deposits in other financial institutions	299,464	68	0.27%
Other	33,594	57	2.04%
Interest-earning assets, gross	5,184,690	26,308	6.09%
Allowance for loan losses	248		
Interest-earning assets, net	5,184,938		
Noninterest-earning assets	814,461		
Total assets			