Hilltop Holdings Inc.
Form 10-Q
November 05, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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

Commission File Number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

Maryland	84-1477939
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 Crescent Court, Suite 1330

Dallas, TX	75201
(Address of principal executive offices)	(Zip Code)

(214) 855-2177

(Registrant's telephone number, including area code)

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

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

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

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

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

The number of shares of the registrant's common stock outstanding at November 5, 2015 was 98,895,584.

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HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2015

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	September 30, 2015	December 31, 2014
Assets		
Cash and due from banks	$ 526,692	$ 782,473
Federal funds sold	24,861	30,602
Securities purchased under agreements to resell	83,889	—
Assets segregated for regulatory purposes	228,251	76,013
Securities:		
Trading, at fair value	292,418	65,717
Available for sale, at fair value (amortized cost of $719,212 and $924,755, respectively)	726,132	925,535
Held to maturity, at amortized cost (fair value of $308,031 and $118,345, respectively)	305,316	118,209
	1,323,866	1,109,461
Loans held for sale	1,354,107	1,309,693
Non-covered loans, net of unearned income	4,999,529	3,920,476
Allowance for non-covered loan losses	(42,989)	(37,041)
Non-covered loans, net	4,956,540	3,883,435
Covered loans, net of allowance of $1,870 and $4,611, respectively	420,547	638,029
Broker-dealer and clearing organization receivables	2,111,864	167,884
Premises and equipment, net	204,273	206,991
FDIC indemnification asset	92,902	130,437
Covered other real estate owned	106,024	136,945
Other assets	644,916	458,862
Goodwill	251,808	251,808
Other intangible assets, net	58,916	59,783
Total assets	$ 12,389,456	$ 9,242,416
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$ 2,173,890	$ 2,076,385
Interest-bearing	4,646,859	4,293,507
Total deposits	6,820,749	6,369,892

Broker-dealer and clearing organization payables	2,045,604	179,042
Short-term borrowings	910,490	762,696
Securities sold, not yet purchased, at fair value	156,775	48
Notes payable	243,556	56,684
Junior subordinated debentures	67,012	67,012
Other liabilities	428,442	345,803
Total liabilities	10,672,628	7,781,177
Commitments and contingencies (see Notes 13 and 14)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Preferred stock, $0.01 par value, 10,000,000 shares authorized; Series B, liquidation value per share of $1,000; 114,068 shares issued and outstanding at December 31, 2014	—	114,068
Common stock, $0.01 par value, 125,000,000 shares authorized; 98,892,539 and 90,181,888 shares issued and outstanding, respectively	989	902
Additional paid-in capital	1,574,769	1,390,788
Accumulated other comprehensive income	4,592	651
Retained earnings (accumulated deficit)	134,748	(45,957)
Deferred compensation employee stock trust, net	1,182	—
Employee stock trust (29,589 shares, at cost)	(590)	—
Total Hilltop stockholders' equity	1,715,690	1,460,452
Noncontrolling interests	1,138	787
Total stockholders' equity	1,716,828	1,461,239
Total liabilities and stockholders' equity	$ 12,389,456	$ 9,242,416

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest income:				
Loans, including fees	$ 111,315	$ 80,719	$ 295,670	$ 252,667
Securities borrowed	10,116	2,078	29,809	5,420
Securities:				
Taxable	6,262	7,688	19,538	22,894
Tax-exempt	1,683	1,150	4,981	3,579
Other	1,169	1,582	3,878	4,893
Total interest income	130,545	93,217	353,876	289,453
Interest expense:				
Deposits	3,719	4,117	11,934	10,972
Securities loaned	7,110	1,182	21,505	2,947
Short-term borrowings	1,189	667	3,356	1,606
Notes payable	2,524	633	5,482	1,913
Junior subordinated debentures	605	594	1,785	1,765
Other	187	264	544	623
Total interest expense	15,334	7,457	44,606	19,826
Net interest income	115,211	85,760	309,270	269,627
Provision for loan losses	5,593	4,033	8,438	12,808
Net interest income after provision for loan losses	109,618	81,727	300,832	256,819
Noninterest income:				
Net realized gains on securities	—	—	4,403	—
Net gains from sale of loans and other mortgage production income	137,303	108,621	405,023	293,786
Mortgage loan origination fees	22,647	17,593	58,194	46,920
Net insurance premiums earned	41,196	41,821	121,081	122,917
Securities commissions and fees	39,070	6,865	123,201	20,857
Investment and securities advisory fees and commissions	27,667	17,190	82,254	46,797
Bargain purchase gain	—	—	81,289	—
Other	28,586	20,045	75,270	54,239
Total noninterest income	296,469	212,135	950,715	585,516

Noninterest expense:				
Employees' compensation and benefits	200,620	126,472	583,415	357,280
Loss and loss adjustment expenses	17,335	22,629	77,436	76,241
Policy acquisition and other underwriting expenses	11,784	11,571	35,198	34,910
Occupancy and equipment, net	29,341	25,345	89,368	77,445
Other	74,422	68,727	215,878	172,709
Total noninterest expense	333,502	254,744	1,001,295	718,585
Income before income taxes	72,585	39,118	250,252	123,750
Income tax expense	25,338	14,010	58,895	44,658
Net income	47,247	25,108	191,357	79,092
Less: Net income attributable to noncontrolling interest	353	296	1,111	583
Income attributable to Hilltop	46,894	24,812	190,246	78,509
Dividends on preferred stock	—	1,426	1,854	4,278
Income applicable to Hilltop common stockholders	$ 46,894	$ 23,386	$ 188,392	$ 74,231
Earnings per common share:				
Basic	$ 0.47	$ 0.26	$ 1.89	$ 0.82
Diluted	$ 0.47	$ 0.26	$ 1.88	$ 0.82
Weighted average share information:				
Basic	98,676	89,711	99,297	89,709
Diluted	99,556	90,558	100,191	90,570

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	$ 47,247	$ 25,108	$ 191,357	$ 79,092
Other comprehensive income (loss):				
Net unrealized gains (losses) on securities available for sale, net of tax of $3,222, $(656), $3,847 and $16,565, respectively	5,697	(1,226)	6,755	31,136
Reclassification adjustment for gains included in net income, net of tax of $(1,589)	—	—	(2,814)	—
Comprehensive income	52,944	23,882	195,298	110,228
Less: comprehensive income attributable to noncontrolling interest	353	296	1,111	583
Comprehensive income applicable to Hilltop	$ 52,591	$ 23,586	$ 194,187	$ 109,645

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

ock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Deferred Compensation Employee Stock Trust, Net	Employee Stock Trust Shares	Employee Stock Trust Amount	Total Hilltop Stockholders Equity
114,068	90,176	$ 902	$ 1,388,641	$ (34,863)	$ (157,607)	$ —	—	$ —	$ 1,311,141
—	—	—	—	—	78,509	—	—	—	78,509
—	—	—	—	31,136	—	—	—	—	31,136
—	—	—	3,316	—	—	—	—	—	3,316
—	7	—	162	—	—	—	—	—	162
—	(3)	—	(12)	—	—	—	—	—	(12)
—	—	—	(4,278)	—	—	—	—	—	(4,278)
—	—	—	3,001	—	—	—	—	—	3,001
—	—	—	—	—	—	—	—	—	—
114,068	90,180	$ 902	$ 1,390,830	$ (3,727)	$ (79,098)	$ —	—	$ —	$ 1,422,975
114,068	90,182	$ 902	$ 1,390,788	$ 651	$ (45,957)	$ —	—	$ —	$ 1,460,452

—	—	—	—	—	190,246	—	—	—	190,246
—	—	—	—	3,941	—	—	—	—	3,941
—	10,113	101	199,932	—	—	—	—	—	200,033
—	—	—	6,220	—	—	—	—	—	6,220
—	8	—	173	—	—	—	—	—	173
—	(19)	—	(17)	—	—	—	—	—	(17)
—	—	—	—	—	(1,854)	—	—	—	(1,854)
(114,068)	—	—	—	—	—	—	—	—	(114,068)
—	(1,391)	(14)	(22,327)	—	(7,687)	—	—	—	(30,028)
—	—	—	—	—	—	1,182	30	(590)	592
—	—	—	—	—	—	—	—	—	—
—	98,893	$ 989	$ 1,574,769	$ 4,592	$ 134,748	$ 1,182	30	$ (590)	$ 1,715,690

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
Operating Activities		
Net income	$ 191,357	$ 79,092
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	8,438	12,808
Depreciation, amortization and accretion, net	(67,557)	(63,367)
Net realized gains on securities	(4,403)	—
Bargain purchase gain	(81,289)	—
Deferred income taxes	11,459	6,418
Other, net	(91)	16,669
Net change in securities purchased under agreements to resell	(39,148)	—
Net change in assets segregated for regulatory purposes	29,372	(29,503)
Net change in trading securities	39,367	(7,256)
Net change in broker-dealer and clearing organization receivables	(680,699)	(164,497)
Net change in FDIC Indemnification Asset	38,561	41,175
Net change in other assets	(90,417)	(51,865)
Net change in broker-dealer and clearing organization payables	708,838	261,206
Net change in other liabilities	3,138	30,303
Net gains from sales of loans	(405,023)	(293,786)
Loans originated for sale	(10,628,783)	(7,954,706)
Proceeds from loans sold	10,965,234	8,067,301
Net cash used in operating activities	(1,646)	(50,008)
Investing Activities		
Proceeds from maturities and principal reductions of securities held to maturity	51,838	2,821
Proceeds from sales, maturities and principal reductions of securities available for sale	599,737	152,537
Purchases of securities held to maturity	(167,284)	(123,021)
Purchases of securities available for sale	(22,769)	(48,730)
Net change in loans	16,205	106,335
Purchases of premises and equipment and other assets	(23,410)	(32,581)
Proceeds from sales of premises and equipment and other real estate owned	94,680	55,097
Proceeds from redemption of bank owned life insurance	822	—

Net cash paid for Federal Home Loan Bank and Federal Reserve Bank stock	(9,292)	(28,383)
Net cash from acquisition	41,097	—
Net cash provided by investing activities	581,624	84,075
Financing Activities		
Net change in deposits	(788,907)	(633,685)
Net change in short-term borrowings	(16,446)	503,897
Proceeds from notes payable	150,078	2,000
Payments on notes payable	(37,787)	(2,643)
Redemption of preferred stock	(114,068)	—
Payments to repurchase common stock	(30,028)	—
Dividends paid on preferred stock	(3,280)	(4,194)
Net cash distributed to noncontrolling interest	(760)	(595)
Other, net	(302)	2,718
Net cash used in financing activities	(841,500)	(132,502)
Net change in cash and cash equivalents	(261,522)	(98,435)
Cash and cash equivalents, beginning of period	813,075	746,023
Cash and cash equivalents, end of period	$ 551,553	$ 647,588
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	$ 41,368	$ 20,935
Cash paid for income taxes, net of refunds	$ 112,282	$ 19,893
Supplemental Schedule of Non-Cash Activities		
Conversion of loans to other real estate owned	$ 45,996	$ 44,815
Common stock issued in acquisition	$ 200,626	$ —

See accompanying notes.

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Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting and Reporting Policies

Nature of Operations

Hilltop Holdings Inc. (“Hilltop” and, collectively with its subsidiaries, the “Company”) is a financial holding company registered under the Bank Holding Company Act of 1956, as amended by the Gramm-Leach-Bliley Act of 1999. The Company’s primary line of business is to provide business and consumer banking services from offices located throughout Texas through PlainsCapital Bank (the “Bank”). In addition, the Company provides an array of financial products and services through its broker-dealer, mortgage origination and insurance subsidiaries.

The Company provides its products and services through three primary operating subsidiaries, PlainsCapital Corporation (“PlainsCapital”), Hilltop Securities Holdings LLC (“Securities Holdings”) and National Lloyds Corporation (“NLC”). PlainsCapital is a financial holding company, headquartered in Dallas, Texas, that provides, through its subsidiaries, traditional banking services, wealth and investment management and treasury management primarily in Texas and residential mortgage lending throughout the United States. Securities Holdings is a holding company, headquartered in Dallas, Texas, that provides, through its subsidiaries, investment banking and other related financial services, including municipal advisory, sales, trading and underwriting of taxable and tax-exempt fixed income securities, equity trading, clearing, securities lending, structured finance and retail brokerage services throughout the United States. NLC is a property and casualty insurance holding company, headquartered in Waco, Texas, that provides, through its subsidiaries, fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the southern United States.

On January 1, 2015, Hilltop completed its acquisition of SWS Group, Inc. (“SWS”) in a stock and cash transaction (the "SWS Merger"), whereby SWS’s broker-dealer subsidiaries, Southwest Securities, Inc. and SWS Financial Services, Inc., became subsidiaries of Securities Holdings, a wholly owned subsidiary of Hilltop initially formed for the purpose of facilitating this transaction, and SWS’s banking subsidiary, Southwest Securities, FSB (“SWS FSB”), was merged into the Bank, an indirect wholly owned subsidiary of Hilltop. As a result of the SWS Merger, each outstanding share of SWS common stock was converted into the right to receive 0.2496 shares of Hilltop common stock and $1.94 in cash, equating to $6.92 per share based on Hilltop’s closing price on December 31, 2014 and resulting in an aggregate purchase price of $349.1 million, consisting of 10.1 million shares of common stock, $78.2 million in cash and $70.3 million associated with Hilltop’s existing investment in SWS common stock. Additionally, due to appraisal rights proceedings filed in connection with the SWS Merger, the merger consideration is subject to change, and is therefore, preliminary as of the date of this report. Based on purchase date valuations, the fair value of the assets acquired was

$3.3 billion, including $707.5 million in securities, $863.8 million in non-covered loans and $1.2 billion in broker-dealer and clearing organization receivables. The fair value of liabilities assumed was $2.9 billion, consisting primarily of deposits of $1.3 billion and $1.1 billion in broker-dealer and clearing organization payables. On October 5, 2015, Southwest Securities, Inc. and SWS Financial Services, Inc. were renamed “Hilltop Securities Inc.” (“Hilltop Securities”) and “Hilltop Securities Independent Network Inc.” (“HTS Independent Network”), respectively.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (“GAAP”), and in conformity with the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of management, these financial statements contain all adjustments necessary for a fair statement of the results of the interim periods presented. Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014 (“2014 Form 10-K”). Results for interim periods are not necessarily indicative of results to be expected for a full year or any future period.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period.

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Actual results could differ from those estimates. Estimates regarding the allowance for loan losses, the fair values of financial instruments, the amounts receivable from the Federal Deposit Insurance Corporation (the "FDIC") under loss-share agreements (the "FDIC Indemnification Asset"), reserves for losses and loss adjustment expenses, the mortgage loan indemnification liability, and the potential impairment of assets are particularly subject to change. The Company has applied its critical accounting policies and estimation methods consistently in all periods presented in these consolidated financial statements.

The operations of SWS were included in the Company's operating results beginning January 1, 2015 and such operations included a preliminary bargain purchase gain of $82.8 million as disclosed in the Company's Quarterly Report on Form 10-Q filed with the SEC on May 6, 2015. In accordance with the Business Combinations Topic of the Accounting Standards Codification ("ASC"), during the quarter ended June 30, 2015, the estimated fair value of the customer relationship intangible asset acquired as of January 1, 2015 was adjusted downward as a result of management's review and approval of certain key assumptions that existed as of January 1, 2015. Additionally, during the quarter ended September 30, 2015, the estimated fair value of deferred tax assets acquired as of January 1, 2015 was adjusted upward as a result of management's review and filing of SWS's consolidated federal tax return for the year ended December 31, 2014. These adjustments resulted in a net decrease in the preliminary bargain purchase gain associated with the SWS Merger to $81.3 million. This change is reflected in the consolidated statements of operations within noninterest income during the nine months ended September 30, 2015. In the aggregate, these adjustments to the preliminary bargain purchase gain decreased net income for the three months ended March 31, 2015 by $1.5 million as compared with amounts previously reported in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2015. Additionally, certain amounts previously reported in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 within the consolidated balance sheet as of March 31, 2015, and the related statements of comprehensive income, stockholders' equity and cash flows for the three months ended March 31, 2015, as well as the notes to the consolidated financial statements, will be revised in future filings.

Certain reclassifications have been made to the prior period consolidated financial statements to conform with the current period presentation. Additionally, during the preparation of the condensed consolidated financial statements for the period ended September 30, 2015, the Company determined that its previously reported unaudited consolidated statements of cash flows contained in the previously filed Quarterly Reports on Form 10-Q filed with SEC on May 6, 2015 and July 29, 2015 contained a classification error related to how certain acquired balances related to its acquisition of SWS were reflected. Management has evaluated the quantitative and qualitative impact of the classification error to previously issued unaudited consolidated statements of cash flows and concluded that the previously issued condensed consolidated financial statements were not materially misstated. However, in order to correctly present the cash flow statements, management has elected to revise the unaudited consolidated statements of cash flows for each of the three months ended March 31, 2015 and six months ended June 30, 2015 in its future filings. The correction had no impact on the Company's financial condition or results of operations for the periods presented. The following table summarizes the revisions made to the Company's unaudited consolidated statements of cash flows for the noted periods (in thousands).

	Three Months Ended March 31, 2015		Six Months Ended June 30,2015	
		As Revised		As Revised

	As Originally Reported		As Originally Reported	
Operating Activities				
Net change in broker-dealer and clearing organization receivables	$ (1,062,969)	$ (793,613)	$ (929,477)	$ (660,121)
Net change in broker-dealer and clearing organization payables	1,039,786	690,552	1,021,493	672,259
Net cash provided by (used in) operating activities	(38,766)	(118,644)	26,540	(53,338)
Investing Activities				
Net change in loans	267,275	(2,080)	244,681	(24,674)
Net cash provided by investing activities	792,267	522,912	737,291	467,936
Financing Activities				
Net change in deposits	(905,043)	(556,657)	(1,123,301)	(774,068)
Net cash used in financing activities	(858,043)	(508,810)	(971,049)	(621,816)
Net change in cash and cash equivalents	(104,542)	(104,542)	(207,218)	(207,218)

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Hilltop owns 100% of the outstanding stock of PlainsCapital. PlainsCapital owns 100% of the outstanding stock of the Bank and 100% of the membership interest in PlainsCapital Equity, LLC. The Bank owns 100% of the outstanding stock of PrimeLending, a PlainsCapital Company ("PrimeLending") and has a 100% membership interest in PlainsCapital Securities, LLC.

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

Hilltop has a 100% membership interest in Securities Holdings, which operates through its wholly-owned subsidiaries, First Southwest Holdings, LLC ("First Southwest"), Hilltop Securities and HTS Independent Network. The principal subsidiaries of First Southwest are First Southwest Company, LLC ("FSC"), a broker-dealer registered with the SEC and the Financial Industry Regulatory Authority ("FINRA") and a member of the New York Stock Exchange ("NYSE"), and First Southwest Asset Management, LLC, a registered investment advisor under the Investment Advisors Act of 1940. Hilltop Securities is a broker-dealer registered with the SEC and FINRA and a member of the NYSE, and HTS Independent Network is an introducing broker-dealer that is also registered with the SEC and FINRA.

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

The consolidated financial statements include the accounts of the above-named entities. All significant intercompany transactions and balances have been eliminated. Noncontrolling interests have been recorded for minority ownership in entities that are not wholly owned and are presented in compliance with the provisions of Noncontrolling Interest in Subsidiary Subsections of the Financial Accounting Standards Board ("FASB") ASC.

PlainsCapital also owns 100% of the outstanding common securities of PCC Statutory Trusts I, II, III and IV (the "Trusts"), which are not included in the consolidated financial statements under the requirements of the Variable Interest Entities Subsections of the ASC, because the primary beneficiaries of the Trusts are not within the consolidated group.

2. Acquisition

SWS Merger

On January 1, 2015, Hilltop completed its acquisition of SWS in a stock and cash transaction as discussed in Note 1 to the consolidated financial statements. The operations of SWS are included in the Company's operating results beginning January 1, 2015. Such operating results include a preliminary bargain purchase gain of $81.3 million and are not necessarily indicative of future operating results. SWS's results of operations prior to the acquisition date are not included in the Company's consolidated operating results.

The SWS Merger was accounted for using the acquisition method of accounting, and accordingly, purchased assets, including identifiable intangible assets, and assumed liabilities were recorded at their respective acquisition date fair values. The components of the consideration paid are shown in the following table (in thousands).

Fair value of preliminary consideration paid:	
Common stock issued	$ 200,626
Cash	78,217
Fair value of Hilltop's existing investment in SWS	70,282
Total preliminary consideration paid	$ 349,125

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The resulting fair values of the identifiable assets acquired, and liabilities assumed, of SWS at January 1, 2015 are summarized in the following table (in thousands).

Cash and due from banks	$ 119,314
Federal funds sold and securities purchased under agreements to resell	44,741
Assets segregated for regulatory purposes	181,610
Securities	707,476
Non-covered loans, net	863,819
Broker-dealer and clearing organization receivables	1,221,793
Other assets	159,906
Total identifiable assets acquired	3,298,659
Deposits	(1,287,509)
Broker-dealer and clearing organization payables	(1,109,978)
Short-term borrowings	(164,240)
Securities sold, not yet purchased, at fair value	(140,409)
Notes payable	(76,643)
Other liabilities	(89,466)
Total liabilities assumed	(2,868,245)
Preliminary estimated bargain purchase gain	(81,289)
	349,125
Less Hilltop existing investment in SWS	(70,282)
Net identifiable assets acquired	$ 278,843

The preliminary bargain purchase gain represents the excess of the estimated fair value of the underlying net tangible assets and intangible assets over the preliminary merger consideration. The SWS Merger was a tax-free reorganization under Section 368(a) of the Internal Revenue Code, therefore no income taxes were recorded in connection with the preliminary bargain purchase gain. The Company used significant estimates and assumptions to value certain identifiable assets acquired and liabilities assumed. The preliminary bargain purchase gain was primarily driven by the Company’s ability to realize acquired deferred tax assets through its consolidated core earnings and the decline in the price of the Company’s common stock between the date the fixed conversion ratio was agreed upon and the closing date.

Included within the fair value of other assets in the table above are identifiable intangible assets recorded in connection with the SWS Merger. The allocation to intangible assets is as follows (in thousands).

	Estimated Useful Life (Years)	Gross Intangible Assets
Customer relationships	14	$ 7,300
Core deposits	4	160

	$ 7,460

Transaction and integration-related expenses associated with the SWS Merger of $2.8 million and $0.3 million during the three months ended September 30, 2015 and 2014, respectively, and $17.2 million and $0.7 million during the nine months ended September 30, 2015 and 2014, respectively, are included in noninterest expense within the consolidated statements of operations. Such expenses were for professional services and other incremental employee and contractual costs associated with the integration of SWS's operations.

In connection with the SWS Merger, Hilltop acquired loans both with and without evidence of credit quality deterioration since origination. The acquired loans were initially recorded at fair value with no carryover of any allowance for loan losses. Acquired loans were segregated between those considered to be purchased credit impaired

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("PCI") loans and those without credit impairment at acquisition. The following table presents details on acquired loans at the acquisition date (in thousands).

	Loans, excluding PCI Loans	PCI Loans	Total Loans
Commercial and industrial (1)	$ 447,959	$ 9,850	$ 457,809
Real estate	324,477	62,218	386,695
Construction and land development	14,708	1,391	16,099
Consumer	3,216	—	3,216
Total	$ 790,360	$ 73,459	$ 863,819

(1) Acquired loans include margin loans to customers and correspondents of $269.4 million associated with acquired broker-dealer operations, none of which are PCI loans.

The following table presents information about the PCI loans at acquisition (in thousands).

Contractually required principal and interest payments	$ 120,078
Nonaccretable difference	32,040
Cash flows expected to be collected	88,038
Accretable difference	14,579
Fair value of loans acquired with a deterioration of credit quality	$ 73,459

The following table presents information about the acquired loans without credit impairment at acquisition (in thousands).

Contractually required principal and interest payments	$ 901,672
Contractual cash flows not expected to be collected	39,721
Fair value at acquisition	790,360

Pro Forma Results of Operations

The results of operations acquired in the SWS Merger have been included in the Company's consolidated financial results since January 1, 2015. The following table discloses the impact of SWS on the Company's results of operations. The table presents pro forma results had the SWS Merger taken place on January 1, 2014 and includes the estimated impact of purchase accounting adjustments (in thousands). The purchase accounting adjustments reflect the impact of recording the acquired loans at fair value, including the estimated accretion of the purchase discount on the loan portfolio. Accretion estimates were based on the acquisition date purchase discount on the loan portfolio, as it was not practicable to determine the amount of discount that would have been recorded based on economic conditions that existed on January 1, 2014. The pro forma results do not include any potential operating cost savings as a result of the SWS Merger. Further, certain costs associated with any integration activities are not reflected in the pro forma results. Pro forma results exclude nonrecurring items resulting directly from the SWS Merger that do not have a continuing impact on results of operations. The pro forma results are not necessarily indicative of what would have occurred had the SWS Merger taken place on the indicated date.

	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Net interest income	$ 106,593	$ 322,231
Other revenues	262,960	743,812
Net income	31,636	87,785

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3. Fair Value Measurements

Fair Value Measurements and Disclosures

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

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

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities that the Company can access at the measurement date.

- Level 2 Inputs: Observable inputs other than Level 1 prices. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, yield curves, prepayment speeds, default rates, credit risks and loss severities), and inputs that are derived from or corroborated by market data, among others.

- Level 3 Inputs: Unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities. Level 3 inputs include pricing models and discounted cash flow techniques, among others.

Fair Value Option

The Company has elected to measure substantially all of PrimeLending's mortgage loans held for sale and retained mortgage servicing rights ("MSR") asset at fair value, under the provisions of the Fair Value Option. The Company elected to apply the provisions of the Fair Value Option to these items so that it would have the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. At September 30, 2015, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was $1.31 billion, and the unpaid principal balance of those loans was $1.25 billion. At December 31, 2014, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was $1.27 billion, and the unpaid principal balance of those loans was $1.22 billion. The interest component of fair value is reported as interest income on loans in the accompanying consolidated statements of operations.

On October 2, 2014, Hilltop exercised its warrant to purchase 8,695,652 shares of SWS common stock at an exercise price of $5.75 per share (the "SWS Warrant") and paid the aggregate exercise price by the automatic elimination of the $50.0 million aggregate principal amount note due to Hilltop under its credit agreement with SWS. Following the exercise of the SWS Warrant, Hilltop owned approximately 21% of the outstanding shares of SWS common stock as of October 2, 2014. Contemporaneous with the exercise of the SWS Warrant, Hilltop changed the accounting method for its investment in SWS common stock and elected to account for its investment in accordance with the provisions of the Fair Value Option as permitted by GAAP. Hilltop had previously accounted for its investment in SWS common stock as an available for sale security. Under the Fair Value Option, Hilltop's investment in SWS common stock is recorded at fair value effective October 2, 2014, with changes in fair value being recorded in other noninterest income within the consolidated statements of operations rather than as a component of other comprehensive income. At December 31, 2014, the fair value of Hilltop's investment in SWS common stock was $70.3 million and is included in other assets within the consolidated balance sheet.

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

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

September 30, 2015	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	$ 9,748	$ 282,669	$ 1	$ 292,418
Available for sale securities	17,456	708,676	—	726,132
Loans held for sale	—	1,278,950	26,704	1,305,654
Derivative assets	—	77,587	—	77,587
MSR asset	—	—	47,527	47,527
Trading liabilities	41,792	114,983	—	156,775
Derivative liabilities	—	42,340	—	42,340

December 31, 2014	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	$ 39	$ 65,678	$ —	$ 65,717
Available for sale securities	13,762	911,773	—	925,535
Loans held for sale	—	1,263,135	9,017	1,272,152
Derivative assets	—	23,805	—	23,805
MSR asset	—	—	36,155	36,155
Investment in SWS common stock	70,282	—	—	70,282
Trading liabilities	—	48	—	48
Derivative liabilities	—	12,849	—	12,849

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

				Total Gains or Losses (Realized or Unrealized)		
	Balance at Beginning of Period	Purchases/ Additions	Sales/ Reductions	Included in Net Income	Included in Other Comprehensive Income (Loss)	Balance at End of Period
Three months ended September 30, 2015						
Trading securities	$ 16	$ —	$ —	$ (15)	$ —	$ 1
Loans held for sale	19,123	11,466	(2,769)	(1,116)	—	26,704
MSR asset	44,985	11,025	—	(8,483)	—	47,527
Total	$ 64,124	$ 22,491	$ (2,769)	$ (9,614)	$ —	$ 74,232
Nine months ended September 30, 2015						
Trading securities	$ —	$ 7,301	$ (3,397)	$ (3,903)	$ —	$ 1
Loans held for sale	9,017	40,075	(12,493)	(9,895)	—	26,704
MSR asset	36,155	23,121	—	(11,749)	—	47,527
Total	$ 45,172	$ 70,497	$ (15,890)	$ (25,547)	$ —	$ 74,232
Three months ended September 30, 2014						
Available for sale securities	$ 63,819	$ —	$ —	$ 639	$ (3,175)	$ 61,283
Loans held for sale	10,409	6,110	(1,600)	(1,156)	—	13,763
MSR asset	35,877	18,982	(11,387)	(1,565)	—	41,907
Derivative liabilities	(6,300)	(177)	—	(350)	—	(6,827)
Total	$ 103,805	$ 24,915	$ (12,987)	$ (2,432)	$ (3,175)	$ 110,126
Nine months ended September 30, 2014						
Available for sale securities	$ 60,053	$ —	$ —	$ 1,848	$ (618)	$ 61,283
Loans held for sale	27,729	16,531	(31,203)	706	—	13,763
MSR asset	20,149	33,790	(11,387)	(645)	—	41,907
Derivative liabilities	(5,600)	(177)	—	(1,050)	—	(6,827)
Total	$ 102,331	$ 50,144	$ (42,590)	$ 859	$ (618)	$ 110,126

All net realized and unrealized gains (losses) in the table above are reflected in the accompanying consolidated financial statements. The available for sale securities noted in the table above reflect Hilltop's note receivable from SWS and the SWS Warrant, which, as previously discussed, Hilltop exercised in full on October 2, 2014. Hilltop paid the aggregate exercise price for the SWS Warrant by the automatic elimination of the $50.0 million aggregate principal amount note due to Hilltop under the credit agreement.

For Level 3 financial instruments measured at fair value on a recurring basis at September 30, 2015, the significant unobservable inputs used in the fair value measurements were as follows.

Financial instrument	Valuation Technique	Unobservable Input	Range (Weighted-Average)
Trading securities	Discounted cash flow	Discount rate	8 - 17 % (10 %)
Loans held for sale	Discounted cash flow / Market comparable	Projected price	93 - 95 % (94 %)
MSR asset	Discounted cash flow	Constant prepayment rate	13.68 %
		Discount rate	10.93 %

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

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Trading securities include corporate debt securities that are valued using a discounted cash flow model with observable market data; however, due to the distressed nature of these bonds, the Company has determined that these securities should be valued as a Level 3 financial instrument.

The MSR asset, which is included in other assets within the Company's consolidated balance sheets, is valued by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair value of the MSR asset is impacted by a variety of factors. Prepayment rates and discount rates, the most significant unobservable inputs, are discussed further in Note 7 to the consolidated financial statements.

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

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

	Three Months Ended September 30, 2015			Three Months Ended September 30, 2014		
	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value
Loans held for sale	$ 18,531	$ —	$ 18,531	$ (15,250)	$ —	$ (15,250)
MSR asset	(8,483)	—	(8,483)	(1,565)	—	(1,565)

	Nine Months Ended September 30, 2015			Nine Months Ended September 30, 2014		
	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value	Net Gains (Losses)	Other Noninterest Income	Total Changes in Fair Value
Loans held for sale	$ 2,773	$ —	$ 2,773	$ 24,918	$ —	$ 24,918
MSR asset	(11,749)	—	(11,749)	(645)	—	(645)

The Company also determines the fair value of certain assets and liabilities on a non-recurring basis. In particular, the fair value of all of the assets acquired and liabilities assumed in the SWS Merger was determined at the acquisition date. In addition, facts and circumstances may dictate a fair value measurement when there is evidence of impairment.

Assets and liabilities measured on a non-recurring basis include the items discussed below.

Impaired Loans — The Company reports impaired loans based on the underlying fair value of the collateral through specific allowances within the allowance for loan losses. PCI loans with a fair value of $172.9 million, $822.8 million and $73.5 million were acquired by the Company upon completion of the merger with PlainsCapital (the “PlainsCapital Merger”), the FDIC-assisted transaction (the “FNB Transaction”) whereby the Bank acquired certain assets and assumed certain liabilities of First National Bank (“FNB”) and the SWS Merger, respectively (collectively, the “Bank Transactions”). Substantially all PCI loans acquired in the FNB Transaction are covered by FDIC loss-share agreements. The fair value of PCI loans was determined using Level 3 inputs, including estimates of expected cash flows that incorporated significant unobservable inputs regarding default rates, loss severity rates assuming default, prepayment speeds on acquired loans accounted for in pools (“Pooled Loans”), and estimated collateral values.

At September 30, 2015, estimates for these significant unobservable inputs were as follows.

	PCI Loans PlainsCapital Merger		FNB Transaction		SWS Merger	
Weighted average default rate	54	%	54	%	54	%
Weighted average loss severity rate	51	%	38	%	38	%
Weighted average prepayment speed	0	%	6	%	1	%

At September 30, 2015, the resulting weighted average expected loss on PCI loans associated with the PlainsCapital Merger, FNB Transaction and SWS Merger was 28%, 21% and 20%, respectively.

The Company obtains updated appraisals of the fair value of collateral securing impaired collateral dependent loans at least annually, in accordance with regulatory guidelines. The Company also reviews the fair value of such collateral on a quarterly basis. If the quarterly review indicates that the fair value of the collateral may have deteriorated, the Company

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orders an updated appraisal of the fair value of the collateral. Because the Company obtains updated appraisals when evidence of a decline in the fair value of collateral exists, it typically does not adjust appraised values.

Other Real Estate Owned — The Company reports other real estate owned ("OREO") at fair value less estimated cost to sell. Any excess of recorded investment over fair value, less cost to sell, is charged against either the allowance for loan losses or the related PCI pool discount when property is initially transferred to OREO. Subsequent to the initial transfer to OREO, downward valuation adjustments are charged against earnings. The Company determines fair value primarily using independent appraisals of OREO properties. The resulting fair value measurements are classified as Level 2 or Level 3 inputs, depending upon the extent to which unobservable inputs determine the fair value measurement. The Company considers a number of factors in determining the extent to which specific fair value measurements utilize unobservable inputs, including, but not limited to, the inherent subjectivity in appraisals, the length of time elapsed since the receipt of independent market price or appraised value, and current market conditions. At September 30, 2015, the most significant unobservable input used in the determination of fair value of OREO was a discount to independent appraisals for estimated holding periods of OREO properties. Such discount was 1% per month for estimated holding periods of 6 to 24 months. Level 3 inputs were used to determine the initial fair value at acquisition of a large group of smaller balance properties that were acquired in the FNB Transaction. In the FNB Transaction, the Bank acquired OREO of $135.2 million, all of which is covered by FDIC loss-share agreements. At September 30, 2015 and December 31, 2014, the estimated fair value of covered OREO was $106.0 million and $136.9 million, respectively, and the underlying fair value measurements utilize Level 2 and Level 3 inputs. The fair value of non-covered OREO at September 30, 2015 and December 31, 2014 was $0.5 million and $0.8 million, respectively, and is included in other assets within the consolidated balance sheets. Level 3 inputs were used to determine the initial fair value at acquisition of properties totaling $5.6 million that were acquired in the SWS Merger. During the reported periods, all fair value measurements for non-covered OREO subsequent to initial recognition utilized Level 2 inputs.

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

	Level 1	Level 2	Level 3	Total	Total Gains (Losses) for the Three Months Ended September 30,		Total Gains (Losses) for the Nine Months Ended September 30,	
September 30, 2015	Inputs	Inputs	Inputs	Fair Value	2015	2014	2015	2014
Non-covered impaired loans	$ —	$ —	$ 62,144	$ 62,144	$ 453	$ (1,714)	$ 224	$ (2,151)
Covered impaired loans	—	—	28,958	28,958	(937)	242	2,712	(2,790)
Non-covered other real	—	—	—	—	—	(210)	(28)	(321)

estate owned								
Covered other real estate owned	—	30,605	—	30,605	(5,370)	(14,440)	(9,428)	(17,399)

The Fair Value of Financial Instruments Subsection of the ASC requires disclosure of the fair value of financial assets and liabilities, including the financial assets and liabilities previously discussed. The methods for determining estimated fair value for financial assets and liabilities is described in detail in Note 3 to the consolidated financial statements included in the Company’s 2014 Form 10-K.

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

		Estimated Fair Value			
September 30, 2015	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Financial assets:					
Cash and cash equivalents	$ 551,553	$ 551,553	$ —	$ —	$ 551,553
Securities purchased under agreements to resell	83,889	—	83,889	—	83,889
Held to maturity securities	305,316	—	308,031	—	308,031
Loans held for sale	48,453	—	48,453	—	48,453
Non-covered loans, net	4,956,540	—	606,293	4,396,423	5,002,716
Covered loans, net	420,547	—	—	569,111	569,111
Broker-dealer and clearing organization receivables	2,111,864	—	2,111,864	—	2,111,864
FDIC indemnification asset	92,902	—	—	92,902	92,902
Other assets	61,606	—	44,950	16,656	61,606
Financial liabilities:					
Deposits	6,820,749	—	6,824,771	—	6,824,771
Broker-dealer and clearing organization payables	2,045,604	—	2,045,604	—	2,045,604
Short-term borrowings	910,490	—	910,490	—	910,490
Debt	310,568	—	303,987	—	303,987
Other liabilities	5,382	—	5,382	—	5,382

		Estimated Fair Value			
December 31, 2014	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Financial assets:					
Cash and cash equivalents	$ 813,075	$ 813,075	$ —	$ —	$ 813,075

Held to maturity securities	118,209	—	118,345	—	118,345
Loans held for sale	37,541	—	37,541	—	37,541
Non-covered loans, net	3,883,435	—	378,425	3,528,769	3,907,194
Covered loans, net	638,029	—	—	767,751	767,751
Broker-dealer and clearing organization receivables	167,884	—	167,884	—	167,884
FDIC indemnification asset	130,437	—	—	130,437	130,437
Other assets	59,432	—	43,937	15,495	59,432
Financial liabilities:					
Deposits	6,369,892	—	6,365,555	—	6,365,555
Broker-dealer and clearing organization payables	179,042	—	179,042	—	179,042
Short-term borrowings	762,696	—	762,696	—	762,696
Debt	123,696	—	117,028	—	117,028
Other liabilities	2,144	—	2,144	—	2,144

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4. Securities

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

	September 30, 2015	December 31, 2014
U.S. Treasury securities	$ 8,428	$ —
U.S. government agencies:		
Bonds	34,241	—
Residential mortgage-backed securities	24,883	5,126
Commercial mortgage-backed securities	20,765	19,932
Collateralized mortgage obligations	1,557	—
Corporate debt securities	69,787	4
States and political subdivisions	80,161	40,616
Unit investment trusts	34,979	—
Private-label securitized product	16,278	—
Other	1,339	39
Totals	$ 292,418	$ 65,717

FSC, Hilltop Securities and HTS Independent Network (collectively, the “Hilltop Broker-Dealers”) enter into transactions that represent commitments to purchase and deliver securities at prevailing future market prices to facilitate customer transactions and satisfy such commitments. Accordingly, the Hilltop Broker-Dealers’ ultimate obligation may exceed the amount recognized in the financial statements. These securities, which are carried at fair value and reported as securities sold, not yet purchased in the consolidated balance sheet, had a value of $156.8 million at September 30, 2015.

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

	Available for Sale			
September 30, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	$ 19,382	$ 363	$ (4)	$ 19,741
U.S. government agencies:				
Bonds	354,611	1,961	(1,333)	355,239
Residential mortgage-backed securities	36,480	1,189	(14)	37,655

Commercial mortgage-backed securities	9,027	103	(2)	9,128
Collateralized mortgage obligations	60,238	112	(944)	59,406
Corporate debt securities	100,471	4,078	(249)	104,300
States and political subdivisions	120,548	2,310	(366)	122,492
Commercial mortgage-backed securities	579	42	—	621
Equity securities	17,876	460	(786)	17,550
Totals	$ 719,212	$ 10,618	$ (3,698)	$ 726,132

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	Available for Sale			
December 31, 2014	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 19,382	$ 264	$ (33)	$ 19,613
U.S. government agencies:				
Bonds	522,008	1,749	(7,516)	516,241
Residential mortgage-backed securities	40,171	1,672	—	41,843
Commercial mortgage-backed securities	11,192	—	(137)	11,055
Collateralized mortgage obligations	89,291	133	(2,300)	87,124
Corporate debt securities	93,406	5,125	(59)	98,472
States and political subdivisions	135,419	2,083	(717)	136,785
Commercial mortgage-backed securities	593	47	—	640
Equity securities	13,293	469	—	13,762
Totals	$ 924,755	$ 11,542	$ (10,762)	$ 925,535

	Held to Maturity			
September 30, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 50,220	$ 16	$ —	$ 50,236
U.S. government agencies:				
Bonds	22,386	206	—	22,592
Residential mortgage-backed securities	24,529	614	—	25,143
Commercial mortgage-backed securities	12,860	345	—	13,205
Collateralized mortgage obligations	177,968	1,487	(31)	179,424
States and political subdivisions	17,353	97	(19)	17,431
Totals	$ 305,316	$ 2,765	$ (50)	$ 308,031

	Held to Maturity			
December 31, 2014	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 25,008	$ —	$ (6)	$ 25,002
U.S. government agencies:				
Residential mortgage-backed securities	29,782	528	—	30,310
Collateralized mortgage obligations	57,328	—	(430)	56,898
States and political subdivisions	6,091	47	(3)	6,135
Totals	$ 118,209	$ 575	$ (439)	$ 118,345

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

	September 30, 2015			December 31, 2014		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Available for sale						
U.S. treasury securities:						
Unrealized loss for less than twelve months	3	$ 4,358	$ 4	4	$ 7,703	$ 27
Unrealized loss for twelve months or longer	—	—	—	1	1,706	6
	3	4,358	4	5	9,409	33
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	7	143,122	571	3	34,847	153
Unrealized loss for twelve months or longer	3	44,601	762	22	373,035	7,363
	10	187,723	1,333	25	407,882	7,516
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	1	1,030	14	—	—	—
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	1	1,030	14	—	—	—
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	1	1,618	2	—	—	—
Unrealized loss for twelve months or longer	10	8	—	4	11,056	137
	11	1,626	2	4	11,056	137
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	2	431	2	3	7,141	40
Unrealized loss for twelve months or longer	7	47,045	942	8	61,108	2,260
	9	47,476	944	11	68,249	2,300
Corporate debt securities:						
Unrealized loss for less than twelve months	12	11,732	186	—	—	—

Unrealized loss for twelve months or longer	1	1,935	63	1	1,939	59
	13	13,667	249	1	1,939	59
States and political subdivisions:						
Unrealized loss for less than twelve months	8	6,524	22	7	4,432	7
Unrealized loss for twelve months or longer	46	31,450	344	81	54,178	710
	54	37,974	366	88	58,610	717
Equity securities:						
Unrealized loss for less than twelve months	3	10,159	656	—	—	—
Unrealized loss for twelve months or longer	2	894	130	—	—	—
	5	11,053	786	—	—	—
Total available for sale:						
Unrealized loss for less than twelve months	37	178,974	1,457	17	54,123	227
Unrealized loss for twelve months or longer	69	125,933	2,241	117	503,022	10,535
	106	$ 304,907	$ 3,698	134	$ 557,145	$ 10,762

	September 30, 2015			December 31, 2014		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Held to Maturity						
U.S. treasury securities:						
Unrealized loss for less than twelve months	—	$ —	$ —	1	$ 25,002	$ 6
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	—	—	—	1	25,002	6
U.S. government agencies:						
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	1	18,514	31	2	56,898	430
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	1	18,514	31	2	56,898	430
States and political subdivisions:						
Unrealized loss for less than twelve months	12	4,300	19	4	1,899	3
Unrealized loss for twelve months or longer	—	—	—	—	—	—

	12	4,300	19	4	1,899	3
Total held to maturity:						
Unrealized loss for less than twelve months	13	22,814	50	7	83,799	439
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	13	$ 22,814	$ 50	7	$ 83,799	$ 439

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During the three and nine months ended September 30, 2015 and 2014, the Company did not record any other-than-temporary impairments. While all of the investments are monitored for potential other-than-temporary impairment, the Company's analysis and experience indicate that these available for sale investments generally do not present a significant risk of other-than-temporary-impairment, as fair values frequently recover over time. Factors considered in the Company's analysis include the reasons for the unrealized loss position, the severity and duration of the unrealized loss position, credit worthiness, and forecasted performance of the investee. While some of the securities held in the investment portfolio have decreased in value since the date of acquisition, the severity of loss and the duration of the loss position are not believed to be significant enough to warrant other-than-temporary impairment of the securities. The Company does not intend, nor does the Company believe that is it likely that the Company will be required, to sell these securities before the recovery of the cost basis. Therefore, management does not believe any other-than-temporary impairments exist at September 30, 2015.

Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The amortized cost and fair value of securities, excluding trading and available for sale equity securities, at September 30, 2015 are shown by contractual maturity below (in thousands).

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 27,223	$ 27,530	$ 51,750	$ 51,770
Due after one year through five years	66,426	69,337	20,098	20,314
Due after five years through ten years	79,749	82,745	4,077	4,093
Due after ten years	421,614	422,160	14,034	14,082
	595,012	601,772	89,959	90,259
Residential mortgage-backed securities	36,480	37,655	24,529	25,143
Collateralized mortgage obligations	60,238	59,406	177,968	179,424
Commercial mortgage-backed securities	9,606	9,749	12,860	13,205
	$ 701,336	$ 708,582	$ 305,316	$ 308,031

The Company realized net gains of $4.8 million and $0.2 million from its trading securities portfolio during the three months ended September 30, 2015 and 2014, respectively, and net gains of $7.6 million and $1.6 million during the nine months ended September 30, 2015 and 2014, respectively, which are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of $780.2 million and $895.5 million (with a fair value of $785.0 million and $890.3 million, respectively) at September 30, 2015 and December 31, 2014, respectively, were pledged to secure public and trust deposits, federal funds purchased and securities sold under agreements to repurchase, and for other purposes as required or permitted by law.

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

At both September 30, 2015 and December 31, 2014, NLC had investments on deposit in custody for various state insurance departments with carrying values of $9.2 million.

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

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

	September 30, 2015	December 31, 2014
Commercial and industrial (1)	$ 2,121,542	$ 1,758,851
Real estate	2,253,286	1,694,835
Construction and land development	576,864	413,643
Consumer	47,837	53,147
	4,999,529	3,920,476
Allowance for non-covered loan losses	(42,989)	(37,041)
Total non-covered loans, net of allowance	$ 4,956,540	$ 3,883,435

(1) Includes margin loans to customers and correspondents of $606.0 million and $378.4 million at September 30, 2015 and December 31, 2014, respectively.

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

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

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

In connection with the Bank Transactions, the Company acquired non-covered loans both with and without evidence of credit quality deterioration since origination. The following table presents the carrying values and the outstanding balances of the non-covered PCI loans (in thousands).

	September 30, 2015	December 31, 2014
Carrying amount	$ 81,161	$ 48,909
Outstanding balance	104,055	67,740

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Changes in the accretable yield for the non-covered PCI loans were as follows (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Balance, beginning of period	$ 22,168	$ 11,904	$ 12,814	$ 17,601
Additions	—	—	14,579	—
Reclassifications from (to) nonaccretable difference, net(1)	6,234	4,270	11,173	13,886
Disposals of loans	—	(744)	(2,778)	(4,928)
Accretion	(9,206)	(2,199)	(16,592)	(13,328)
Balance, end of period	$ 19,196	$ 13,231	$ 19,196	$ 13,231

(1) Reclassifications from nonaccretable difference are primarily due to net increases in expected cash flows in the quarterly recasts. Reclassifications to nonaccretable difference occur when accruing loans are moved to nonaccrual and expected cash flows are no longer predictable and the accretable yield is eliminated.

The remaining nonaccretable difference for non-covered PCI loans was $31.1 million and $18.4 million at September 30, 2015 and December 31, 2014, respectively.

Impaired loans exhibit a clear indication that the borrower's cash flow may not be sufficient to meet principal and interest payments, which is generally when a loan is 90 days past due unless the asset is both well secured and in the process of collection. Non-covered impaired loans include non-accrual loans, troubled debt restructurings ("TDRs"), PCI loans and partially charged-off loans.

The amounts shown in following tables include loans accounted for on an individual basis, as well as Pooled Loans. For Pooled Loans, the recorded investment with allowance and the related allowance consider impairment measured at the pool level. Non-covered impaired loans are summarized by class in the following tables (in thousands).

September 30, 2015	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
Commercial and industrial:					
Secured	$ 59,402	$ 20,089	$ 12,623	$ 32,712	$ 2,695
Unsecured	3,534	76	—	76	—
Real estate:					
Secured by commercial properties	68,436	24,509	23,961	48,470	2,393
Secured by residential properties	18,658	9,640	4,396	14,036	198

Construction and land development:					
Residential construction loans	397	1	225	226	7
Commercial construction loans and land development	8,583	3,764	1,517	5,281	180
Consumer	4,502	867	90	957	43
	$ 163,512	$ 58,946	$ 42,812	$ 101,758	$ 5,516

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December 31, 2014	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
Commercial and industrial:					
Secured	$ 51,036	$ 14,096	$ 11,783	$ 25,879	$ 3,341
Unsecured	4,120	92	68	160	—
Real estate:					
Secured by commercial properties	29,865	7,243	15,536	22,779	1,878
Secured by residential properties	4,701	1,583	1,390	2,973	85
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	16,108	8,062	1,819	9,881	154
Consumer	5,785	171	1,967	2,138	282
	$ 111,615	$ 31,247	$ 32,563	$ 63,810	$ 5,740

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Commercial and industrial:				
Secured	$ 33,137	$ 24,897	$ 29,296	$ 31,953
Unsecured	73	395	118	913
Real estate:				
Secured by commercial properties	55,050	23,715	35,625	29,707
Secured by residential properties	14,853	3,611	8,505	3,259
Construction and land development:				
Residential construction loans	289	—	113	—
Commercial construction loans and land development	5,455	10,674	7,581	15,206
Consumer	1,061	2,872	1,548	3,582
	$ 109,918	$ 66,164	$ 82,786	$ 84,620

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

	September 30, 2015	December 31, 2014

Commercial and industrial:		
Secured	$ 22,244	$ 16,488
Unsecured	58	160
Real estate:		
Secured by commercial properties	4,600	438
Secured by residential properties	1,028	1,253
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	118	703
Consumer	14	—
	$ 28,062	$ 19,042

At September 30, 2015 and December 31, 2014, non-covered non-accrual loans included non-covered PCI loans of $9.6 million and $6.6 million, respectively, for which discount accretion has been suspended because the extent and timing of cash flows from these non-covered PCI loans can no longer be reasonably estimated. In addition to the non-covered non-accrual loans in the table above, $1.5 million and $3.0 million of real estate loans secured by residential properties and classified as held for sale were in non-accrual status at September 30, 2015 and December 31, 2014, respectively.

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Interest income, including recoveries and cash payments, recorded on non-covered impaired loans was $4.9 million and $0.1 million during the three months ended September 30, 2015 and 2014, respectively, and $7.4 million and $2.6 million during the nine months ended September 30, 2015 and 2014, respectively. Except as noted above, non-covered PCI loans are considered to be performing due to the application of the accretion method.

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

The outstanding balance of TDRs granted in the three and nine months ended September 30, 2015 and the nine months ended September 30, 2014 is shown in the following tables (in thousands). There were no TDRs granted during the three months ended September 30, 2014. The TDR granted during the three months ended March 31, 2015 was paid off as of June 30, 2015. At September 30, 2015, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs. At December 31, 2014, the Bank had $0.5 million in unadvanced commitments to borrowers whose loans have been restructured in TDRs.

	Recorded Investment in Loans Modified by			
Three months ended September 30, 2015	A/B Note	Interest Rate Adjustment	Payment Term Extension	Total Modification
Commercial and industrial:				
Secured	$ —	$ —	$ 88	$ 88
Unsecured	—	—	—	—
Real estate:				
Secured by commercial properties	—	—	1,083	1,083
Secured by residential properties	—	—	—	—
Construction and land development:				
Residential construction loans	—	—	—	—
Commercial construction loans and land development	—	—	—	—
Consumer	—	—	—	—
	$ —	$ —	$ 1,171	$ 1,171

	Recorded Investment in Loans Modified by			
		Interest Rate	Payment Term	Total

Nine months ended September 30, 2015	A/B Note	Adjustment	Extension	Modification
Commercial and industrial:				
Secured	$ —	$ —	$ 88	$ 88
Unsecured	—	—	—	—
Real estate:				
Secured by commercial properties	—	—	1,083	1,083
Secured by residential properties	—	—	—	—
Construction and land development:				
Residential construction loans	—	—	—	—
Commercial construction loans and land development	—	—	—	—
Consumer	—	—	—	—
	$ —	$ —	$ 1,171	$ 1,171

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	Recorded Investment in Loans Modified by			
Nine months ended September 30, 2014	A/B Note	Interest Rate Adjustment	Payment Term Extension	Total Modification
Commercial and industrial:				
Secured	$ —	$ —	$ —	$ —
Unsecured	—	—	—	—
Real estate:				
Secured by commercial properties	—	—	326	326
Secured by residential properties	—	—	253	253
Construction and land development:				
Residential construction loans	—	—	—	—
Commercial construction loans and land development	—	—	133	133
Consumer	—	—	—	—
	$ —	$ —	$ 712	$ 712

The following table presents information regarding TDRs granted in the three and nine months ended September 30, 2015 for which a payment was at least 30 days past due in the three and nine months ended September 30, 2015 (dollars in thousands).

	Number of Loans	Recorded Investment
Commercial and industrial:		
Secured	—	$ —
Unsecured	—	—
Real estate:		
Secured by commercial properties	1	1,083
Secured by residential properties	—	—
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	—	—
Consumer	—	—
	1	$ 1,083

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

Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non-PCI) Past Due 90 Days or Mor

September 30, 2015								
Commercial and industrial:								
Secured	$ 1,153	$ 1,120	$ 9,506	$ 11,779	$ 1,999,207	$ 13,632	$ 2,024,618	$ 115
Unsecured	53	30	—	83	96,824	17	96,924	—
Real estate:								
Secured by commercial properties	277	—	—	277	1,476,626	48,077	1,524,980	—
Secured by residential properties	3,949	417	392	4,758	710,459	13,089	728,306	337
Construction and land development:								
Residential construction loans	—	—	—	—	95,669	225	95,894	—
Commercial construction loans and land development	1,157	117	—	1,274	474,532	5,164	480,970	—
Consumer	343	54	—	397	46,483	957	47,837	—
	$ 6,932	$ 1,738	$ 9,898	$ 18,568	$ 4,899,800	$ 81,161	$ 4,999,529	$ 452

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December 31, 2014	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non-PCI) Past Due 90 Days or M
Commercial and industrial:								
Secured	$ 6,073	$ 964	$ 8,022	$ 15,059	$ 1,620,000	$ 13,374	$ 1,648,433	$ —
Unsecured	35	3	—	38	110,312	68	110,418	—
Real estate:								
Secured by commercial properties	67	—	—	67	1,173,504	22,341	1,195,912	—
Secured by residential properties	454	1,187	—	1,641	495,472	1,810	498,923	—
Construction and land development:								
Residential construction loans	175	—	—	175	64,871	—	65,046	—
Commercial construction loans and land development	4,319	—	575	4,894	334,525	9,178	348,597	—
Consumer	414	37	—	451	50,558	2,138	53,147	—
	$ 11,537	$ 2,191	$ 8,597	$ 22,325	$ 3,849,242	$ 48,909	$ 3,920,476	$ —

In addition to the non-covered loans shown in the table above, $37.0 million and $19.2 million of loans included in loans held for sale (with an unpaid principal balance of $37.2 million and $19.2 million, respectively) were 90 days past due and accruing interest at September 30, 2015 and December 31, 2014, respectively. These loans are guaranteed by U.S. government agencies and include loans that are subject to repurchase, or have been repurchased, by PrimeLending.

Management tracks credit quality trends on a quarterly basis related to: (i) past due levels, (ii) non-performing asset levels, (iii) classified loan levels, (iv) net charge-offs, and (v) general economic conditions in the state and local markets.

The Bank utilizes a risk grading matrix to assign a risk grade to each of the loans in its portfolio. A risk rating is assigned based on an assessment of the borrower’s management, collateral position, financial capacity, and economic factors. The general characteristics of the various risk grades are described below.

Pass – “Pass” loans present a range of acceptable risks to the Bank. Loans that would be considered virtually risk-free are rated Pass – low risk. Loans that exhibit sound standards based on the grading factors above and present a reasonable risk to the Bank are rated Pass – normal risk. Loans that exhibit a minor weakness in one or more of the grading criteria but still present an acceptable risk to the Bank are rated Pass – high risk.

Special Mention – “Special Mention” loans have potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in a deterioration of the repayment prospects for the loans and weaken the Bank’s credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to require adverse classification.

Substandard – “Substandard” loans are inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Many substandard loans are considered impaired.

PCI – “PCI” loans exhibited evidence of credit deterioration at acquisition that made it probable that all contractually required principal payments would not be collected.

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

September 30, 2015	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 1,940,761	$ 8,516	$ 61,709	$ 13,632	$ 2,024,618
Unsecured	96,839	—	68	17	96,924
Real estate:					
Secured by commercial properties	1,450,440	2,390	24,073	48,077	1,524,980
Secured by residential properties	709,692	—	5,525	13,089	728,306
Construction and land development:					
Residential construction loans	95,669	—	—	225	95,894
Commercial construction loans and land development	474,342	—	1,464	5,164	480,970
Consumer	46,805	—	75	957	47,837
	$ 4,814,548	$ 10,906	$ 92,914	$ 81,161	$ 4,999,529

December 31, 2014	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 1,566,208	$ 1,105	$ 67,746	$ 13,374	$ 1,648,433
Unsecured	110,256	—	94	68	110,418
Real estate:					
Secured by commercial properties	1,151,454	712	21,405	22,341	1,195,912
Secured by residential properties	492,549	—	4,564	1,810	498,923
Construction and land development:					
Residential construction loans	65,046	—	—	—	65,046
Commercial construction loans and land development	338,078	—	1,341	9,178	348,597
Consumer	50,968	—	41	2,138	53,147
	$ 3,774,559	$ 1,817	$ 95,191	$ 48,909	$ 3,920,476

Allowance for Loan Losses

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management’s best estimate of probable losses inherent in the existing portfolio of loans.

It is management's responsibility at the end of each quarter, or more frequently as deemed necessary, to analyze the level of the allowance for loan losses to ensure that it is appropriate for the estimated credit losses in the portfolio consistent with the Interagency Policy Statement on the Allowance for Loan and Lease Losses and the Receivables and Contingencies Topics of the ASC. Estimated credit losses are the probable current amount of loans that the Company will be unable to collect given facts and circumstances as of the evaluation date. When management determines that a loan or portion thereof is uncollectible, the loan, or portion thereof, is charged off against the allowance for loan losses, or for acquired loans accounted for in pools, charged against the pool discount. Recoveries on charge-offs of loans acquired in the Bank Transactions that occurred prior to their acquisition represent contractual cash flows not expected to be collected and are recorded as accretion income. Recoveries on acquired loans charged-off subsequent to their acquisition are credited to the allowance for loan loss, except for recoveries on loans accounted for in pools, which are credited to the pool discount. The Bank's loan portfolio is designated into two populations: acquired loans and originated loans. The allowance for loan losses is calculated separately for acquired and originated loans.

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

The allowance for both originated and acquired loans is subject to regulatory examinations and determinations as to appropriateness, which may take into account such factors as the methodology used to calculate the allowance and the size of the allowance.

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

Three Months Ended September 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	$ 18,853	$ 14,565	$ 6,845	$ 221	$ 40,484
Provision charged to (recapture from) operations	1,636	1,812	847	(15)	4,280
Loans charged off	(2,685)	(212)	—	(29)	(2,926)
Recoveries on charged off loans	927	195	—	29	1,151
Balance, end of period	$ 18,731	$ 16,360	$ 7,692	$ 206	$ 42,989

Nine Months Ended September 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	$ 18,999	$ 11,131	$ 6,450	$ 461	$ 37,041
Provision charged to (recapture from) operations	1,065	5,481	1,242	(129)	7,659
Loans charged off	(4,305)	(581)	—	(208)	(5,094)
Recoveries on charged off loans	2,972	329	—	82	3,383
Balance, end of period	$ 18,731	$ 16,360	$ 7,692	$ 206	$ 42,989

Three Months Ended September 30, 2014	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	$ 18,062	$ 9,998	$ 8,086	$ 285	$ 36,431

Provision charged to operations	2,302	1,064	395	425	4,186
Loans charged off	(1,976)	(28)	—	(116)	(2,120)
Recoveries on charged off loans	457	31	18	24	530
Balance, end of period	$ 18,845	$ 11,065	$ 8,499	$ 618	$ 39,027

Nine Months Ended September 30, 2014	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	$ 16,865	$ 8,331	$ 7,957	$ 88	$ 33,241
Provision charged to operations	5,876	2,689	361	731	9,657
Loans charged off	(5,707)	(100)	—	(275)	(6,082)
Recoveries on charged off loans	1,811	145	181	74	2,211
Balance, end of period	$ 18,845	$ 11,065	$ 8,499	$ 618	$ 39,027

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

September 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Loans individually evaluated for impairment	$ 17,126	$ 100	$ —	$ —	$ 17,226
Loans collectively evaluated for impairment	2,090,767	2,192,020	571,475	46,880	4,901,142
PCI Loans	13,649	61,166	5,389	957	81,161
	$ 2,121,542	$ 2,253,286	$ 576,864	$ 47,837	$ 4,999,529

December 31, 2014	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Loans individually evaluated for impairment	$ 11,842	$ 1,420	$ 703	$ —	$ 13,965
Loans collectively evaluated for impairment	1,733,567	1,669,264	403,762	51,009	3,857,602
PCI Loans	13,442	24,151	9,178	2,138	48,909
	$ 1,758,851	$ 1,694,835	$ 413,643	$ 53,147	$ 3,920,476

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

September 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Loans individually evaluated for impairment	$ 917	$ —	$ —	$ —	$ 917
Loans collectively evaluated for impairment	16,036	13,769	7,505	163	37,473
PCI Loans	1,778	2,591	187	43	4,599
	$ 18,731	$ 16,360	$ 7,692	$ 206	$ 42,989

December 31, 2014	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Loans individually evaluated for impairment	$ 421	$ —	$ —	$ —	$ 421
Loans collectively evaluated for impairment	15,658	9,168	6,296	179	31,301
PCI Loans	2,920	1,963	154	282	5,319
	$ 18,999	$ 11,131	$ 6,450	$ 461	$ 37,041

6. Covered Assets and Indemnification Asset

On September 13, 2013, the Bank assumed substantially all of the liabilities, including all of the deposits, and acquired substantially all of the assets of FNB in an FDIC-assisted transaction. As part of the Purchase and Assumption Agreement by and among the FDIC (as receiver of FNB), the Bank and the FDIC (the “P&A Agreement”), the Bank and the FDIC entered into loss-share agreements covering future losses incurred on certain acquired loans and OREO. The Company refers to acquired commercial and single family residential loan portfolios and OREO that are subject to the loss-share agreements as “covered loans” and “covered OREO”, respectively, and these assets are presented as separate line items in the Company's consolidated balance sheets. Collectively, covered loans and covered OREO are referred to as "covered assets". Pursuant to the loss-share agreements, the FDIC has agreed to reimburse the Bank the following amounts with respect to the covered assets: (i) 80% of net losses on the first $240.4 million of net losses incurred; (ii) 0% of net losses in excess of $240.4 million up to and including $365.7 million of net losses incurred; and (iii) 80% of net losses in excess of $365.7 million of net losses incurred. Net losses are defined as book value losses plus certain defined expenses incurred in the resolution of assets, less subsequent recoveries. Under the loss-share agreement for commercial assets, the amount of subsequent recoveries that are reimbursable to the FDIC for a particular asset is limited to book value losses and expenses actually billed plus any book value charge-offs incurred prior to September 13, 2013 (the "Bank Closing Date"). There is no limit on the amount of subsequent recoveries reimbursable to the FDIC under the loss-share agreement for single family residential assets. The loss-share agreements for commercial and single family residential assets are in effect for 5 years and 10 years, respectively, from the Bank Closing Date, and the loss recovery provisions to the FDIC are in effect for 8 years and 10 years, respectively, from the Bank Closing Date. The asset arising from the loss-share agreements, referred to as the "FDIC Indemnification Asset," is measured separately from the covered loan portfolio because the agreements are not contractually embedded in the covered loans and are not transferable should the Bank choose to dispose of the covered loans.

In accordance with the loss-share agreements, the Bank may be required to make a "true-up" payment to the FDIC approximately 10 years following the Bank Closing Date if the FDIC's initial estimate of losses on covered assets is greater than the actual realized losses. The "true-up" payment is calculated using a defined formula set forth in the P&A Agreement.

Covered Loans and Allowance for Covered Loan Losses

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

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

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

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loans, are consistent with that of acquired non-covered loans, as described in Note 5 to the consolidated financial statements. The Company has established under its PCI accounting policy a framework to aggregate certain acquired covered loans into various loan pools based on a minimum of two layers of common risk characteristics for the purpose of determining their respective fair values as of their acquisition dates, and for applying the subsequent recognition and measurement provisions for income accretion and impairment testing.

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

	September 30, 2015	December 31, 2014
Commercial and industrial	$ 14,972	$ 30,780
Real estate	373,391	552,850
Construction and land development	34,054	59,010
Consumer	—	—
	422,417	642,640
Allowance for covered loans	(1,870)	(4,611)
Total covered loans, net of allowance	$ 420,547	$ 638,029

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

	September 30, 2015	December 31, 2014
Carrying amount	$ 251,018	$ 435,388
Outstanding balance	450,581	685,393

Changes in the accretable yield for the covered PCI loans were as follows (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Balance, beginning of period	$ 185,981	$ 186,141	$ 193,493	$ 156,548
Reclassifications from (to) nonaccretable difference, net(1)	35,338	25,026	61,339	82,607
Transfer of loans to covered OREO(2)	(153)	(281)	1,346	5,091

Accretion	(32,301)	(18,146)	(67,313)	(51,506)
Balance, end of period	$ 188,865	$ 192,740	$ 188,865	$ 192,740

(1) Reclassifications from nonaccretable difference are primarily due to net increases in expected cash flows in the quarterly recasts, but may also include the reclassification and immediate income recognition of nonaccretable difference due to the favorable resolution of loans accounted for individually. Reclassifications to nonaccretable difference occur when accruing loans are moved to nonaccrual and expected cash flows are no longer predictable and the accretable yield is eliminated.

(2) Transfer of loans to covered OREO is the difference between the value removed from the pool and the expected cash flows for the loan.

The remaining nonaccretable difference for covered PCI loans was $191.9 million and $382.5 million at September 30, 2015 and December 31, 2014, respectively. During the three and nine months ended September 30, 2015 and 2014, a combination of factors affecting the inputs to the Bank’s quarterly recast process led to the reclassifications from nonaccretable difference to accretable yield. These transfers resulted from revised cash flows that reflect better-than-expected performance of the covered PCI loan portfolio as a result of the Bank’s strategic decision to dedicate resources to the liquidation of covered loans during the noted periods.

Covered impaired loans include non-accrual loans, TDRs, PCI loans and partially charged-off loans. Substantially all covered impaired loans are PCI loans. The amounts shown in following tables include Pooled Loans, as well as loans accounted for on an individual basis. For Pooled Loans, the recorded investment with allowance and the related allowance consider impairment measured at the pool level.

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Covered impaired loans are summarized by class in the following tables (in thousands).

September 30, 2015	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
Commercial and industrial:					
Secured	$ 16,949	$ 6,332	$ 557	$ 6,889	$ 35
Unsecured	10,888	2,735	—	2,735	—
Real estate:					
Secured by commercial properties	244,655	112,987	14	113,001	10
Secured by residential properties	195,716	102,944	4,007	106,951	883
Construction and land development:					
Residential construction loans	1,808	893	—	893	—
Commercial construction loans and land development	62,832	16,414	7,463	23,877	894
Consumer	—	—	—	—	—
	$ 532,848	$ 242,305	$ 12,041	$ 254,346	$ 1,822

December 31, 2014	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
Commercial and industrial:					
Secured	$ 26,447	$ 7,436	$ 6,636	$ 14,072	$ 265
Unsecured	14,111	2,107	4,697	6,804	882
Real estate:					
Secured by commercial properties	387,302	193,111	35,142	228,253	2,381
Secured by residential properties	235,505	129,571	12,918	142,489	937
Construction and land development:					
Residential construction loans	2,749	1,018	354	1,372	69
Commercial construction loans and land development	94,949	45,646	—	45,646	—
Consumer	—	—	—	—	—
	$ 761,063	$ 378,889	$ 59,747	$ 438,636	$ 4,534

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Commercial and industrial:				
Secured	$ 8,258	$ 17,953	$ 10,481	$ 22,794
Unsecured	3,118	7,994	4,770	8,735
Real estate:				
Secured by commercial properties	132,133	297,511	170,627	322,396
Secured by residential properties	111,224	168,636	124,720	180,492
Construction and land development:				
Residential construction loans	904	2,356	1,133	3,459
Commercial construction loans and land development	29,370	71,795	34,762	93,185
Consumer	—	—	—	—
	$ 285,007	$ 566,245	$ 346,493	$ 631,061

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Covered non-accrual loans are summarized by class in the following table (in thousands).

	September 30, 2015	December 31, 2014
Commercial and industrial:		
Secured	$ 71	$ 442
Unsecured	—	883
Real estate:		
Secured by commercial properties	452	30,823
Secured by residential properties	1,486	1,046
Construction and land development:		
Residential construction loans	775	1,018
Commercial construction loans and land development	25	11
Consumer	—	—
	$ 2,809	$ 34,223

At December 31, 2014, covered non-accrual loans included covered PCI loans of $31.2 million, for which discount accretion has been suspended because the extent and timing of cash flows from these covered PCI loans can no longer be reasonably estimated. There were no covered non-accrual PCI loans at September 30, 2015.

Interest income, including recoveries and cash payments, recorded on covered impaired loans was $14.3 million during the three and nine months ended September 30, 2015, respectively. Interest income recorded on covered impaired loans during the three and nine months ended September 30, 2014 was nominal. Except as noted above, covered PCI loans are considered to be performing due to the application of the accretion method.

The Bank classifies loan modifications of covered loans as TDRs in a manner consistent with that of non-covered loans as discussed in Note 5 to the consolidated financial statements. The outstanding balance of TDRs granted in the three and nine months ended September 30, 2015 is shown in the following tables (in thousands). Pooled Loans are not in the scope of the disclosure requirements for TDRs. A TDR granted during the three months ended March 31, 2015 of $0.6 million, and for which a payment was at least 30 days past due in the three months ended June 30, 2015, was paid off as of September 30, 2015. There were no TDRs granted during the period from September 14, 2013 through September 30, 2014. At September 30, 2015, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

Recorded Investment in Loans Modified by

Three Months Ended September 30, 2015	A/B Note	Interest Rate Adjustment	Payment Term Extension	Total Modification
Commercial and industrial:				
Secured	$ —	$ —	$ —	$ —
Unsecured	—	—	—	—
Real estate:				
Secured by commercial properties	—	—	—	—
Secured by residential properties	—	55	—	55
Construction and land development:				
Residential construction loans	—	—	—	—
Commercial construction loans and land development	—	—	—	—
Consumer	—	—	—	—
	$ —	$ 55	$ —	$ 55

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	Recorded Investment in Loans Modified by			
Nine Months Ended September 30, 2015	A/B Note	Interest Rate Adjustment	Payment Term Extension	Total Modification
Commercial and industrial:				
Secured	$ —	$ —	$ —	$ —
Unsecured	—	—	—	—
Real estate:				
Secured by commercial properties	—	—	—	—
Secured by residential properties	119	191	254	564
Construction and land development:				
Residential construction loans	—	—	—	—
Commercial construction loans and land development	—	—	—	—
Consumer	—	—	—	—
	$ 119	$ 191	$ 254	$ 564

The following table presents information regarding TDRs granted in the three and nine months ended September 30, 2015 for which a payment was at least 30 days past due in the three and nine months ended September 30, 2015 (dollars in thousands).

	Number of Loans	Recorded Investment
Commercial and industrial:		
Secured	—	$ —
Unsecured	—	—
Real estate:		
Secured by commercial properties	1	—
Secured by residential properties	1	254
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	—	—
Consumer	—	—
	2	$ 254

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

	Loans Past Due 30 59 Days	Loans Past Due 60 89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non PCI) Past D 90 Days or More

September 30, 2015								
Commercial and industrial:								
Secured	$ 3,853	$ —	$ 71	$ 3,924	$ 1,495	$ 6,818	$ 12,237	$ —
Unsecured	—	—	—	—	—	2,735	2,735	—
Real estate:								
Secured by commercial properties	171	409	436	1,016	30,256	112,549	143,821	335
Secured by residential properties	2,484	687	2,045	5,216	119,408	104,946	229,570	1,672
Construction and land development:								
Residential construction loans	—	—	775	775	268	118	1,161	—
Commercial construction loans and land development	38	—	95	133	8,908	23,852	32,893	87
Consumer	—	—	—	—	—	—	—	—
	$ 6,546	$ 1,096	$ 3,422	$ 11,064	$ 160,335	$ 251,018	$ 422,417	$ 2,094

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December 31, 2014	Loans Past Due 30 59 Days	Loans Past Due 60 89 Days	Loans Past Due 90 Days or More	Total Past Due Loans	Current Loans	PCI Loans	Total Loans	Accruing Loans (Non PCI) Past 90 Days or More
Commercial and industrial:								
Secured	$ —	$ —	$ 454	$ 454	$ 8,681	$ 13,630	$ 22,765	$ 11
Unsecured	10	—	—	10	1,200	6,805	8,015	—
Real estate:								
Secured by commercial properties	876	—	105	981	41,576	227,772	270,329	—
Secured by residential properties	3,089	493	405	3,987	137,342	141,192	282,521	48
Construction and land development:								
Residential construction loans	—	—	896	896	390	354	1,640	—
Commercial construction loans and land development	39	25	8	72	11,663	45,635	57,370	8
Consumer	—	—	—	—	—	—	—	—
	$ 4,014	$ 518	$ 1,868	$ 6,400	$ 200,852	$ 435,388	$ 642,640	$ 67

The Bank assigns a risk grade to each of its covered loans in a manner consistent with the existing loan review program and risk grading matrix used for non-covered loans, as described in Note 5 to the consolidated financial statements. The following tables present the internal risk grades of covered loans in the portfolio by class (in thousands).

September 30, 2015	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 4,848	$ —	$ 571	$ 6,818	$ 12,237
Unsecured	—	—	—	2,735	2,735
Real estate:					
Secured by commercial properties	26,025	—	5,247	112,549	143,821
Secured by residential properties	115,201	499	8,924	104,946	229,570

Construction and land development:					
Residential construction loans	265	—	778	118	1,161
Commercial construction loans and land development	7,180	—	1,861	23,852	32,893
Consumer	—	—	—	—	—
	$ 153,519	$ 499	$ 17,381	$ 251,018	$ 422,417

December 31, 2014	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 7,712	$ —	$ 1,423	$ 13,630	$ 22,765
Unsecured	1,210	—	—	6,805	8,015
Real estate:					
Secured by commercial properties	35,973	—	6,584	227,772	270,329
Secured by residential properties	133,756	—	7,573	141,192	282,521
Construction and land development:					
Residential construction loans	268	—	1,018	354	1,640
Commercial construction loans and land development	9,501	—	2,234	45,635	57,370
Consumer	—	—	—	—	—
	$ 188,420	$ —	$ 18,832	$ 435,388	$ 642,640

The Bank’s impairment methodology for the covered loans is consistent with that of non-covered loans as discussed in Note 5 to the consolidated financial statements. To the extent there is experienced or projected credit deterioration on the acquired covered loan pools subsequent to amounts estimated at the previous quarterly recast date and expected cash flows for a loan or pool decreases, an increase in the allowance for loan losses is made through a charge to the provision for loan losses. If expected cash flows for a loan or pool increase, any previously established allowance for loan losses is reversed and any remaining difference increases the accretable yield. This increase in accretable yield is taken into income over the remaining life of the loan. Additionally, provision for credit losses will be recorded on advances on covered loans subsequent to the acquisition date in a manner consistent with the allowance for non-covered loan losses.

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

Three months ended September 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	$ 130	$ 469	$ 335	$ —	$ 934
Provision charged to (recapture from) operations	(100)	851	562	—	1,313
Loans charged off	38	(403)	—	—	(365)
Recoveries on charged off loans	(14)	2	—	—	(12)
Balance, end of period	$ 54	$ 919	$ 897	$ —	$ 1,870

Nine months ended September 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	$ 1,193	$ 3,334	$ 84	$ —	$ 4,611
Provision charged to (recapture from) operations	(230)	186	823	—	779
Loans charged off	(915)	(2,702)	(10)	—	(3,627)
Recoveries on charged off loans	6	101	—	—	107
Balance, end of period	$ 54	$ 919	$ 897	$ —	$ 1,870

Three months ended September 30, 2014	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	$ 1,146	$ 2,551	$ 418	$ —	$ 4,115
Provision charged to (recapture from) operations	(211)	(342)	400	—	(153)
Loans charged off	—	(169)	(32)	—	(201)
Recoveries on charged off loans	—	—	—	—	—
Balance, end of period	$ 935	$ 2,040	$ 786	$ —	$ 3,761

Nine months ended September 30, 2014	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Balance, beginning of period	$ 1,053	$ 8	$ —	$ —	$ 1,061
Provision charged to (recapture from) operations	(27)	2,245	933	—	3,151
Loans charged off	(91)	(213)	(147)	—	(451)
Recoveries on charged off loans	—	—	—	—	—
Balance, end of period	$ 935	$ 2,040	$ 786	$ —	$ 3,761

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

September 30, 2015	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Loans individually evaluated for impairment	$ —	$ —	$ 775	$ —	$ 775
Loans collectively evaluated for impairment	5,419	155,896	9,309	—	170,624
PCI Loans	9,553	217,495	23,970	—	251,018
	$ 14,972	$ 373,391	$ 34,054	$ —	$ 422,417

December 31, 2014	Commercial and Industrial	Real Estate	Construction and Land Development	Consumer	Total
Loans individually evaluated for impairment	$ —	$ —	$ 801	$ —	$ 801
Loans collectively evaluated for impairment	10,345	183,886	12,220	—	206,451
PCI Loans	20,435	368,964	45,989	—	435,388
	$				