Hilltop Holdings Inc.
Form 10-Q
October 25, 2018
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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, 2018

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.)

2323 Victory Avenue, Suite 1400

Dallas, TX	75219
(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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

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

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

The number of shares of the registrant's common stock outstanding at October 25, 2018 was 94,595,843.

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HILLTOP HOLDINGS INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2018

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	September 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$ 405,682	$ 486,977
Federal funds sold	468	405
Assets segregated for regulatory purposes	220,115	186,578
Securities purchased under agreements to resell	164,656	186,537
Securities:		
Trading, at fair value	660,314	730,685
Available for sale, at fair value (amortized cost of $893,500 and $748,255, respectively)	874,496	744,319
Held to maturity, at amortized cost (fair value of $332,388 and $349,939, respectively)	348,163	355,849
Equity, at fair value	21,555	21,241
	1,904,528	1,852,094
Loans held for sale	1,524,980	1,715,357
Non-covered loans, net of unearned income	6,796,278	6,273,669
Allowance for non-covered loan losses	(58,861)	(60,957)
Non-covered loans, net	6,737,417	6,212,712
Covered loans, net of allowance of $1,291 and $2,729, respectively	142,737	179,400
Broker-dealer and clearing organization receivables	1,491,507	1,464,378
Premises and equipment, net	236,172	177,577
FDIC indemnification asset	22,831	29,340
Covered other real estate owned	29,856	36,744
Other assets	551,758	549,447
Goodwill	291,435	251,808
Other intangible assets, net	40,394	36,432
Total assets	$ 13,764,536	$ 13,365,786
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$ 2,525,677	$ 2,411,849
Interest-bearing	5,764,556	5,566,270
Total deposits	8,290,233	7,978,119

Broker-dealer and clearing organization payables	1,396,401	1,287,563
Short-term borrowings	1,216,649	1,206,424
Securities sold, not yet purchased, at fair value	179,582	232,821
Notes payable	220,192	208,809
Junior subordinated debentures	67,012	67,012
Other liabilities	430,309	470,231
Total liabilities	11,800,378	11,450,979
Commitments and contingencies (see Notes 13 and 14)		
Stockholders' equity:		
Hilltop stockholders' equity:		
Common stock, $0.01 par value, 125,000,000 shares authorized; 94,593,561 and 95,982,184 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	946	960
Additional paid-in capital	1,504,467	1,526,369
Accumulated other comprehensive loss	(14,722)	(394)
Retained earnings	448,923	384,545
Deferred compensation employee stock trust, net	860	848
Employee stock trust (10,971 and 11,672 shares, at cost, respectively)	(252)	(247)
Total Hilltop stockholders' equity	1,940,222	1,912,081
Noncontrolling interests	23,936	2,726
Total stockholders' equity	1,964,158	1,914,807
Total liabilities and stockholders' equity	$ 13,764,536	$ 13,365,786

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, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Interest income:				
Loans, including fees	$ 113,535	$ 102,546	$ 317,403	$ 306,330
Securities borrowed	16,346	11,404	50,132	29,054
Securities:				
Taxable	11,994	10,214	35,463	25,647
Tax-exempt	1,717	1,471	5,186	4,090
Other	4,734	3,309	13,542	8,370
Total interest income	148,326	128,944	421,726	373,491
Interest expense:				
Deposits	12,353	6,841	31,164	16,995
Securities loaned	13,984	8,935	42,798	22,756
Short-term borrowings	7,831	4,567	18,340	9,633
Notes payable	2,702	2,680	7,636	8,320
Junior subordinated debentures	955	774	2,695	2,229
Other	160	167	484	502
Total interest expense	37,985	23,964	103,117	60,435
Net interest income	110,341	104,980	318,609	313,056
Provision (recovery) for loan losses	(371)	1,260	(1,838)	8,818
Net interest income after provision (recovery) for loan losses	110,712	103,720	320,447	304,238
Noninterest income:				
Net gains from sale of loans and other mortgage production income	116,243	138,498	354,488	416,336
Mortgage loan origination fees	27,004	25,256	76,948	70,788
Securities commissions and fees	36,968	38,735	114,005	115,596
Investment and securities advisory fees and commissions	23,487	25,620	63,806	73,359
Net insurance premiums earned	34,185	34,493	102,605	106,653
Other	31,810	35,875	72,422	131,876
Total noninterest income	269,697	298,477	784,274	914,608
Noninterest expense:				

Employees' compensation and benefits	205,575	209,747	588,807	611,352
Occupancy and equipment, net	29,015	29,073	84,695	84,285
Professional services	27,984	25,560	78,959	77,301
Loss and loss adjustment expenses	18,712	31,234	58,653	86,118
Other	54,425	58,228	171,316	181,529
Total noninterest expense	335,711	353,842	982,430	1,040,585
Income before income taxes	44,698	48,355	122,291	178,261
Income tax expense	7,600	18,003	26,122	58,792
Net income	37,098	30,352	96,169	119,469
Less: Net income attributable to noncontrolling interest	1,293	146	2,843	353
Income attributable to Hilltop	$ 35,805	$ 30,206	$ 93,326	$ 119,116
Earnings per common share:				
Basic	$ 0.38	$ 0.31	$ 0.98	$ 1.22
Diluted	$ 0.38	$ 0.31	$ 0.98	$ 1.22
Cash dividends declared per common share	$ 0.07	$ 0.06	$ 0.21	$ 0.18
Weighted average share information:				
Basic	94,554	96,096	95,264	97,554
Diluted	94,610	96,306	95,355	97,803

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,	
	2018	2017	2018	2017
Net income	$ 37,098	$ 30,352	$ 96,169	$ 119,469
Other comprehensive income:				
Net unrealized gains (losses) on securities available for sale, net of tax of $(847), $263, $(3,335) and $1,190, respectively	(2,900)	473	(11,751)	2,109
Reclassification adjustment for gains (losses) included in net income, net of tax of $7, $0, $7 and $(5), respectively	24	—	24	(9)
Comprehensive income	34,222	30,825	84,442	121,569
Less: comprehensive income attributable to noncontrolling interest	1,293	146	2,843	353
Comprehensive income applicable to Hilltop	$ 32,929	$ 30,679	$ 81,599	$ 121,216

See accompanying notes.

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HILLTOP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

Common Stock		Additional	Accumulated Other		Deferred Compensation Employee	Employee		Total Hilltop	
		Paid-in	Comprehensive	Retained	Stock Trust,	Stock Trust		Stockholders'	Noncontrolli
Shares	Amount	Capital	Income	Earnings	Net	Shares	Amount	Equity	Interest
98,544	$ 985	$ 1,572,877	$ 485	$ 295,568	$ 903	15	$ (309)	$ 1,870,509	$ 4,011
—	—	—	—	119,116	—	—	—	119,116	353
—	—	—	2,100	—	—	—	—	2,100	—
—	—	8,396	—	—	—	—	—	8,396	—
12	—	327	—	—	—	—	—	327	—
264	3	(2,433)	—	—	—	—	—	(2,430)	—
(2,916)	(29)	(53,998)	—	(20,427)	—	—	—	(74,454)	—
—	—	—	—	(17,384)	—	—	—	(17,384)	—
—	—	—	—	—	(63)	(3)	68	5	—
—	—	—	—	—	—	—	—	—	(1,193)

	95,904	$ 959	$ 1,525,169	$ 2,585	$ 376,873	$ 840	12	$ (241)	$ 1,906,185	$ 3,171
	95,982	$ 960	$ 1,526,369	$ (394)	$ 384,545	$ 848	12	$ (247)	$ 1,912,081	$ 2,726
	—	—	—	—	93,326	—	—	—	93,326	2,843
e	—	—	—	(11,727)	—	—	—	—	(11,727)	—
	—	—	6,725	—	—	—	—	—	6,725	—
k d	22	—	513	—	—	—	—	—	513	—
	292	3	(1,811)	—	—	—	—	—	(1,808)	—
f	(1,702)	(17)	(27,329)	—	(11,475)	—	—	—	(38,821)	—
	—	—	—	—	(20,074)	—	—	—	(20,074)	—
	—	—	—	—	—	12	(1)	(5)	7	—
e	—	—	—	(2,601)	2,601	—	—	—	—	—
	—	—	—	—	—	—	—	—	—	18,367
	94,594	$ 946	$ 1,504,467	$ (14,722)	$ 448,923	$ 860	11	$ (252)	$ 1,940,222	$ 23,936

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, 2018	2017
Operating Activities		
Net income	$ 96,169	$ 119,469
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	(1,838)	8,818
Depreciation, amortization and accretion, net	3,558	(11,300)
Net realized gains on securities	—	(14)
Net change in fair value of equity securities	396	—
Deferred income taxes	653	6,013
Other, net	6,355	8,540
Net change in securities purchased under agreements to resell	21,881	(45,224)
Net change in trading securities	70,371	(410,877)
Net change in broker-dealer and clearing organization receivables	(42,516)	(157,908)
Net change in FDIC indemnification asset	—	24,637
Net change in other assets	39,208	(35,967)
Net change in broker-dealer and clearing organization payables	85,409	223,043
Net change in other liabilities	(79,283)	(100,970)
Net change in securities sold, not yet purchased	(53,239)	19,620
Proceeds from sale of mortgage servicing rights asset	9,303	17,499
Net gains from sales of loans	(354,488)	(416,336)
Loans originated for sale	(11,148,919)	(11,251,438)
Proceeds from loans sold	11,665,782	11,520,363
Net cash provided by (used in) operating activities	318,802	(482,032)
Investing Activities		
Proceeds from maturities and principal reductions of securities held to maturity	36,729	42,185
Proceeds from sales, maturities and principal reductions of securities available for sale	190,266	248,578
Proceeds from sales, maturities and principal reductions of equity securities	3	—
Purchases of securities held to maturity	(29,377)	(58,831)
Purchases of securities available for sale	(276,710)	(415,282)
Purchases of equity securities	(719)	—
Net change in loans	(113,918)	(206,362)

Purchases of premises and equipment and other assets	(60,473)	(20,093)
Proceeds from sales of premises and equipment and other real estate owned	18,440	27,333
Net cash received from (paid for) Federal Home Loan Bank and Federal Reserve Bank stock	(5,447)	14,540
Net cash paid for acquisition	(63,245)	—
Net cash used in investing activities	(304,451)	(367,932)
Financing Activities		
Net change in deposits	(40,850)	547,163
Net change in short-term borrowings	10,225	59,912
Proceeds from notes payable	455,776	285,806
Payments on notes payable	(444,312)	(303,472)
Payments to repurchase common stock	(38,821)	(27,388)
Dividends paid on common stock	(20,074)	(17,384)
Net cash contributed from (distributed to) noncontrolling interest	18,367	(1,193)
Taxes paid on employee stock awards netting activity	(1,806)	(2,431)
Other, net	(551)	(501)
Net cash provided by (used in) financing activities	(62,046)	540,512
Net change in cash and cash equivalents	(47,695)	(309,452)
Cash, cash equivalents and restricted cash, beginning of period	673,960	871,757
Cash, cash equivalents and restricted cash, end of period	$ 626,265	$ 562,305
Reconciliation of Cash, Cash Equivalents and Restricted Cash to Consolidated Balance Sheets		
Cash and due from banks	$ 405,682	$ 354,569
Federal funds sold	468	400
Assets segregated for regulatory purposes	220,115	207,336
Total cash, cash equivalents and restricted cash	$ 626,265	$ 562,305
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	$ 101,402	$ 57,504
Cash paid for income taxes, net of refunds	$ 5,806	$ 69,863
Supplemental Schedule of Non-Cash Activities		
Construction in progress related to build-to-suit lease obligations	$ 23,773	$ —
Conversion of loans to other real estate owned	$ 5,868	$ 8,319
Additions to mortgage servicing rights	$ 21,090	$ 8,429

See accompanying notes.

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting and Reporting Policies

Nature of Operations

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

The Company, headquartered in Dallas, Texas, provides its products and services through three primary business units, PlainsCapital Corporation ("PCC"), Hilltop Securities Holdings LLC ("Securities Holdings") and National Lloyds Corporation ("NLC"). PCC is a financial holding company that provides, through its subsidiaries, traditional banking, wealth and investment management and treasury management services primarily in Texas and residential mortgage lending throughout the United States. Securities Holdings is a holding company that provides, through its subsidiaries, investment banking and other related financial services, including municipal advisory, sales, trading and underwriting of taxable and tax-exempt fixed income securities, equity trading, clearing, securities lending, structured finance and retail brokerage services throughout the United States. NLC is a property and casualty insurance holding company 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 August 1, 2018, the Company acquired privately-held, Houston-based The Bank of River Oaks ("BORO") in an all-cash transaction (the "BORO Acquisition"). Pursuant to the terms of the definitive agreement, the Company paid cash in the aggregate amount of $85 million to the shareholders and option holders of BORO. Based on preliminary purchase date valuations, the fair value of the assets acquired was $434.8 million, including $326.6 million in loans, while the fair value of liabilities assumed was $389.4 million, consisting primarily of $376.4 million in deposits.

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, 2017 ("2017 Form 10-K"). Results for interim periods are not necessarily indicative of results to be expected for a full year or any future period.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates regarding the allowance for 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 ("LAE"), 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. As discussed in Note 3 to the consolidated financial statements, the BORO Acquisition purchase date valuations associated with loans, intangibles and taxes are considered preliminary because management's review and approval of certain key assumptions is not complete.

Hilltop owns 100% of the outstanding stock of PCC. PCC owns 100% of the outstanding stock of the Bank and 100% of the membership interest in Hilltop Opportunity Partners LLC, formerly known as PlainsCapital Equity, LLC, a merchant

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Unaudited)

bank utilized to facilitate investments in companies engaged in non-financial activities. The Bank owns 100% of the outstanding stock of PrimeLending, a PlainsCapital Company (“PrimeLending”).

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

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

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

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

In addition, Hilltop owns 100% of the membership interest in each of HTH Hillcrest Project LLC and Hilltop Investments I, LLC. Hilltop Investments I, LLC owns 50% of the membership interest in HTH Diamond Hillcrest Land LLC which is consolidated under the aforementioned VIE Subsections of the ASC. These entities are related to the Hilltop Plaza investment discussed in detail in Note 13 to the consolidated financial statements.

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

Subsidiary Subsections of the ASC.

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

Significant accounting policies are detailed in Note 1 to the consolidated financial statements included in the Company's 2017 Form 10-K. As a result of the adoption of Accounting Standards Update ("ASU") 2016-01 and ASU 2016-18, the Company has updated its accounting policies related to securities and cash flow reporting, respectively, as presented below.

Securities

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

Debt securities held but not intended to be held to maturity or on a long-term basis are classified as available for sale. Securities included in this category are those that management intends to use as part of its asset/liability management

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strategy and that may be sold in response to changes in interest rates, resultant prepayment risk, and other factors related to interest rate and resultant prepayment risk changes. Debt securities available for sale are carried at fair value. Unrealized holding gains and losses on debt securities available for sale, net of taxes, are reported in other comprehensive income (loss) until realized. Premiums and discounts are recognized in interest income using the effective interest method and consider any optionality that may be embedded in the security.

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

Purchases and sales (and related gain or loss) of securities are recorded on the trade date, based on specific identification. Declines in the fair value of available-for-sale debt securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the other-than-temporary impairment ("OTTI") is related to credit losses. The amount of the OTTI related to other factors is recognized in other comprehensive income (loss). In estimating OTTI, management considers in developing its best estimate of cash flows, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, (iii) the historic and implied volatility of the security, (iv) failure of the issuer to make scheduled interest payments and (v) changes to the rating of the security by a rating agency.

Cash Flow Reporting

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

2. Recently Issued Accounting Standards

Adoption of New Accounting Standards

In June 2018, FASB issued ASU 2018-07 which expands the scope of ASC 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. The Company early adopted the amendment as of July 1, 2018, which did not have a significant effect on its consolidated financial statements.

In February 2018, FASB issued ASU 2018-02 to help organizations address certain stranded income tax effects in accumulated other comprehensive income ("AOCI") resulting from the Tax Cuts and Jobs Act of 2017 ("Tax Legislation"). The amendment provides an option to reclassify stranded tax effects within AOCI to retained earnings in each period in which the effect of the changes in the U.S. federal corporate income tax rate in the Tax Legislation (or portion thereof) is recorded. The amendment also includes disclosure requirements regarding the issuer's accounting policy for releasing income tax effects from AOCI. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. As permitted within the amendment, the Company elected to early adopt and apply the provisions of this amendment as of January 1, 2018. The adoption of the amendment resulted in a reclassification of $0.1 million from AOCI to retained earnings, representing an increase to retained earnings. This reclassification is included within the adoption of accounting standards line item in the consolidated statements of stockholders' equity.

In May 2017, FASB issued ASU 2017-09 which provides clarity and reduces both diversity in practice and cost and complexity associated with changes to the terms or conditions of a share-based payment award and, specifically, which changes require an entity to apply modification accounting. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Company adopted the

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amendments as of January 1, 2018, which did not have a significant effect on the Company's consolidated financial statements.

In January 2017, FASB issued ASU 2017-01 which provides guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendment is effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017, using the prospective method. The Company adopted the amendment as of January 1, 2018 and will prospectively apply its provisions.

In November 2016, FASB issued ASU 2016-18 which requires that restricted cash be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statements of cash flows. We have adopted the requirements of the new standard as of January 1, 2018. As a result, assets segregated for regulatory purposes, which consist of cash and cash equivalents, are now included in the beginning-of-period and end-of-period total amounts shown on the statements of cash flows for the nine months ended September 30, 2018 and 2017. Furthermore, the consolidated statements of cash flows now include disclosure of the line items in the consolidated balance sheets which make up cash, cash equivalents and restricted cash. The quarterly reports on Form 10-Q for the periods ended March 31, 2018 and June 30, 2018, filed with the SEC on April 26, 2018 and July 26, 2018, respectively, incorrectly included the change in assets segregated for regulatory purposes in the operating section of the statements of cash flows. Previously disclosed net changes in assets segregated for regulatory purposes of ($11.6) million and $58.2 million for the three months ended March 31, 2018 and six months ended June 30, 2018, respectively, should have been excluded from the cash flows from operating activities and the beginning-of-period and end-of-period balances of assets segregated for regulatory purposes should have been included in total cash, cash equivalents and restricted cash. Accordingly, net cash provided by operating activities for the three months ended March 31, 2018, originally reported as $173.9 million, should have been $185.5 million, and net cash used in operating activities for the six months ended June 30, 2018, originally reported as ($261.2) million, should have been ($319.4) million. Management has evaluated the quantitative and qualitative impact of the error to previously issued unaudited consolidated statements of cash flows and concluded that the previously issued consolidated financial statements were not materially misstated. However, management has elected to revise the unaudited consolidated statements of cash flows for each of the three months ended March 31, 2018 and six months ended June 30, 2018 in its future filings in order to correctly reflect the change in presentation of assets segregated for regulatory purposes. The balance of assets segregated for regulatory purposes was $186.6 million, $198.2 million and $128.4 million at January 1, 2018 (the date of adoption), March 31, 2018 and June 30, 2018, respectively. The correction had no impact on the Company's financial condition or results of operations for the periods presented.

In October 2016, FASB issued ASU 2016-16 which addresses improvement in accounting for income tax consequences of intra-equity transfers of assets other than inventory. The amendment requires that an entity recognize the income tax consequences of the intra-equity transfer of an asset other than inventory when the transfer occurs. The amendment was effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017, using the modified retrospective transition method. The Company adopted the amendment as of January 1, 2018, which did not have a significant effect on its consolidated financial statements.

In August 2016, FASB issued ASU 2016-15 to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows and to eliminate the diversity in practice related to such classifications. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017 using a retrospective transition method. The Company adopted the amendments as of January 1, 2018, which did not have a significant effect on the Company's consolidated financial statements.

In January 2016, FASB issued ASU 2016-01 related to financial instruments and subsequently issued technical corrections to the amendment in ASU 2018-03. The amendments require that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The amendments also impact financial liabilities under the Fair Value Option and the presentation and disclosure requirements for financial instruments and modify the required process used to evaluate deferred tax assets on available for sale securities. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The

Company adopted the amendments as of January 1, 2018, which resulted in $21.2 million of securities being reclassified from available for sale to equity within the consolidated balance sheets consistent with the provisions of the amendments, while certain other equity investments of $42.8 million are included in other assets within the consolidated balance sheets at September 30, 2018. The adoption of the amendments also resulted in $2.5 million being reclassified from accumulated other comprehensive income to retained earnings, representing an increase to retained earnings as of January 1, 2018. This reclassification is included within the adoption of accounting standards line item in the consolidated statement of stockholders' equity. All subsequent changes in fair value related to these equity investments will be recognized in net income. Additionally, the enhanced disclosures required by the amendments are included within the notes to the consolidated financial statements, including the disclosure of the fair value of the loan portfolio using an exit price method instead of the prior discounted cash flow method. These disclosure changes did not have a significant effect on the Company's consolidated financial statements.

On January 1, 2018, the Company adopted the provisions of ASC 606, Revenue from Contracts with Customers, using the modified, cumulative-effect approach wherein the guidance is applied only to existing contracts as of the date of initial application and to new contracts entered into thereafter. The new standard outlines a single comprehensive model for entities to depict the transfer of goods or services to customers in amounts that reflect the payment to which a company expects to be entitled in exchange for those goods or services. The standard also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. Revenue from the Company's mortgage origination and insurance segments are not in the scope of the new guidance, while certain revenue from contracts with customers within the broker-dealer and banking segments are subject to the new guidance.

The revenue recognition policies within the Company's broker-dealer segment were affected upon adoption of ASC 606. Specifically, the new guidance required changes to the principal versus agent conclusion for certain advisory and underwriting revenues and expenses which, as of January 1, 2018, are recorded on a gross basis while legacy guidance required these revenues to be recognized net of the related expenses. Conversely, certain contract costs related to clearing and retail operations are now netted against the revenues while the legacy guidance required these revenues and expenses to be recognized on a gross basis. These changes did not have a material effect on the Company's consolidated financial statements during the three and nine months ended September 30, 2018. As the measurement and timing of revenue recognition was not affected for any of the Company's revenue streams, the implementation of the new guidance had no impact on opening retained earnings as of January 1, 2018.

The Company's broker-dealer segment has six primary lines of business: (i) public finance, (ii) capital markets, (iii) retail, (iv) structured finance, (v) clearing services and (vi) securities lending. Revenue from contracts with customers subject to the guidance in ASC 606 from the broker-dealer segment is included within the securities commissions and fees and investment and securities advisory fees and commissions line items within the consolidated statements of operations. Commissions and fees revenue is generally recognized at a point in time upon the delivery of contracted services based on a predefined contractual amount or on the trade date for trade execution services based on prevailing market prices and internal and regulatory guidelines.

The Company's banking segment has three primary lines of business: (i) business banking, (ii) personal banking and (iii) wealth and investment management. Revenue from contracts with customers subject to the guidance in ASC 606 from the banking segment (certain retail and trust fees) is included within the other noninterest income line item within the consolidated statements of operations. Retail and trust fees are generally recognized at the time the related transaction occurs or when services are completed. Fees are based on the dollar amount of the transaction or are otherwise predefined in contracts associated with each customer account depending on the type of account and services provided. There were no material changes to the revenue recognition policies of the banking segment upon adoption.

Accounting Standards Issued But Not Yet Adopted

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

In August 2018, FASB issued ASU 2018-13 which includes various removals, modifications and additions to existing guidance regarding fair value disclosures. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the provisions of the amendments but does not expect the amendments to have a material impact on its future consolidated financial statements.

In July 2018, FASB issued ASU 2018-09 which clarifies, corrects and makes minor improvements to a wide variety of topics in the ASC. The amendments make the ASC easier to understand and apply by eliminating inconsistencies and providing clarifications. The transition and effective dates are based on the facts and circumstances of each amendment, with some amendments becoming effective upon issuance of the ASU, and others becoming effective for annual periods beginning after December 15, 2018. Those amendments that were effective upon issuance of the ASU did not have a significant impact on the Company's consolidated financial statements. The Company is currently evaluating the impact of the adoption of the other amendments on its future consolidated financial statements.

In August 2017, FASB issued ASU 2017-12 which provides targeted improvements to accounting for hedging activities. The purpose of the amendment is to better align a company's risk management activities with its financial reporting for hedging relationships, to simplify the hedge accounting requirements and to improve the disclosures of hedging arrangements. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, and all transition requirements and elections should be applied to hedging relationships existing on the date of adoption. The Company has not historically applied hedge accounting to its derivative transactions. However, the Company is currently evaluating the provisions of the amendment and the impact, if any, on its future consolidated financial statements.

In June 2016, FASB issued ASU 2016-13 which sets forth a "current expected credit loss" (CECL) model which requires entities to measure all credit losses expected over the life of an exposure (or pool of exposures) for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. The new standard, which is codified in ASC 326, Financial Instruments – Credit Losses, replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. The new standard also requires enhanced disclosures to help financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. The new standard is effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2019 with a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. The Company does not intend to adopt the provisions of the new standard early. The Company's cross-functional team has begun the implementation of new credit forecasting models and a credit scoring system that will be utilized to estimate the likelihood of default and loss severity as a part of its credit loss estimation methodology in accordance with the new standard. In addition, the Company continues to identify and assess key interpretive policy issues, as well as design and build new or modified policies and procedures that will be used to calculate its credit loss reserves. However, the magnitude of the change in allowance for loan losses upon adoption will depend on, among other things, the portfolio composition and quality at the adoption date, as well as economic conditions and forecasts at that time.

In February 2016, FASB issued ASU 2016-02 related to leases and subsequently issued amendments and technical corrections in ASU 2018-01, ASU 2018-10 and ASU 2018-11. The new standard, which is codified in ASC 842, Leases, is intended to increase transparency and comparability among organizations and require lessees to record a right-to-use asset and liability representing the obligation to make lease payments for long-term leases. Accounting by lessors will remain largely unchanged. The new standard is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Adoption will require a modified retrospective transition where the lessees and lessors are required to recognize and measure leases at the date of adoption which is January 1, 2019 for calendar year-end entities. The Company's implementation efforts are ongoing, including the installation of an enhanced technology solution, which will aid in determining the magnitude of the increases in assets and liabilities and their impact on the consolidated financial statements. The Company expects to recognize lease liabilities and corresponding right-of-use assets (at their present value) related to predominantly all of the future minimum lease payments required under operating leases as disclosed in Note 18 to the consolidated financial statements in the 2017 Form 10-K. Upon implementation, the balance sheet effects of the new lease accounting standard will also impact regulatory capital ratios, performance ratios, and other measures which are dependent upon asset or liability balances. The Company expects to record operating lease liabilities in the range of approximately $105 million to $125 million and right-to-use assets in the range of approximately $100 million to $120 million upon adoption of the new standard. However, the population of contracts subject to balance sheet recognition, their initial measurement and the expected impact to the aforementioned balances and measures remain under evaluation.

3. Acquisition

BORO Acquisition

On August 1, 2018, the Company completed its acquisition of BORO in an $85 million all-cash transaction as discussed in Note 1 to the consolidated financial statements. The operations of BORO are included in the Bank's operating results beginning August 1, 2018. BORO's results of operations prior to the acquisition date are not included in the Company's consolidated operating results.

The BORO Acquisition was accounted for using the acquisition method of accounting, and accordingly, purchased assets, including identifiable intangible assets, and assumed liabilities were recorded at their respective acquisition date fair values. The resulting preliminary fair values of the identifiable assets acquired and liabilities assumed from BORO at August 1, 2018 are summarized in the following table (in thousands).

Cash and due from banks	$ 21,756
Securities	60,477
Non-covered loans, net	326,618
Other assets	25,912
Total identifiable assets acquired	434,763
Deposits	376,393
Short-term borrowings	10,000
Other liabilities	2,996
Total liabilities assumed	389,389
Net identifiable assets acquired	45,374
Preliminary goodwill resulting from the acquisition	39,627
Net assets acquired	$ 85,001

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(Unaudited)

The preliminary goodwill of $39.6 million resulting from the acquisition represents the inherent long-term value expected from the business opportunities created from combining BORO with the Company. The Company used significant estimates and assumptions to value the identifiable assets acquired and liabilities assumed. Because management's review and approval of certain key assumptions is not yet complete, the purchase date valuations related to loans, intangibles and taxes are considered preliminary and are subject to change for up to one year after the acquisition date. While the Company is in the process of finalizing its purchase price allocation, significant changes are not anticipated. The amount of goodwill recorded in connection with the Company's acquisition of BORO is not deductible for tax purposes.

Included within the fair value of other assets in the table above are identifiable core deposits intangible assets recorded in connection with the BORO Acquisition of $10.0 million.

During both the three and nine months ended September 30, 2018, transaction- and integration-related expenses of $6.6 million associated with the BORO Acquisition are included in noninterest expense within the consolidated statement of operations. Such expenses were for professional services and other incremental employee costs associated with the integration of BORO's operations.

In connection with the BORO Acquisition, the Company 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 ("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	$ 98,259	$ 2,127	$ 100,386
Real estate	174,675	5,389	180,064
Construction and land development	37,134	—	37,134
Consumer	9,021	13	9,034

Total	$ 319,089	$ 7,529	$ 326,618

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

Contractually required principal and interest payments	$ 10,730
Nonaccretable difference	2,859
Cash flows expected to be collected	7,871
Accretable difference	342
Fair value of loans acquired with a deterioration of credit quality	$ 7,529

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

Contractually required principal and interest payments	$ 381,551
Contractual cash flows not expected to be collected	15,286
Fair value at acquisition	319,089

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4. Fair Value Measurements

Fair Value Measurements and Disclosures

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

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

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

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

- Level 3 Inputs: Unobservable inputs that reflect an entity’s own 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, 2018 and December 31, 2017, the aggregate fair value of PrimeLending's mortgage loans held for sale accounted for under the Fair Value Option was $1.39 billion and $1.58 billion, respectively, and the unpaid principal balance of those loans was $1.35 billion and $1.53 billion, respectively. The interest component of fair value is reported as interest income on loans in the accompanying consolidated statements of operations.

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

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

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

September 30, 2018	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	$ 2,341	$ 657,973	$ —	$ 660,314
Available for sale securities	—	874,496	—	874,496
Equity securities	21,555	—	—	21,555
Loans held for sale	—	1,333,257	54,365	1,387,622
Derivative assets	—	45,979	—	45,979
MSR asset	—	—	68,804	68,804
Securities sold, not yet purchased	116,965	62,617	—	179,582
Derivative liabilities	—	15,291	—	15,291

December 31, 2017	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	$ 3,329	$ 727,356	$ —	$ 730,685
Available for sale securities	—	744,319	—	744,319
Equity securities	21,241	—	—	21,241
Loans held for sale	—	1,544,631	36,972	1,581,603
Derivative assets	—	34,150	—	34,150
MSR asset	—	—	54,714	54,714
Securities sold, not yet purchased	156,586	76,235	—	232,821
Derivative liabilities	—	13,197	—	13,197

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, 2018						
Loans held for sale	$ 40,781	$ 19,156	$ (4,614)	$ (958)	$ —	$ 54,365
MSR asset	57,373	11,361	—	70	—	68,804
Total	$ 98,154	$ 30,517	$ (4,614)	$ (888)	$ —	$ 123,169
Nine months ended September 30, 2018						
Loans held for sale	$ 36,972	$ 39,706	$ (17,127)	$ (5,186)	$ —	$ 54,365
MSR asset	54,714	21,090	(9,303)	2,303	—	68,804
Total	$ 91,686	$ 60,796	$ (26,430)	$ (2,883)	$ —	$ 123,169
Three months ended September 30, 2017						
Loans held for sale	30,037	8,881	(5,685)	(1,688)	—	31,545
MSR asset	43,580	5,939	—	(1,753)	—	47,766
Total	$ 73,617	$ 14,820	$ (5,685)	$ (3,441)	$ —	$ 79,311
Nine months ended September 30, 2017						
Loans held for sale	35,801	25,384	(23,108)	(6,532)	—	31,545
MSR asset	61,968	8,429	(17,499)	(5,132)	—	47,766
Total	$ 97,769	$ 33,813	$ (40,607)	$ (11,664)	$ —	$ 79,311

All net realized and unrealized gains (losses) in the tables above are reflected in the accompanying consolidated financial statements. The unrealized gains (losses) relate to financial instruments still held at September 30, 2018.

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Notes to Consolidated Financial Statements (continued)

(Unaudited)

For Level 3 financial instruments measured at fair value on a recurring basis at September 30, 2018, the significant unobservable inputs used in the fair value measurements were as follows.

Financial instrument	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
Loans held for sale	Discounted cash flows / Market comparable	Projected price	92 - 96 % (95 %)
MSR asset	Discounted cash flows	Constant prepayment rate	9.15 %
		Discount rate	11.11 %

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

The MSR asset, which is included in other assets within the Company's consolidated balance sheets, is reported at fair value using Level 3 inputs. The MSR asset is valued by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair value of the MSR asset is impacted by a variety of factors. Prepayment rates and discount rates, the most significant unobservable inputs, are discussed further in Note 8 to the consolidated financial statements.

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

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

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017

	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	$ (20,417)	$ —	$ (20,417)	$ (4,443)	$ —	$ (4,443)
MSR asset	70	—	70	(1,753)	—	(1,753)

	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
	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	$ (12,693)	$ —	$ (12,693)	$ 26,650	$ —	$ 26,650
MSR asset	2,303	—	2,303	(5,132)	—	(5,132)

The Company also determines the fair value of certain assets and liabilities on a non-recurring basis. 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 individually 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, $73.5 million and $7.5 million were acquired by the Company upon completion of the merger with PCC (the “PlainsCapital Merger”), the FDIC-assisted transaction whereby the Bank acquired certain assets and assumed certain liabilities of Edinburg, Texas-based First National Bank (“FNB”) on September 13, 2013 (the “FNB Transaction”), the acquisition of SWS Group, Inc. (“SWS”) in a stock and cash transaction (the "SWS Merger"), whereby SWS’s banking subsidiary, Southwest Securities, FSB, was merged into the Bank, and the BORO Acquisition, respectively (collectively, the “Bank Transactions”). Substantially all PCI loans acquired in the FNB Transaction were 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, 2018, estimates for these significant unobservable inputs were as follows.

	PCI Loans PlainsCapital Merger	FNB Transaction	SWS Merger	BORO Acquisition
Weighted average default rate	83 %	35 %	70 %	63 %
Weighted average loss severity rate	67 %	13 %	28 %	45 %
Weighted average prepayment speed	0 %	6 %	0 %	0 %

At September 30, 2018, the resulting weighted average expected loss on PCI loans associated with the PlainsCapital Merger, FNB Transaction, SWS Merger and BORO Acquisition was 55%, 5%, 20% and 26%, 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 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 determines fair value primarily using independent appraisals of other real estate owned (“OREO”) properties. The resulting fair value measurements are classified as Level 2 inputs. In the FNB Transaction, the Bank acquired OREO of $135.2 million, all of which were covered by FDIC loss-share agreements. At September 30, 2018 and December 31, 2017, the estimated fair value of covered OREO was $29.9 million and $36.7 million, respectively, and the underlying fair value measurements utilized Level 2 inputs. The fair value of non-covered OREO at September 30, 2018 and December 31, 2017 was $2.7 million and $3.9 million, respectively, and is included in other assets within the consolidated balance sheets. 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).

September 30, 2018	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value	Total Gains (Losses) for the Three Months Ended September 30, 2018	2017	Total Gains (Losses) for the Nine Months Ended September 30, 2018	2017
Non-covered impaired loans	$ —	$ —	$ 17,749	$ 17,749	$ (15)	$ 793	$ (1,486)	$ 323
Covered impaired loans	—	—	63,194	63,194	683	(787)	1,429	(1,764)
Non-covered other real estate owned	—	529	—	529	(91)	(135)	(167)	(258)
Covered other real estate owned	—	19,555	—	19,555	(303)	(388)	(2,027)	(2,523)

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. In accordance with ASU 2016-01, effective January 1, 2018, the fair values of non-covered and covered loans are measured using an exit price method. There have been no other changes to the methods for determining estimated fair value for financial assets and liabilities as described in detail in Note 3 to the consolidated financial statements included in the Company’s 2017 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, 2018	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Financial assets:					
Cash and cash equivalents	$ 406,150	$ 406,150	$ —	$ —	$ 406,150
Assets segregated for regulatory purposes	220,115	220,115	—	—	220,115
Securities purchased under agreements to resell	164,656	—	164,656	—	164,656
Held to maturity securities	348,163	—	332,388	—	332,388
Loans held for sale	137,358	—	137,358	—	137,358
Non-covered loans, net	6,737,417	—	593,276	6,240,441	6,833,717
Covered loans, net	142,737	—	—	217,503	217,503
Broker-dealer and clearing organization receivables	1,491,507	—	1,491,507	—	1,491,507
FDIC indemnification asset	22,831	—	—	22,831	22,831
Other assets	70,998	—	69,940	1,058	70,998
Financial liabilities:					
Deposits	8,290,233	—	8,279,098	—	8,279,098
Broker-dealer and clearing organization payables	1,396,401	—	1,396,401	—	1,396,401
Short-term borrowings	1,216,649	—	1,216,649	—	1,216,649
Debt	287,204	—	284,921	—	284,921
Other liabilities	6,032	—	6,032	—	6,032

		Estimated Fair Value			
December 31, 2017	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Financial assets:					
Cash and cash equivalents	$ 487,382	$ 487,382	$ —	$ —	$ 487,382
Assets segregated for regulatory purposes	186,578	186,578	—	—	186,578

Securities purchased under agreements to resell	186,537	—	186,537	—	186,537
Held to maturity securities	355,849	—	349,939	—	349,939
Loans held for sale	133,754	—	133,754	—	133,754
Non-covered loans, net	6,212,712	—	577,889	5,828,868	6,406,757
Covered loans, net	179,400	—	—	269,386	269,386
Broker-dealer and clearing organization receivables	1,464,378	—	1,464,378	—	1,464,378
FDIC indemnification asset	29,340	—	—	20,122	20,122
Other assets	64,862	—	59,053	5,809	64,862
Financial liabilities:					
Deposits	7,978,119	—	7,973,101	—	7,973,101
Broker-dealer and clearing organization payables	1,287,563	—	1,287,563	—	1,287,563
Short-term borrowings	1,206,424	—	1,206,424	—	1,206,424
Debt	275,821	—	289,719	—	289,719
Other liabilities	4,795	—	4,795	—	4,795

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The Company held equity investments other than securities of $42.8 million and $38.7 million at September 30, 2018 and December 31, 2017, respectively, which are included within other assets in the consolidated balance sheets. Of the $42.8 million of such equity investments held at September 30, 2018, $26.4 million do not have readily determinable fair values and each is measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The following table presents the adjustments to the carrying value of these investments (in thousands).

	Three months ended, September 30, 2018	Nine months ended, September 30, 2018
Balance, beginning of period	$ 26,151	$ 22,946
Additional investments	—	1,411
Upward adjustments	265	3,642
Impairments and downward adjustments	(1)	(1,584)
Dispositions	—	—
Balance, end of period	$ 26,415	$ 26,415

5. Securities

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

	September 30, 2018	December 31, 2017
U.S. Treasury securities	$ 2,328	$ —
U.S. government agencies:		
Bonds	30,223	52,078
Residential mortgage-backed securities	360,091	372,817
Commercial mortgage-backed securities	5,781	6,125
Collateralized mortgage obligations	35,708	5,122
Corporate debt securities	74,249	96,182
States and political subdivisions	119,751	170,413
Unit investment trusts	24,013	22,612
Private-label securitized product	4,806	1,631
Other	3,364	3,705
Totals	$ 660,314	$ 730,685

The Hilltop Broker-Dealers enter into transactions that represent commitments to purchase and deliver securities at prevailing future market prices to facilitate customer transactions and satisfy such commitments. Accordingly, the Hilltop Broker-Dealers’ ultimate obligations may exceed the amount recognized in the financial statements. These securities, which are carried at fair value and reported as securities sold, not yet purchased in the consolidated balance sheets, had a value of $179.6 million and $232.8 million at September 30, 2018 and December 31, 2017, respectively.

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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, 2018	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 18,314	$ —	$ (150)	$ 18,164
U.S. government agencies:				
Bonds	80,879	326	(858)	80,347
Residential mortgage-backed securities	379,759	81	(10,627)	369,213
Commercial mortgage-backed securities	11,760	34	(205)	11,589
Collateralized mortgage obligations	290,576	213	(7,614)	283,175
Corporate debt securities	56,647	277	(507)	56,417
States and political subdivisions	55,565	477	(451)	55,591
Totals	$ 893,500	$ 1,408	$ (20,412)	$ 874,496

	Available for Sale			
December 31, 2017	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities	$ 24,665	$ 107	$ (103)	$ 24,669
U.S. government agencies:				
Bonds	96,177	829	(366)	96,640
Residential mortgage-backed securities	246,707	538	(3,740)	243,505
Commercial mortgage-backed securities	11,966	105	(48)	12,023
Collateralized mortgage obligations	237,848	106	(4,142)	233,812
Corporate debt securities	66,868	1,819	(25)	68,662
States and political subdivisions	64,024	1,099	(115)	65,008
Totals	$ 748,255	$ 4,603	$ (8,539)	$ 744,319

	Held to Maturity			
September 30, 2018	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agencies:				
Bonds	$ 39,017	$ —	$ (2,283)	$ 36,734
Residential mortgage-backed securities	22,804	—	(605)	22,199
Commercial mortgage-backed securities	87,296	5	(3,065)	84,236

Collateralized mortgage obligations	148,399	—	(7,264)	141,135
States and political subdivisions	50,647	17	(2,580)	48,084
Totals	$ 348,163	$ 22	$ (15,797)	$ 332,388

	Held to Maturity			
December 31, 2017	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agencies:				
Bonds	$ 39,015	$ —	$ (1,188)	$ 37,827
Residential mortgage-backed securities	16,130	44	—	16,174
Commercial mortgage-backed securities	71,373	241	(735)	70,879
Collateralized mortgage obligations	173,928	19	(3,969)	169,978
States and political subdivisions	55,403	437	(759)	55,081
Totals	$ 355,849	$ 741	$ (6,651)	$ 349,939

Additionally, the Company had unrealized net gains of $0.1 million and $1.6 million from equity securities with fair values of $21.6 million and $21.2 million held at September 30, 2018 and December 31, 2017, respectively. The Company recognized net gains of $0.1 million during the three months ended September 30, 2018, and net losses of $0.4 million during the nine months ended September 30, 2018, due to changes in the fair value of equity securities still held

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Hilltop Holdings Inc. and Subsidiaries

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at the balance sheet date. During the three and nine months ended September 30, 2018, net gains recognized from equity securities sold were nominal.

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

	September 30, 2018			December 31, 2017		
	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	5	$ 12,855	$ 91	6	$ 15,449	$ 69
Unrealized loss for twelve months or longer	4	5,309	59	1	4,150	34
	9	18,164	150	7	19,599	103
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	10	33,051	152	10	83,476	366
Unrealized loss for twelve months or longer	2	20,192	705	—	—	—
	12	53,243	857	10	83,476	366
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	37	219,163	3,721	15	121,968	820
Unrealized loss for twelve months or longer	18	130,927	6,906	11	93,358	2,920
	55	350,090	10,627	26	215,326	3,740
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	1	2,882	9	1	5,048	48
Unrealized loss for twelve months or longer	1	4,883	196	—	—	—
	2	7,765	205	1	5,048	48

Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	19	86,977	1,383	16	90,886	819
Unrealized loss for twelve months or longer	25	126,497	6,231	17	80,492	3,323
	44	213,474	7,614	33	171,378	4,142
Corporate debt securities:						
Unrealized loss for less than twelve months	29	34,933	432	1	5,073	25
Unrealized loss for twelve months or longer	1	1,923	76	—	—	—
	30	36,856	508	1	5,073	25
States and political subdivisions:						
Unrealized loss for less than twelve months	80	28,786	182	9	6,981	97
Unrealized loss for twelve months or longer	11	6,100	269	9	2,876	18
	91	34,886	451	18	9,857	115
Total available for sale:						
Unrealized loss for less than twelve months	181	418,647	5,970	58	328,881	2,244
Unrealized loss for twelve months or longer	62	295,831	14,442	38	180,876	6,295
	243	$ 714,478	$ 20,412	96	$ 509,757	$ 8,539

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(Unaudited)

	September 30, 2018			December 31, 2017		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Held to Maturity						
U.S. government agencies:						
Bonds:						
Unrealized loss for less than twelve months	1	$ 5,674	$ 326	1	$ 5,950	$ 50
Unrealized loss for twelve months or longer	3	31,060	1,957	3	31,877	1,138
	4	36,734	2,283	4	37,827	1,188
Residential mortgage-backed securities:						
Unrealized loss for less than twelve months	4	22,199	605	—	—	—
Unrealized loss for twelve months or longer	—	—	—	—	—	—
	4	22,199	605	—	—	—
Commercial mortgage-backed securities:						
Unrealized loss for less than twelve months	11	40,122	1,057	7	39,396	271
Unrealized loss for twelve months or longer	7	37,325	2,008	2	12,659	464
	18	77,447	3,065	9	52,055	735
Collateralized mortgage obligations:						
Unrealized loss for less than twelve months	7	16,262	519	10	37,064	264
Unrealized loss for twelve months or longer	18	124,873	6,745	12	128,270	3,705
	25	141,135	7,264	22	165,334	3,969
States and political subdivisions:						
Unrealized loss for less than twelve months	55	23,981	681	22	11,079	71
Unrealized loss for twelve months or longer	51	19,179	1,899	46	18,598	688

	106	43,160	2,580	68	29,677	759
Total held to maturity:						
Unrealized loss for less than twelve months	78	108,238	3,188	40	93,489	656
Unrealized loss for twelve months or longer	79	212,437	12,609	63	191,404	5,995
	157	$ 320,675	$ 15,797	103	$ 284,893	$ 6,651
Equity						
Common and preferred stock:						
Unrealized loss for less than twelve months	—	—	—	1	944	13
Unrealized loss for twelve months or longer	—	—	—	1	6,800	103
	—	$ —	$ —	2	$ 7,744	$ 116

During the three and nine months ended September 30, 2018 and 2017, the Company did not record any OTTI. While some of the securities held in the Company's investment portfolio have decreased in value since the date of acquisition, the severity of loss and the duration of the loss position are not significant enough to warrant recording any OTTI of the securities. 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. The Company does not intend to sell, nor does the Company believe that it is likely that the Company will be required to sell, these securities before the recovery of the cost basis.

Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The amortized cost and fair value of securities, excluding trading and equity securities, at September 30, 2018 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	$ 49,477	$ 49,466	$ 1,398	$ 1,396
Due after one year through five years	104,633	103,861	25,735	24,447
Due after five years through ten years	34,663	34,218	4,914	4,769
Due after ten years	22,632	22,974	57,617	54,206
	211,405	210,519	89,664	84,818
Residential mortgage-backed securities	379,759	369,213	22,804	22,199
Collateralized mortgage obligations	290,576	283,175	148,399	141,135
Commercial mortgage-backed securities	11,760	11,589	87,296	84,236
	$ 893,500	$ 874,496	$ 348,163	$ 332,388

The Company realized net gains from its trading portfolio of $3.2 million and $5.8 million during the three months ended September 30, 2018 and 2017, respectively, and $5.1 million and $18.7 million during the nine months ended September 30, 2018 and 2017, respectively. In addition, the Hilltop Broker-Dealers realized net gains from structured product trading activities of $12.2 million and $21.8 million during the three months ended September 30, 2018 and 2017, respectively, and $29.7 million and $38.8 million during the nine months ended September 30, 2018 and 2017, respectively. All such realized net gains are recorded as a component of other noninterest income within the consolidated statements of operations.

Securities with a carrying amount of $571.3 million and $738.5 million (with a fair value of $552.4 million and $730.1 million, respectively) at September 30, 2018 and December 31, 2017, respectively, were pledged by the Bank to secure public and trust deposits, federal funds purchased and securities sold under agreements to repurchase, and for other purposes as required or permitted by law. Substantially all of these pledged securities were included in our available for sale and held to maturity securities portfolios at September 30, 2018 and December 31, 2017.

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

At September 30, 2018 and December 31, 2017, NLC had investments on deposit in custody for various state insurance departments with aggregate carrying values of $12.1 million and $9.3 million, respectively.

6. 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 7 to the consolidated financial statements. Non-covered loans summarized by portfolio segment are as follows (in thousands).

	September 30, 2018	December 31, 2017
Commercial and industrial	$ 1,722,097	$ 1,681,205
Real estate	3,381,757	3,011,524
Construction and land development	1,052,409	962,605
Consumer	46,739	40,446
Broker-dealer (1)	593,276	577,889
	6,796,278	6,273,669
Allowance for non-covered loan losses	(58,861)	(60,957)
Total non-covered loans, net of allowance	$ 6,737,417	$ 6,212,712

(1) Represents margin loans to customers and correspondents associated with our broker-dealer segment operations.

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 non-covered PCI loans (in thousands).

	September 30, 2018	December 31, 2017
Carrying amount	$ 32,553	$ 37,204
Outstanding balance	47,698	51,064

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Hilltop Holdings Inc. and Subsidiaries

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Balance, beginning of period	$ 5,259	$ 9,793	$ 7,013	$ 13,116
Additions	340	—	340	—
Reclassifications from nonaccretable difference, net(1)	1,053	277	1,603	854
Disposals of loans	—	(603)	(98)	(664)
Accretion	(1,504)	(1,851)	(3,710)	(5,690)
Balance, end of period	$ 5,148	$ 7,616	$ 5,148	$ 7,616

(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 non-accrual and expected cash flows are no longer predictable and the accretable yield is eliminated.

The remaining nonaccretable difference for non-covered PCI loans was $21.3 million and $19.2 million at September 30, 2018 and December 31, 2017, respectively.

Impaired loans exhibit a clear indication that the borrower's cash flow may not be sufficient to meet contractual principal and interest payments, which generally occurs 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 the following tables include loans accounted for on an individual basis, as well as acquired 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, segregated between those considered to be PCI loans and those without credit impairment at acquisition, are summarized by class in the following tables (in thousands).

September 30, 2018	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					

Commercial and industrial:					
Secured	$ 15,988	$ 4,392	$ 1,136	$ 5,528	$ 22
Unsecured	2,108	1,385	—	1,385	—
Real estate:					
Secured by commercial properties	30,671	13,556	7,514	21,070	891
Secured by residential properties	6,149	1,879	1,974	3,853	319
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	1,189	183	524	707	112
Consumer	2,039	10	—	10	—
Broker-dealer	—	—	—	—	—
	58,144	21,405	11,148	32,553	1,344
Non-PCI					
Commercial and industrial:					
Secured	25,012	12,878	5,010	17,888	2,739
Unsecured	590	13	—	13	—
Real estate:					
Secured by commercial properties	6,717	3,076	3,130	6,206	782
Secured by residential properties	1,225	769	—	769	—
Construction and land development:					
Residential construction loans	15	—	—	—	—
Commercial construction loans and land development	3,475	2,857	545	3,402	49
Consumer	152	45	—	45	—
Broker-dealer	—	—	—	—	—
	37,186	19,638	8,685	28,323	3,570
	$ 95,330	$ 41,043	$ 19,833	$ 60,876	$ 4,914

Hilltop Holdings Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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December 31, 2017	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
PCI					
Commercial and industrial:					
Secured	$ 19,752	$ 3,610	$ 2,489	$ 6,099	$ 89
Unsecured	—	—	—	—	—
Real estate:					
Secured by commercial properties	34,598	7,583	12,092	19,675	1,391
Secured by residential properties	12,600	5,307	4,558	9,865	325
Construction and land development:					
Residential construction loans	—	—	—	—	—
Commercial construction loans and land development	2,001	428	1,010	1,438	215
Consumer	2,377	12	115	127	18
Broker-dealer	—	—	—	—	—
	71,328	16,940	20,264	37,204	2,038
Non-PCI					
Commercial and industrial:					
Secured	23,666	15,308	2,072	17,380	365
Unsecured	761	616	—	616	—
Real estate:					
Secured by commercial properties	15,504	10,934	3,686	14,620	932
Secured by residential properties	1,596	1,177	—	1,177	—
Construction and land development:					
Residential construction loans	15	—	—	—	—
Commercial construction loans and land development	653	—	611	611	93
Consumer	162	56	—	56	—
Broker-dealer	—	—	—	—	—
	42,357	28,091	6,369	34,460	1,390
	$ 113,685	$ 45,031	$ 26,633	$ 71,664	$ 3,428

Average recorded 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,	
	2018	2017	2018	2017
Commercial and industrial:				
Secured	$ 23,654	$ 20,452	$ 23,448	$ 18,717
Unsecured	912	713	1,007	817
Real estate:				
Secured by commercial properties	28,488	35,458	30,786	36,606
Secured by residential properties	4,677	11,412	7,832	11,387
Construction and land development:				
Residential construction loans	—	—	—	14
Commercial construction loans and land development	2,798	2,590	3,079	3,204
Consumer	52	324	119	382
Broker-dealer	—	—	—	—
	$ 60,581	$ 70,949	$ 66,271	$ 71,127

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(Unaudited)

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

	September 30, 2018	December 31, 2017
Commercial and industrial:		
Secured	$ 21,310	$ 20,262
Unsecured	13	616
Real estate:		
Secured by commercial properties	7,506	14,620
Secured by residential properties	1,178	1,614
Construction and land development:		
Residential construction loans	—	—
Commercial construction loans and land development	3,402	611
Consumer	45	56
Broker-dealer	—	—
	$ 33,454	$ 37,779

At September 30, 2018 and December 31, 2017, non-covered non-accrual loans included non-covered PCI loans of $5.1 million and $3.3 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, $3.3 million and $2.7 million of real estate loans secured by residential properties and classified as held for sale were in non-accrual status at September 30, 2018 and December 31, 2017, respectively.

Interest income, including recoveries and cash payments, recorded on non-covered impaired loans was $0.2 million and nominal during the three months ended September 30, 2018 and 2017, respectively, and $0.4 million and $0.3 million during the nine months ended September 30, 2018 and 2017, 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 may also reconfigure a single loan into two or more loans (“A/B Note”). The typical A/B Note restructure results in a “bad” loan which is charged off and a “good” loan or loans, the terms of which comply with the Bank’s customary underwriting policies. The debt charged off on the “bad” loan is not forgiven to the debtor.

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(Unaudited)

The Bank did not grant any TDRs during three or nine months ended September 30, 2018 or during the three months ended September 30, 2017. Information regarding TDRs granted during the nine months ended September 30, 2017 is shown in the following tables (dollars in thousands). At September 30, 2018 and December 31, 2017, the Bank had nominal unadvanced commitments to borrowers whose loans have been restructured in TDRs.

	Nine Months Ended September 30, 2017		
	Number of Loans	Balance at Extension	Balance at End of Period
Commercial and industrial:			
Secured	1	$ 1,357	$ 1,235
Unsecured	—	—	—
Real estate:			
Secured by commercial properties	1	1,481	1,385
Secured by residential properties	—	—	—
Construction and land development:			
Residential construction loans	—	—	—
Commercial construction loans and land development	1	655	626
Consumer	—	—	—
Broker-dealer	—	—	—
	3	$ 3,493	$ 3,246

All of the non-covered loan modifications included in the tables above involved payment term extensions. The Bank did not grant principal reductions on any restructured non-covered loans during the three and nine months ended September 30, 2018 and 2017.

The following table presents information regarding TDRs granted during the twelve months preceding September 30, 2018 and 2017, respectively, for which a payment was at least 30 days past due (dollars in thousands).

	Twelve Months Preceding September 30, 2018		Twelve Months Preceding September 30, 2017	
		Balance at		Balance at

	Number of Loans	Extension	Balance at End of Period	Number of Loans	Extension	Balance at End of Period
Commercial and industrial:						
Secured	—	$ —	$ —	—	$ —	$ —
Unsecured	—	—	—	—	—	—
Real estate:						
Secured by commercial properties	1	3,294	3,130	1	1,481	1,385
Secured by residential properties	—	—	—	—	—	—
Construction and land development:						
Residential construction loans	—	—	—	—	—	—
Commercial construction loans and land development	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Broker-dealer	—	—	—	—	—	—
	1	$ 3,294	$ 3,130	1	$ 1,481	$ 1,385

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

September 30, 2018	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	Accruin (Non-PC Past Du 90 Days
Commercial and industrial:								
Secured	$ 17,853	$ 12,710	$ 6,035	$ 36,598	$ 1,528,645	$ 5,528	$ 1,570,771	$ 3,544
Unsecured	2,417	460	—	2,877	147,064	1,385	151,326	—
Real estate:								
Secured by commercial properties	6,970	3,130	1,821	11,921	2,445,812	21,070	2,478,803	—
Secured by residential properties	1,248	663	696	2,607	896,494	3,853	902,954	688
Construction and land development:								
Residential construction loans	739	—	—	739	240,901	—	241,640	—
Commercial construction loans and land development	3,100	1,035	—	4,135	805,927	707	810,769	—
Consumer	373	1,293	—	1,666	45,063	10	46,739	—
Broker-dealer	—	—	—	—	593,276	—	593,276	—
	$ 32,700	$ 19,291	$ 8,552	$ 60,543	$ 6,703,182	$ 32,553	$ 6,796,278	$ 4,232

December 31, 2017	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 Loa (Non-PCI) Past Due 90 Days or M

Commercial and industrial:								
Secured	$ 2,060	$ 312	$ 5,714	$ 8,086	$ 1,544,131	$ 6,099	$ 1,558,316	$ 640
Unsecured	642	—	—	642	122,247	—	122,889	—
Real estate:								
Secured by commercial properties	442	—	2,195	2,637	2,213,331	19,675	2,235,643	—
Secured by residential properties	1,490	1,290	418	3,198	762,818	9,865	775,881	—
Construction and land development:								
Residential construction loans	315	—	—	315	176,937	—	177,252	—
Commercial construction loans and land development	1,370	101	—	1,471	782,444	1,438	785,353	—
Consumer	194	20	—	214	40,105	127	40,446	—
Broker-dealer	—	—	—	—	577,889	—	577,889	—
	$ 6,513	$ 1,723	$ 8,327	$ 16,563	$ 6,219,902	$ 37,204	$ 6,273,669	$ 640

In addition to the non-covered loans shown in the tables above, PrimeLending had $76.4 million and $84.5 million of loans included in loans held for sale (with an aggregate unpaid principal balance of $77.2 million and $85.2 million, respectively) that were 90 days past due and accruing interest at September 30, 2018 and December 31, 2017, 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 state and local markets.

The Company utilizes a risk grading matrix to assign a risk grade to each of the loans in its portfolio with the exception of broker-dealer margin loans. 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 Company. 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 Company 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 Company 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 Company's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Company 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 Company 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.

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

September 30, 2018	Pass	Special Mention	Substandard	PCI	Total
Commercial and industrial:					
Secured	$ 1,499,468	$ 7,289	$ 58,486	$ 5,528	$ 1,570,771
Unsecured	148,499	122	1,320	1,385	151,326
Real estate:					
Secured by commercial properties	2,399,783	—	57,950	21,070	2,478,803
Secured by residential properties	885,974	—	13,127	3,853	902,954
Construction and land development:					
Residential construction loans	241,640	—	—	—	241,640
Commercial construction loans and land development	806,594	—	3,468	707	810,769
Consumer	46,634	—	95		