

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

1. Reporting Entity and Nature of Operations

SWBC Investment Services, LLC (the Company) was organized in the state of Texas in August 2004, as a single member limited liability company, for the purpose of forming a registered broker dealer with membership in the Financial Industry Regulatory Authority (FINRA). The Company's single member is Southwest Business Corporation (SWBC or the Member). Effective May 16, 2005, the Company received approval to operate as a broker dealer with an exemption from the Securities and Exchange Commission (SEC) Rule 15c3-3 under Section k(2)(ii).

Effective January 17, 2007, the Company began clearing transactions for its customers on a fully disclosed basis as customers of National Financial Services, LLC (National Financial). National Financial is wholly owned by Fidelity Global Brokerage Group, Inc., a wholly owned subsidiary of FMR Corporation. The Company does not hold customer cash or securities in connection with these transactions. The Company's commission revenues are generated from investment services provided in various states.

Effective February 2, 2015, the Company began proprietary trading of fixed income securities, including U.S. municipal bonds and corporate debt securities.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP).

2. Summary of Significant Accounting Policies

Use of estimates in financial statement presentation

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 and 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.

Cash and cash equivalents

Cash and cash equivalents consists of interest-bearing and non-interest-bearing deposit accounts held at financial institutions.

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

2. Summary of Significant Accounting Policies (continued)

Deposit with clearing firm

Deposit with clearing firm consists of required cash balances for contractual escrow deposits in accordance with the clearing agreement at National Financial. As of December 31, 2015, restricted balance totaled \$500,000.

Trading securities

In 2015, the Company began proprietary trading of fixed income securities including U.S. municipal bonds and corporate debt securities. Securities owned are valued at estimated fair value as determined by listed market exchanges, with the resulting change in appreciation or depreciation included in trading income, net in the statement of operations. Securities sold, not yet purchased represent the Company's obligation to deliver the specified security at the contracted price and, thereby, creates a liability to purchase the security in the market at prevailing rates. The Company intends to hold fixed income securities for a short period of time, typically less than 30 days.

Commissions receivable

Commissions receivable primarily represents receivables from commission revenue earned by the Company. At December 31, 2015, no allowance for doubtful accounts was established, as it is management's opinion that losses, if incurred, would not materially affect the financial statements.

Trading income receivable

Trading income receivables primarily represents the interest earned on securities owned that has not been received. The related income is reflected in trading income.

Property and equipment, net

Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the asset. Repairs and maintenance expenses are charged against earnings as incurred and expenditures for renewals and betterments are capitalized.

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

2. Summary of Significant Accounting Policies (continued)

The Company reviews the carrying value of property and equipment for impairment whenever events or circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to the amount by which the carrying value exceeds the fair value of the asset. The factors considered by management in performing this assessment include current operating results, trends and prospects, the effects of obsolescence and other economic factors. Based on this assessment, there was no impairment for the year ended December 31, 2015.

Commissions and administrative fees payable

Commissions and administrative fees payable represents earned investment commissions payable to Company employees and fees payable related to contracts with customers to pay rent, telephone, copier and other office supply charges.

Revenue recognition

The Company receives securities and insurance commissions generated by its registered representatives. The Company derives commissions and trading income from customer transactions in fixed income securities. Commissions, trading income, and related transaction charges executed through National Financial are recorded on a trade-date basis. Revenues are recorded as the income is earned and the related services are performed.

Federal and state income taxes

There is no federal income tax provision included in these financial statements as the Company is a single member limited liability company. As such, the Company is a disregarded entity for federal tax purposes and SWBC is responsible for reporting all federal taxes due on net income of the Company. In accordance with the Company's tax sharing agreement with SWBC, during 2015, the Company was allocated \$57,055 for state taxes. The Company has a state tax payable of \$51,940 at December 31, 2015, reflected in accounts payable and accrued expenses.

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

2. Summary of Significant Accounting Policies (continued)

Recent accounting pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. The standard is part of a joint effort by the FASB and the International Accounting Standards Board to enhance financial reporting by creating common revenue recognition guidance for all preparers, literature for revenue recognition and will be effective for the Company on January 1, 2018. Entities are allowed to transition to the new standard by either retrospective application or recognizing the cumulative effect. The Company is currently evaluating the newly issued guidance, including which transition approach will be applied and the estimated impact it will have on its financial statements.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*. The standard provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. The standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued. An entity must provide certain disclosures if "conditions or events raise substantial doubt about the entity's ability to continue as a going concern." The ASU applies to all entities and is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. The Company does not believe the adoption of the standard will impact the financial statements.

3. Fair Value

The fair value of all of the Company's financial assets and financial liabilities approximates the carrying amounts of such instruments due to their short maturities.

The requirements of fair value measurements and disclosures apply to all financial instruments and all nonfinancial assets and nonfinancial liabilities that are being measured and reported on a fair value basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements and disclosures also establish a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

3. Fair Value (continued)

- Level 1 Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Inputs are observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

All corporate debt securities and U. S. municipal debt securities held by the Company are recorded at fair value. The fair values of corporate debt securities and municipal debt securities are determined using recently executed transactions or market price quotations for identical assets or liabilities. The following table summarizes the Company's fair value hierarchy:

	Level 1	Level 2	Level 3
Assets			
Securities owned:			
Corporate debt securities	\$ 282,867	\$ -	\$ -
U.S. municipal debt securities	21,113,766	-	-
	\$ 21,396,633	\$ -	\$ -
Liabilities			
Securities sold, not yet purchased	\$ 117,089	\$ -	\$ -

4. Trading securities

At December 31, 2015, securities owned totaled \$21,396,633 and consisted primarily of fixed income securities reported at fair value with changes in unrealized holding gains and losses included in trading income. Payable to clearing firm totaling \$13,598,455 at December 31, 2015 reflects the amount funded by the clearing firm for trading purposes. The Company incurred \$117,239 of interest expense related to the payable to clearing firm during 2015.

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

4. Trading securities (continued)

Trading income during 2015 was as follows:

Net gain on sales transactions	\$ 2,471,824
Interest income	638,890
Unrealized losses	(41,000)
Trading income, net	<u>\$ 3,069,714</u>

5. Property and Equipment

Property and equipment consist of the following:

	<u>Useful Life</u>	<u>2015</u>
Furniture, fixtures and equipment	3-10 years	\$ 262,167
Software	3- 6 years	46,725
Leasehold improvements	3- 7 years	<u>136,450</u>
		445,342
Less accumulated depreciation and amortization		<u>264,889</u>
		<u>\$ 180,453</u>

The Company recorded depreciation and amortization expense on property, equipment and software of \$44,420 for the year ended December 31, 2015.

6. Intangible Asset

The Company reviews the carrying value of purchased customer relationships for impairment annually and whenever events and circumstances indicate the carrying value of an asset may not be recoverable. The factors considered by management in performing this assessment include current operating results, loss of customer relationships, the effects of obsolescence, demand, competition, and other economic factors. Generally, the Company's intent and ability to renew a customer contract impacts anticipated cash flows and the underlying value of the intangible asset.

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

6. Intangible Asset (continued)

In 2015, the Company determined that the entire amount of \$303,875 recorded for customer relationships was impaired as the customer list no longer contained current customers. No other intangible asset exists as of December 31, 2015.

7. Related-Party Transactions

In accordance with the Company's cost sharing agreements with SWBC and its subsidiaries, during 2015, the Company reimbursed and was reimbursed for direct payroll costs, employee benefits and commission expenses. Additional reimbursed costs include direct operating expenses and allocated services, which are based on actual usage. These costs are reflected in the statement of operations in the appropriate expense line item. The Company uses intercompany payable and receivable accounts with SWBC and its subsidiaries to reflect this activity. No interest expense related to the intercompany accounts is recorded.

In 2015, \$9,670,116 was charged to the Company for these services and costs, and \$8,236,560 was paid to SWBC and its subsidiaries for these services and costs.

In October 2013, the Company entered into a \$10,000,000 Revolving Credit Facility Agreement (the Agreement) with SWBC to fund the trading and holding of inventory in certain securities. Interest is payable at *Wall Street Journal* prime plus 1%. The Agreement matured in October 2015 and was automatically renewed for one year under the same terms. During 2015, the Company made a draw of \$3,000,000 on the Agreement. Also, during 2015, the Company repaid \$1,000,000 of the draw. In August 2015, the outstanding balance of \$2,000,000 was approved as a contribution by the Member. At December 31, 2015, the Company had no borrowings outstanding under the Agreement. Interest expense of \$47,576 was incurred in 2015 related to the Agreement.

In addition to the contribution of the outstanding balance on the line of credit by the Member, the Member contributed \$1,500,000 in cash in March 2015, bringing the total Member contributions to \$3,500,000 during 2015.

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

8. Commitments, Contingencies and Credit Risks

The Company is party to claims and legal proceedings arising in the ordinary course of business. The Company believes it is unlikely the final outcome of the claim or any proceedings to which the Company is a party would have a material adverse effect on its financial statements.

The Company's customer accounts are carried by National Financial. All execution and clearing services are also performed by National Financial. The agreement between the Company and National Financial stipulates that all losses resulting from the Company's inability to fulfill its contractual obligations are the responsibility of the Company.

The Company maintains its cash in deposit accounts, which, at times, may exceed federally insured limits. Accounts are guaranteed by the Securities Investor Protection Corporation or the Federal Deposit Insurance Corporation up to a maximum of \$250,000. The Company has not experienced any losses in such accounts.

9. Fully Disclosed Clearing Agreement

The Company has an agreement to provide brokerage clearing services on a fully disclosed basis with National Financial entitled Fully Disclosed Clearing Agreement. At December 31, 2015, this agreement required a minimum net capital of \$500,000 and an escrow deposit of \$500,000. The escrow deposit is reflected as deposits with clearing firm in the statement of financial condition.

National Financial clears transactions for the Company's customers and carries the accounts of such customers on a fully disclosed basis. The Company does not hold customer cash or securities in connection with such transactions.

In 2015, the Company entered into an agreement with National Financial for the purpose of funding an aggregate net debit balance up to \$25 million at a rate of the prevailing Targeted Fed Funds rate plus 90 basis points.

10. Major Supplier Relationships

The Company markets the products of several registered investment companies, insurance companies and third-party providers. One insurance company accounted for approximately 22% of commissions revenue for the year ended December 31, 2015.

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

11. Employee Benefits

The Company participates in the Southwest Business Corporation 401(k) Profit Sharing Plan (the Plan). The Plan is a defined contribution plan covering employees of the Company when they begin employment. Participants may contribute up to 100% of their compensation, subject to Internal Revenue Service limitations, and may elect to invest in various investment options offered by the Plan.

The Company offers a discretionary matching program which matches 50% of participant contributions up to 6% of a participant's compensation for the year ended December 31, 2015. The Company may also make discretionary profit sharing contributions to the Plan. During 2015, the Company's expense related to the Plan totaled \$132,830, and is reported in salaries and benefits in the statement of operation.

The Company's employees participate in SWBC's medical and dental plans, which cover all full-time employees. SWBC is self-insured under these plans up to a maximum of \$250,000 per claim and maximum aggregate claims of \$15,367,802 for the year ended December 31, 2015. During 2015, the Company recorded \$221,696 of expense relating to these medical and dental plans in salaries and benefits in the statement of operations.

Certain employees of the Company participate in The Executive Nonqualified Excess Plan of Southwest Business Corporation (NQDC Plan) which provides the opportunity for eligible employees to defer compensation in excess of qualified retirement plan limits on a pre-tax basis and accumulate tax-deferred earnings. The NQDC Plan stipulates eligible compensation and deferral limits and qualifying distribution events, as well as special death benefits. The liability for the NQDC Plan, which is included in accrued compensation expenses, was \$1,510,845 at December 31, 2015.

12. Net Capital Requirements

The Company is subject to the United States Securities and Exchange Commission Uniform Net Capital Rule (SEC Rule 15c3-1). During 2014, the Company received approval for a change in business operations from FINRA. Accordingly, the Company's minimum net capital requirement was increased to the greater of \$100,000 or 1/15 of aggregate indebtedness, and requires that the ratio of aggregate indebtedness to net capital shall not exceed 15 to 1.

SWBC Investment Services, LLC

Notes to Financial Statements

December 31, 2015

12. Net Capital Requirements (continued)

Because the Company began proprietary trading of fixed income securities in 2015, the Company's minimum net capital requirement for National Financial was increased to \$250,000 in February 2015. In August 2015, the Company's minimum net capital requirement for National Financial was increased again from \$250,000 to \$500,000. At December 31, 2015, the Company had net capital of \$5,024,908, which was \$3,817,232 in excess of its required net capital of \$1,207,676. The Company's ratio of aggregate indebtedness to net capital was 3.61 to 1 at December 31, 2015.

13. Subsequent Events

The Company has evaluated subsequent events through the date the financial statements were available to be issued. The Company is not aware of any events occurring subsequent to December 31, 2015 that would have a material effect on its financial condition.