

SMBC NIKKO SECURITIES AMERICA, INC. AND SUBSIDIARY

(An Indirect Subsidiary of Sumitomo Mitsui Banking Corporation)

Notes to Consolidated Statement of Financial Condition

December 31, 2018

(1) Organization

SMBC Nikko Securities America, Inc. (the Company) is registered as a broker dealer under the Securities Exchange Act of 1934, is a member of the Financial Industry Regulatory Authority (FINRA), and is also registered with the Municipal Securities Rulemaking Board. The Company was incorporated on August 8, 1990 and commenced operations in December 1991. The Company is exempt from the Securities and Exchange Commission (SEC) Rule 15c3-3 pursuant to provisions (k)(2)(i) and (k)(2)(ii) of such rule.

The Company provides underwriting services of debt and equity securities and provides services to assist in the sale of securities underwritten by other entities. The Company enters into repurchase and reverse repurchase agreements, engages in trading of U.S. government securities, corporate debt securities, and asset-backed securities. The Company also provides buy-back services to corporate clients for the purchase of clients' own stocks, and acts as selling agent by selling Japanese Domestic Equity Offerings to clients. The Company also acts as an originator, placement, and facility agent in connection with the origination and servicing of asset-backed, secured lending, and asset purchase transactions on behalf of an affiliate. The Company's business lines also include brokerage services for certain debt and equity products, distribution of globally branded research reports, and merger and acquisition advisory services. The primary targets for these services are corporate issuers, and sophisticated institutional investors such as asset management companies, investment trusts, hedge funds, and trust banks.

The Company is an indirect majority-owned subsidiary of Sumitomo Mitsui Banking Corporation (SMBC) which is ultimately wholly owned by Sumitomo Mitsui Financial Group (SMFG), a Japanese corporation. SMBC Americas Holdings, Inc. (formerly SMBC Financial Services, Inc.), a wholly owned U.S. subsidiary of SMBC, owns 80% of each of the outstanding Class A, Class B and Class C common stock, and SMBC Nikko Securities, Inc. (SMBC-Nikko) owns 20% of each of the outstanding Class A, Class B and Class C common stock. Refer to Note 8, Stock Rights and Privileges.

On June 1, 2018, SMBC Nikko Securities Canada, Ltd. (Nikko Canada) was incorporated in British Columbia, Canada as a wholly-owned subsidiary of the Company. Nikko Canada is established to underwrite and privately place Canadian debt and equity securities on an economics only basis from referrals it will receive from SMBC Canada Branch. Similar to the Company, Nikko Canada will not receive or maintain any customer funds or securities. As of December 31, 2018, Nikko Canada was seeking approval for membership with regulatory bodies: Investment Industry Regulatory Organization of Canada (IIROC) as an Investment Dealer, Ontario Securities Commission, and FINRA. Membership with FINRA is a condition for Nikko Canada to be a registered broker dealer with the SEC.

(2) Significant Accounting Policies

(a) *Basis of Presentation and Use of Estimates*

The Company's consolidated statement of financial condition has been prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP). The preparation of the consolidated statement of financial condition requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the consolidated statement of financial condition. Management believes that the estimates utilized in preparing its consolidated statement of financial condition is reasonable. Such estimates are subject to change in the future as additional information becomes available or previously existing circumstances are modified. Actual results could differ from those estimates. Items subject to such estimates and assumptions include the valuation of securities and realization of deferred tax assets.

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The consolidated statement of financial condition includes the Company and its wholly owned subsidiary, Nikko Canada in which the Company has a controlling financial interest. All material intercompany balances and transactions have been eliminated.

A controlling financial interest may also be achieved through arrangements that do not involve voting interests which are generally obtained through stock ownership. Therefore, the Company evaluates entities for consolidation under the “variable interest entity (VIE) model” in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810, Consolidation. A VIE is an entity that has either a total equity investment that is insufficient to finance its activities without additional subordinated financial support or whose equity investors lack the ability to control the entity’s activities or lack the ability to receive expected benefits or absorb obligations in a manner that’s consistent with their investment in the entity. A VIE is consolidated by its primary beneficiary, the party that has both the power to direct the activities that most significantly impact the VIE’s economic performance and a variable interest (obligation to absorb losses from or the right to receive benefits of the VIE) that could potentially be significant to the VIE. A variable interest is a contractual, ownership or other interest that changes with changes in the fair value of the VIE’s net assets. To determine whether or not a variable interest the Company holds could potentially be significant to the VIE, the Company considers both qualitative and quantitative factors regarding the nature, size and form of our involvement with the VIE. The Company had no variable interests in a variable interest entity that required consolidation at December 31, 2018.

(b) Recently Issued Accounting Standards

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU No. 2016-01 amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments. In February 2018, the FASB issued ASU No. 2018-03, *Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10)*, to clarify certain provisions in ASU No. 2016-01. Specifically, the amendments in ASU No. 2016-01 affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The ASUs also require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The ASUs also provide an instrument-by-instrument election to measure equity investments without readily determinable fair values using a measurement alternative. Under the measurement alternative, the investment is carried at cost less impairment plus or minus changes resulting from observable prices in orderly transactions for the identical or a similar investment of the same issuer. ASU No. 2016-01 is effective for public business entities for annual periods beginning after December 15, 2017. Therefore, the Company adopted this guidance on January 1, 2018. The adoption of ASU No. 2016-01 did not have any impact on the consolidated statement of financial condition of the Company.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. Topic 842 was subsequently amended by ASU No. 2018-01, *Land Easement Practical Expedient for Transition to Topic 842*; ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*; ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements* and ASU No. 2018-20, *Leases (Topic 842)- Narrow-*

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Scope Improvements for Lessors. ASU No. 2016-02 requires that, at lease inception for all leases, a lessee recognize in the consolidated statement of financial condition a right-of-use asset, for the right to use the underlying asset over the lease term, and a lease liability, for the liability to make lease payments for all leases with a term longer than 12 months. The classification criteria for distinguishing between finance leases and operating leases are substantially similar to the classification criteria for distinguishing between capital leases and operating leases in the previous leases guidance. In addition, ASU No. 2016-02 requires expanded disclosures about the nature and terms of lease agreements and is effective for public business entities for annual reporting periods beginning after December 15, 2018. Therefore, the Company adopted this guidance on January 1, 2019. A modified retrospective transition approach is required, which requires application of the new standard to all leases existing at the date of initial application (which the Company chose as the adoption date, January 1, 2019). The new standard provides a number of optional practical expedients in transition. The Company elected the package of practical expedients, which permits the Company not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. The Company did not elect to adopt the use-of-hindsight or the practical expedient pertaining to land easements; the latter not being applicable to the Company. The adoption of Topic 842 resulted in both right-of-use assets and lease liabilities of \$34,710,653 based on the present value of the remaining minimum rental payments (which does not include executory costs) under current leasing standards for existing operating leases.

In June 2016, FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Assets*, which is to replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to develop credit loss estimates. Specifically, the amendments in this ASU would eliminate the probable initial recognition threshold in current U.S. GAAP and, instead, reflect an entity's current estimate of all expected credit losses. The amendments in this ASU also retained many of the disclosure amendments in ASU No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, updated to reflect the change from an incurred loss methodology to an expected credit loss methodology. ASU No. 2016-13 is effective for entities that are public business entities for annual periods beginning after December 15, 2019. Therefore, the ASU will be effective for the Company on January 1, 2020. The Company is further evaluating the effect of this new guidance on its consolidated statement of financial condition.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820) – Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, that eliminates, adds and modifies certain disclosure requirements for fair value measurements as part of its disclosure framework project. The guidance is effective for all entities for fiscal years beginning after December 15, 2019, but entities are permitted to early adopt either the entire ASU No. 2018-13 or only the provisions that eliminate or modify the fair value requirements. Therefore, the ASU will be effective for the Company on January 1, 2020. The Company is evaluating the effect that ASU 2018-13 will have on its consolidated statement of financial condition.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles – Goodwill and Other – Internal Use Software (Sub Topic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*, which generally aligns the guidance on recognizing implementation costs incurred in a cloud computing arrangement that is a service contract with the guidance for implementation costs incurred to develop or obtain internal-use software, including hosting arrangements that include an internal-use software license. Accordingly,

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the amendments require an entity (customer) in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The amendments also require the entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement, which includes reasonably certain renewals. The amendments in ASU 2018-15 are effective for public business entities for fiscal years beginning after December 15, 2019. For all other entities, the amendments in ASU 2018-15 are effective for annual reporting periods beginning after December 15, 2020. Early adoption of the amendments in ASU 2018-15 is permitted for all entities. The amendments in ASU 2018-15 should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. Therefore, the ASU will be effective for the Company on January 1, 2020. The Company is evaluating the effect that ASU No. 2018-15 will have on its consolidated statement of financial condition.

(c) Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of demand deposits held in banks which amounted to \$172,573,660 as of December 31, 2018.

Restricted cash are cash that is considered legally restricted as to withdrawal or usage. The Company identified restricted cash stated in other line items in the balance sheet.

(d) Securities Transactions

Securities transactions are recorded on a trade-date basis. Securities owned are carried at fair value. At December 31, 2018, securities owned consist primarily of U.S. treasury securities, corporate debt securities, and asset-backed securities, of which \$24,965,072 is pledged to a clearing organization as collateral.

(e) Securities Sold, Not Yet Purchased

The Company has sold securities that it does not own (i.e. securities sold short) and is therefore, obligated to purchase such securities at a future date. The Company has recorded this obligation on the consolidated statement of financial condition at the fair value of the securities sold short.

(f) Repurchase Agreements

A reverse repurchase agreement (also known as a reverse repo) refers to a transaction that is accounted for as a collateralized lending in which the Company buys securities with an agreement to resell them to the counterparty at a stated price plus interest at a specified date or in specified circumstances. The receivable under a reverse repurchase agreement refers to the amount due from the counterparty for the repurchase of the securities from the Company.

A repurchase agreement (repo) refers to a transaction that is accounted for as a collateralized borrowing in which the Company sells those securities to a counterparty with an agreement to repurchase them at a stated price plus interest at a specified date or in specified circumstances. The payable under a repurchase agreement refers to the amount of the Company's obligation recognized for the future repurchase of the securities from the counterparty. Repurchase and resale agreements are presented on a net basis on the consolidated statement of financial condition where permitted by ASC 210-20, *Balance Sheet-Offsetting*.

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The Company's policy is generally to take possession of securities purchased under agreements to resell, and to receive securities and cash posted as collateral (with rights of re-hypothecation). The market value of collateral accepted or pledged by the Company under reverse repurchase agreements and repurchase agreements before offsetting was \$11,204,601,854 and \$11,035,348,426, respectively at December 31, 2018. Substantially all of the collateral accepted under reverse repurchase agreements has been resold as collateral under repurchase agreements. Collateral received from counterparties are U.S. treasury securities and corporate debt securities, and valued daily, and should the market value of the securities received decline below the principal amount loaned plus accrued interest, additional collateral is requested when appropriate.

(g) *Fair Value Measurement*

The Company follows ASC 820, *Fair Value Measurement*, which defines fair value, establishes a framework for measuring fair value, and expands disclosure requirements. ASC 820, among other things, requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date.

ASC 820 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. In accordance with ASC 820, when considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

Level 1 - Valuation based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

Level 2 - Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 - Valuations based on inputs that are unobservable and supported by little or no market activity, and significant to the overall fair value measurement.

The inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement falls in its entirety is determined based on the lowest level of input that is significant to the fair value measurement in its entirety.

This hierarchy requires the use of observable market data when available. ASC 820 requires disclosure of fair value information for assets and liabilities that are measured at fair value on a recurring or nonrecurring basis on the consolidated statement of financial condition after initial recognition, including the valuation techniques and inputs used to develop those measurements. In determining fair value, the Company uses the market approach. Based on this approach, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk.

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The following are the types of valuation methodologies for the Company's material categories of financial assets and financial liabilities that are fair valued on the consolidated statement of financial condition:

U.S. treasury securities U.S. treasury securities are valued using quoted market prices and are generally classified as Level 1 in the fair value hierarchy.

Corporate debt securities Corporate debt securities are valued based on either the most recent observable trade and or external quotes, depending on availability. Corporate debt securities are generally classified as Level 2 in the fair value hierarchy because these valuation inputs are usually observable or market corroborated when obtained from alternative pricing sources.

Asset-backed securities Asset-backed securities are primarily based on actively traded markets where prices are based on either direct market quotes or observed transactions. As such, asset backed securities are categorized as Level 2. Most of the asset-backed-securities in inventory are collateralized auto loans and credit card loans.

As of December 31, 2018, the Company has no assets or liabilities measured at fair value on a recurring basis that it classifies as Level 3.

Repo and reverse repos are not carried at fair value on the consolidated statement of financial condition, but are carried at amounts which approximate fair value due to their short-term nature and negligible credit risk. The Company reports reverse repo and repo agreements at contract prices, plus accrued interest, which are considered level 2 financial instruments.

(h) Furniture, Equipment, and Leasehold Improvements

Furniture, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation on furniture and equipment is provided on a straight line basis over the assets' estimated useful lives of five years. Amortization on leasehold improvements is provided on a straight line basis over the lesser of the terms of the related leases or useful lives of the improvements.

(i) Foreign Currency

Assets and liabilities denominated in non-U.S. dollar currencies are remeasured into U.S. dollar equivalents using year-end adjusted spot foreign currency rates. The effects of foreign currency translations of the financial statements of the Company's consolidated subsidiary where the functional currency is other than U.S. dollar are included in stockholders' equity.

(j) Compensation and Benefits

The Company pays discretionary cash bonuses to its employees. Starting in 2012, certain cash bonuses are deferred over a service period of three years. An employee with a deferred bonus earns a portion of the cash bonus in each of the three years if they continue employment at the Company. All deferred cash bonuses have clawback provisions. None of the clawback provisions has been triggered for the year ended December 31, 2018. The deferred compensation liability amounts to \$2,223,392 as of December 31, 2018.

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The Company accounts for all income taxes in accordance with the asset-and-liability method of accounting required under ASC 740, *Income Taxes*. Under this method, deferred income taxes are recognized for future tax consequences attributable to differences between the consolidated statement of financial condition carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to be recovered or settled.

It is the Company's policy that, pursuant to ASC 740, any state or local tax computed based on capital is considered a franchise tax.

(3) Fair Value of Financial Instruments

The following are types of financial instruments the Company held as of December 31, 2018:

	Fair Value Hierarchy			
	Level 1	Level 2	Level 3	Total
Assets:				
Securities owned				
U.S. treasury securities	\$ 26,553,223	\$ —	\$ —	\$ 26,553,223
Money-market securities	—	12,000,000	—	12,000,000
Corporate debt securities	—	500,956,734	—	500,956,734
Asset backed securities	—	149,382,793	—	149,382,793
Other	179,211	—	—	179,211
Total securities owned	\$ 26,732,434	\$ 662,339,527	\$ —	\$ 689,071,961
Liabilities:				
Securities sold, not yet purchased				
U.S. treasury securities	\$ 152,867,564	\$ —	\$ —	\$ 152,867,564
Corporate debt securities	—	199,149,027	—	199,149,027
Total securites sold, not yet purchased	\$ 152,867,564	\$ 199,149,027	\$ —	\$ 352,016,591

Other consists of equity shares issued by DTCC to the Company, which amounts to \$179,211.

(4) Receivable from and Payable to Brokers, Dealers, and Clearing Organizations

Amounts receivable from and payable to brokers, dealers, and clearing organizations at December 31, 2018 consist of the following:

	Receivable	Payable
Brokers and clearing organizations	\$ 124,561,377	\$ 10,991,039
Fails	14,721,741	9,860,739
Trades pending settlement, net	6,829,152	—
Total	<u>\$ 146,112,270</u>	<u>\$ 20,851,778</u>

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The Company clears its customer transactions through another broker-dealer on a fully disclosed basis under (k)(2)(ii). The amount receivable from broker, dealers and clearing organizations relates to the aforementioned transactions.

Net receivable for trades pending settlement represents the contract price of securities to be delivered net by the contract price of securities to be received by the Company. The value of such securities at December 31, 2018 approximates the amounts owed. Trades pending settlement at December 31, 2018 were settled without a material effect on the Company's consolidated statement of financial condition.

At December 31, 2018, cash included in receivable from brokers, dealers, and clearing organizations amounting to \$14,500,000 is pledged to a clearing organization as collateral to meet depository requirements which varies depending on daily activity. As of December 31, 2018, the minimum cash requirement amounts to \$2,487,154, which is accounted for as restricted cash.

(5) Collateralized Transactions

The Company enters into reverse repurchase agreements and repurchase agreements to accommodate customers' needs and invest the Company's capital. The Company manages credit exposure arising from such transactions by, in appropriate circumstances, entering into master repurchase agreements with counterparties that provide the Company, in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), the right to net a counterparty's rights and obligations under such agreement and liquidate and setoff collateral against the net amount owed by the counterparty.

The following tables present information about the offsetting of these instruments and related collateral amounts.

	<u>Gross amounts</u>	<u>Amounts offset in the consolidated statement of financial condition (i)</u>	<u>Net amounts presented in the consolidated statement of financial condition</u>	<u>Noncash collateral not offset in the consolidated statement of financial condition (ii)</u>	<u>Net Amount</u>
Assets:					
Securities purchased under agreements to resell					
U.S. treasuries	\$ 10,934,498,749	\$ (6,951,284,429)	\$ 3,983,214,320	\$ (3,982,320,558)	\$ 893,762
Corporate bonds	157,366,374	—	157,366,374	(156,842,393)	523,981
Total	<u>\$ 11,091,865,123</u>	<u>\$ (6,951,284,429)</u>	<u>\$ 4,140,580,694</u>	<u>\$ (4,139,162,951)</u>	<u>\$ 1,417,743</u>
Liabilities:					
Securities sold under agreements to repurchase					
U.S. treasuries	\$ 10,756,532,704	\$ (6,951,284,429)	\$ 3,805,248,275	\$ (3,805,248,275)	\$ —
Corporate bonds	144,030,597	—	144,030,597	(144,030,597)	—
Total	<u>\$ 10,900,563,301</u>	<u>\$ (6,951,284,429)</u>	<u>\$ 3,949,278,872</u>	<u>\$ (3,949,278,872)</u>	<u>\$ —</u>

(i) Amounts offset in the consolidated statement of financial condition related to master netting agreements and similar agreements which have been determined by the Company to be legally enforceable in the event of default and where certain other criteria are met in accordance with ASC 210-20.

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(ii) Amounts relating to agreements where the Company does not have a legal right of offset as certain criteria are not met in accordance with ASC 210-20. There are limits in the disclosure regarding the inclusion of excess collateral amounts. The amount of collateral pledged is limited to the net amount of securities sold under agreement to repurchase presented on the consolidated statement of financial condition, and excludes overcollateralization.

The Company offsets its securities purchased under agreements to resell and securities sold under agreements to repurchase, in accordance with ASC 210-20.

The table below represents payables under repurchase agreements by remaining contractual term to maturity and class of collateral pledged as of December 31, 2018.

Class of Collateral Pledged	Remaining Contractual Maturity			
	Open	Up to 30 days	31-90 days	Total
Securities sold under agreements to repurchase				
U.S. treasuries	\$ 198,466,372	\$ 5,870,977,887	\$ 4,687,088,445	\$ 10,756,532,704
Corporate bonds	—	144,030,597	—	144,030,597
Total	<u>\$ 198,466,372</u>	<u>\$ 6,015,008,484</u>	<u>\$ 4,687,088,445</u>	<u>\$ 10,900,563,301</u>

The Company is required to post collateral with a market value equal to or in excess of the principal amount borrowed under repurchase agreements. To ensure that the market value of the underlying collateral remains sufficient, collateral is valued daily and the Company may be required to deposit additional collateral or may receive or return collateral pledged, when appropriate. Repurchase agreements are generally short term. The Company manages liquidity risks related to these agreements by sourcing funding from a diverse group of counterparties, providing a range of securities collateral. As of December 31, 2018, the Company had no repurchase-to-maturity transactions.

(6) Related-Party Transactions

In the normal course of business the Company engages in transactions with SMFG, SMBC and affiliated companies including SMBC-Nikko, SMBC, SMBC New York Branch (SMBC-NY), SMBC Cayman Branch (SMBC-CIB), SMBC Capital Markets, Inc. (SMBC-CM), Manhattan Asset Funding Company LLC (MAF), Nikko Systems Solutions (NKSOL), SMBC Nikko Securities Hong Kong, Ltd. (Nikko-HK), and SMBC Nikko Capital Markets Limited (SMBC-LTD). The nature of these relationships and a description of the transactions are disclosed below and throughout the notes.

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The related-party transactions include but are not limited to collateralized transactions, loans, trade execution, underwriting referral services, and advisory services. The following amounts related to transactions with SMBC and affiliated companies are included in the accompanying consolidated statement of financial condition as of December 31, 2018:

Consolidated Statement of Financial Condition:

Assets:

Securities purchased under agreements to resell	\$ 8,071,376,716
Other assets	3,727,514
Total	<u>8,075,104,230</u>

Liabilities:

Securities sold under repurchase agreements	20,229,968
Subordinated debt	225,000,000
Total	<u>\$ 245,229,968</u>

The Company enters into reverse repurchase and repurchase transactions with SMBC-Nikko, SMBC-CM and SMBC-LTD as part of ordinary course of business. Total repurchase transaction balances as of December 31, 2018 with SMBC-Nikko and SMBC-CM, on a gross basis before netting, are as follows:

	SMBC-CM	SMBC-Nikko	Total
Securities purchased under agreements to resell	\$ 80,761,357	\$ 7,990,615,359	\$ 8,071,376,716
Securities sold under repurchase agreements	—	20,229,968	20,229,968

The Company has pledged cash collateral to SMBC-NY to secure any unsecured extensions of credit pursuant to Section 23A and 23B of the Federal Reserve Act. At December 31, 2018, such amount was \$3,727,514, which is accounted as restricted cash.

The Company has a \$225,000,000 subordinated loan agreement with SMBC-CIB which is approved regulatory capital by the FINRA, replacing \$25,000,000 subordinated debt upon repayment on November 9, 2018. Refer to Note 7 Subordinated Borrowing and Other Financing.

The Company has variable interests as defined by FASB ASC 810-10 in an affiliated variable interest entity (VIE) in the form of fees earned for providing facilitation and origination services to that entity. The Company has no assets or liabilities reported in its consolidated statement of financial condition as of December 31, 2018 that relate to the Company's variable interest in that VIE, and has no exposure to its losses. The Company is not the primary beneficiary of the VIE as defined by FASB ASC 810-10 as it does not have the power to direct the activities that most significantly impact the VIE's financial performance and has no obligations to absorb the VIE's losses. Such power and obligations are the responsibility of a related party. As such, the Company does not consolidate the accounts of the VIE in the consolidated statement of financial condition.

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(7) Subordinated Borrowing and Other Financing

The Company had a \$25,000,000 subordinated loan agreement with SMBC-CIB which was paid off on November 9, 2018. Upon repayment of \$25,000,000, a new subordinated loan of \$225,000,000 with SMBC-CIB was drawn. The loan has a scheduled maturity date of November 9, 2021 with an automatic extension of the scheduled maturity date by an additional year unless SMBC-CIB notifies the Company before the day thirteen months preceding the current scheduled maturity date in writing that such maturity date shall not be extended. The loan bears interest at three-month LIBOR plus 60 basis points. The subordinated loan has been approved as regulatory capital by the FINRA and constitutes part of the Company's net capital under the SEC Uniform Net Capital Rule 15c3-1 (Rule 15c3-1), and may be repaid only if, after giving effect to such repayment, the Company meets the specified requirements of the SEC.

The Company has a committed and revolving line of credit with SMBC-CIB for \$200 million with a credit period maturity date of July 31, 2019. Any borrowing will bear a market interest rate agreed upon by the Company and SMBC-CIB at the time of the advance. No amounts were outstanding under this facility as of December 31, 2018. The Company is obligated to pay a commitment fee on any unused amount of the revolving facility. The commitment fee payable was \$68,889 as of December 31, 2018.

On June 28, 2018, the Company renewed its uncommitted and revolving multicurrency credit line agreements with SMBC-CIB for \$1 billion and \$7 billion which are subject to at a market interest rate to be determined by SMBC-CIB. As of December 31, 2018, there were no outstanding loan under the \$1 billion and the \$7 billion credit facility lines. These uncommitted facilities were put in place to ensure that the Company has adequate funds to meet its short-term liquidity needs. The last draw down date on these facilities is June 28, 2019.

(8) Stock Rights and Privileges

Class A common stock, Class B common stock, and Class C common stock are identical in all respects and have equal rights and privileges, except as described in (c) below.

- (a) Dividend rights on all classes of common stock may be declared and paid only to the extent of the assets of the Company legally available for the payment of dividends. The declaration and payment of dividends on all classes of common stock is at the sole discretion of the Board of Directors of the Company.
- (b) Class dividends may be declared by the Board of Directors, in its sole discretion, payable exclusively to the holders of any of the respective classes of common stock, or to the holders of any or all such classes in equal or unequal amounts, notwithstanding the respective amounts available for dividends to each class, the respective voting and liquidation rights of each class, the amount of prior dividends declared on each class, or any other factor.
- (c) The voting rights of each share of the Company's Class A common stock entitles the holder to one hundred (100) votes on any matter on which stockholders of the Company are entitled to vote. Each share of the Company's Class B common stock entitles the holder to 0.5025126 votes on any matter on which stockholders of the Company are entitled to vote. Lastly, each share of the Company's Class C common stock entitles the holder to one (1) vote on any matter on which stockholders of the Company are entitled to vote.

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(9) Commitments and Contingencies

The Company occupies office space under long-term non-cancelable sublease agreements with SMBC, which expires on various dates through 2037. The rent payable by the Company under the sublease will be equal to its allocable share of the annual rent payable by SMBC under its prime lease. In 2018, the Company's sublease agreement with SMBC was amended after SMBC renewed certain lease agreements and entered into new lease agreements, which the Company reflected in its proportionate share on future lease payments over the lease term.

Future minimum rentals under the sublease are estimated as follows:

Remaining years	Minimum Future Lease Payments
2019	3,461,583
2020	3,335,031
2021	2,551,754
2022	2,464,520
2023	2,464,520
Thereafter	32,359,638
	<u>\$ 46,637,046</u>

In the normal course of business, the Company enters into resale and repurchase agreements that settle at a future date. They are secured by U.S. treasury securities and corporate debt securities. These agreements do not meet the definition of a derivative, and therefore, are not recorded on the consolidated statement of financial condition until settlement date. At December 31, 2018, the Company had forward-starting collateralized agreements with start dates ranging from January 2, 2019 to January 7, 2019. The contract values of these transactions total \$97,449,879 for repurchase agreements and \$675,476,319 for reverse repurchase agreements.

In the normal course of business, the Company enters into underwriting commitments. There were no open transactions relating to such underwriting commitments at December 31, 2018.

As a member of the Government Securities Division of the Fixed Income Clearing Corporation (FICC), the Company participates in the Capped Contingency Liquidity Facility (CCLF). CCLF is a commitment by FICC's solvent firms to enter into a repurchase agreement with FICC in the event a member firm fails, the funding to offset FICC's portfolio would be sourced across FICC's solvent members. As of December 31, 2018, the Company's commitment to the CCLF was \$30,828,279 of which no utilization had occurred. This amount is calculated by FICC based on membership size and volumes, and is subject to fluctuation.

The Company is involved in litigation arising in the normal course of business from time to time. It is management's opinion that there are no matters pending, which are probable of having a material adverse effect on the financial condition of the Company.

(10) Financial Instruments with Off-Balance-Sheet Risk and Concentration of Credit Risk

In the normal course of business, the Company executes, settles, and finances securities transactions. These activities expose the Company to off-balance-sheet risk arising from the possibility that the counterparty may fail to satisfy its obligations. In these situations, the Company may be required to purchase or sell financial instruments at unfavorable market prices to satisfy obligations to counterparties.

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The Company provides trading, financing, and related services to a diverse group of domestic counterparties, including corporations and institutional investors. In connection with these activities, the Company enters into collateralized reverse repurchase and repurchase agreements that may result in significant credit exposure in the event the counterparty to the transaction is unable to fulfill its contractual obligations. The Company minimizes credit risk associated with these activities by monitoring customer credit exposure and collateral values on a daily basis, and by requiring additional collateral to be deposited with or returned to the Company when deemed necessary.

(11) Net Capital Requirements

The Company, as a registered broker dealer in securities, is subject to the net capital requirements of SEC Rule 15c3-1. Effective January 1, 2000, the Company elected the alternative method for calculating net capital. This requires the Company to maintain minimum net capital of \$250,000. As of December 31, 2018, the Company's net capital was \$651,083,802 which exceeded the required minimum by \$650,833,802.

(12) Income Taxes

The Company accounts for income taxes in accordance with ASC 740. The Company's deferred income tax assets as of December 31, 2018 relate to tax basis differences on employee bonus accrual and depreciation. The Company evaluates its uncertain tax positions and the related tax reserves in accordance with the framework set out under ASC 740. ASC 740 prescribes a recognition threshold and a measurement attribute for the consolidated statement of financial condition recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the amount of benefit that represents a greater than 50% likelihood of being realized upon ultimate settlement. As of December 31, 2018, the Company has no unrecognized tax benefits and has accrued no interest or penalties with respect to any tax positions taken.

Effective January 1, 2018, the Company, a subsidiary of SMBC Americas Holdings, Inc. (AH), entered into a tax sharing agreement (TSA) with AH and AH's other subsidiaries that are in the same U.S. consolidated group. The TSA mandates that the individual members of the TSA calculate their stand-alone tax liabilities and pay such amount to AH. Entities that generate losses which reduce the consolidated tax liabilities receive payments equals to the tax benefits that are generated by such losses.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company's net deferred tax assets as of December 31, 2018 are as follows:

Employee bonus accrual	\$ 7,714,688
Depreciation	(2,344,226)
Deferred tax assets, net	<u>\$ 5,370,462</u>

Although realization is not assured for the above net deferred tax assets, management believes it is more likely than not that they will be realized through future taxable earnings and, accordingly, has not recorded a valuation allowance as of December 31, 2018.

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ASC 740, *Income Taxes*, requires the effect of the changes in tax rates and laws on deferred tax balances to be recognized in the period in which the legislation is enacted. Therefore, the Company remeasured the existing deferred tax assets and liabilities in the period of enactment.

All years subsequent to and including 2012 for U.S. Federal, state and local tax audits remain open to examination by the taxing authorities. The Company is not currently undergoing any such audits.

(13) Employee Benefit Plans

The Company participates in a defined benefit noncontributory retirement plan (Sumitomo Mitsui Banking Corporation Retirement Plan) and a defined contribution plan (Sumitomo Mitsui Banking Corporation 401(k) Plan) sponsored by its Parent, SMBC. The plans cover all eligible local employees. The retirement plan costs are allocated to the Company based on actuarial computations. No separate determination has been made of the actuarial present value of accumulated benefits and the retirement plan's assets as they relate to the employees of the Company. Participants in the 401(k) plan may contribute amounts up to 50% of their eligible compensation, subject to certain limitations. The Company will match 401(k) contributions in an amount equal to the lesser of 100% of the first 3% contributed by the participant or 3% of total eligible compensation. Company's matching contributions gradually vest over the first five years of service.

(14) Subsequent Events

The Company has performed an evaluation of events that have occurred subsequent to December 31, 2018, and through February 25, 2019. There have been no material subsequent events that occurred during such period that would require disclosure in this report or would be required to be recognized.