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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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<b>Annual Audited Report Form X-17A-5 Part III</b>	Information Required of Brokers and Dealers Pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17a-5 Thereunder	<u>Sec File No.</u>  <u>8 - 44243</u>
REPORT FOR THE PERIOD BEGINNING	<u>01/01/08</u> AND ENDING	<u>12/31/08</u>
	MM/DD/YY	MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER: Waterstone Financial Group, Inc. Official Use Only

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

500 Park Boulevard, Suite 800  
(No. and Street)  
Itasca IL 60143  
(City) (State) (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Stephen S. Dudas 630-250-7000  
(Area Code - Telephone No.)

**B. ACCOUNTANT IDENTIFICATION**

INDEPENDENT PUBLIC ACCOUNTANT (Whose opinion is contained in this Report\*)

Deloitte & Touche LLP  
(Name -- if individual, state last, first, middle name)  
111 S. Wacker Drive Chicago IL 60606  
(Address) City State Zip Code

CHECK ONE:  
 Certified Public Accountant  
 Public Accountant  
 Accountant not resident in United States or any of its possessions.

FOR OFFICIAL USE ONLY

\* Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

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**OATH OR AFFIRMATION**

I, Stephen S. Dudas, CFO, affirm that, to the best of my knowledge and belief, the accompanying financial statements and supplemental schedules pertaining to Waterstone Financial Group (the "Company") as of and for the year ended December 31, 2008 are true and correct. I further affirm that neither the Company nor any member, officer, or director has any proprietary interest in any account classified solely as that of a customer.



Allison Kudelka  
Notary Public

Stephen S. Dudas  
Signature

CFO  
Title

This report contains (check all applicable boxes):

- (x) Independent Auditors' Report.
- (x) (a) Facing Page.
- (x) (b) Statement of Financial Condition.
- (x) (c) Statement of Income.
- (x) (d) Statement of Cash Flows.
- (x) (e) Statement of Changes in Stockholder's Equity.
- ( ) (f) Statement of Changes in Liabilities Subordinated to the Claims of General Creditors. (Not Applicable)
- (x) Notes to Financial Statements.
- (x) (g) Schedule I: Computation of Net Capital for Brokers and Dealers Pursuant to Rule 15c3-1 under the Securities Exchange Act of 1934.
- (x) (h) Schedule II: Computation for Determination of Reserve Requirements for Brokers and Dealers Pursuant to Rule 15c3-3 under the Securities Exchange Act of 1934.
- (x) (i) Schedule III: Information Relating to the Possession or Control Requirements for Brokers and Dealers Pursuant to Rule 15c3-3 under the Securities Exchange Act of 1934.
- ( ) (j) A Reconciliation, Including Appropriate Explanations, of the Computation of Net Capital under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements under Rule 15c3-3. (Not Applicable)
- ( ) (k) A Reconciliation between the Audited and Unaudited Statements of Financial Condition with Respect to Methods of Consolidation. (Not Applicable)
- (x) (l) An Oath or Affirmation.
- ( ) (m) A Copy of the SIPC Supplemental Report. (Not Required)
- (x) (n) A Report describing any material inadequacies found to exist or found to have existed since the date of the previous audit. (Supplemental Report on Internal Control)
- ( ) (o) Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges Pursuant to Section 4d(2) under the Commodity Exchange Act. (Not Applicable)

# Waterstone Financial Group, Inc.

(SEC I.D. No. 8-44243)

Statement of Financial Condition as of December 31, 2008, and  
Independent Auditors' Report and Supplemental Report on Internal  
Control

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of  
Waterstone Financial Group, Inc.  
Itasca, Illinois

We have audited the accompanying statement of financial condition of Waterstone Financial Group, Inc. (the "Company") (an indirect wholly owned subsidiary of LPL Investment Holdings Inc.) as of December 31, 2008 that you are filing pursuant to Rule 17a-5 under the Securities Exchange Act of 1934. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such statement of financial condition presents fairly, in all material respects, the financial position of Waterstone Financial Group, Inc. at December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

February 25, 2009

**WATERSTONE FINANCIAL GROUP, INC.**  
**STATEMENT OF FINANCIAL CONDITION**  
**AS OF DECEMBER 31, 2008**  
(Dollars in thousands)

**ASSETS**

Cash and cash equivalents	\$	4,951
Receivables from:		
Product sponsors and clearing broker-dealers		2,559
Others		1,035
Fixed assets, net of accumulated depreciation and amortization of \$152		315
Goodwill		2,426
Intangible assets, net of accumulated amortization of \$749		9,051
Trademark and trade name, net of accumulated amortization of \$153		147
Due from affiliates—net		227
Prepaid expenses		194
Other assets		439
Total assets	\$	<u>21,344</u>

**LIABILITIES AND STOCKHOLDER'S EQUITY**

**LIABILITIES:**

Accrued commissions and advisory fees payable		2,701
Accounts payable and accrued liabilities		1,675
Unearned revenue		28
Total liabilities		<u>4,404</u>

**COMMITMENTS AND CONTINGENCIES (Notes 10 and 14)**

**STOCKHOLDER'S EQUITY:**

Common stock, no par value; 100,000 shares authorized;		
3,217 shares issued and outstanding		3
Additional paid-in capital		20,526
Accumulated deficit		(3,589)
Total stockholder's equity		<u>16,940</u>
Total liabilities and stockholder's equity	\$	<u>21,344</u>

See accompanying notes to statement of financial condition.

**WATERSTONE FINANCIAL GROUP, INC.**

**NOTES TO STATEMENT OF FINANCIAL POSITION  
AS OF DECEMBER 31, 2008**

**1. ORGANIZATION AND DESCRIPTION OF THE COMPANY**

Waterstone Financial Group, Inc. (the "Company"), an Illinois corporation, was incorporated in 1979. The Company is an introducing broker-dealer registered with the Securities and Exchange Commission ("SEC") and a member of the Financial Industry Regulatory Authority, Inc. ("FINRA"). The Company uses other brokers as clearing brokers on a fully disclosed basis. The Company engages in the brokerage of mutual funds, life insurance, annuities, stocks, and bonds and serves a network of independent financial advisors ("FAs") throughout the United States.

The Company was a wholly owned subsidiary of Pacific Select Group LLC ("PSG"). On June 20, 2007, LPL Investment Holdings Inc. ("LPLIH") and its wholly owned subsidiary, LPL Holdings, Inc. ("LPLH") acquired PSG and its wholly owned subsidiaries (the "acquisition") from Pacific Life Insurance Company ("Pacific Life" or the "seller"). In connection with the acquisition, PSG changed its name to LPL Independent Advisor Services Group LLC ("IASG"), and became a wholly owned subsidiary of LPLH.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**—This statement of financial condition is prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), which require the Company to make estimates and assumptions regarding the valuation of certain financial instruments, intangible assets, allowance for doubtful accounts, accruals for liabilities and income taxes and other matters that affect the financial statement and related disclosures. Actual results could differ materially from those estimates.

**Cash and Cash Equivalents**—Cash and cash equivalents are composed of interest and noninterest-bearing deposits and money market funds that meet the definition of cash equivalents. Cash equivalents are highly liquid investments, with original maturities of less than 90 days, that are not required to be segregated under federal or other regulations.

**Receivables From Product Sponsors and Clearing Broker-Dealers**—Receivables from product sponsors and clearing broker-dealers primarily consists of commission and transaction-related receivables.

**Receivable From Others**—Receivable from others primarily consists of other accrued fees from product sponsors and FAs.

**Securities Transactions**—Securities transactions for the accounts of the Company or its customers are executed and cleared by independent clearing brokers on a fully disclosed basis.

**Fixed Assets**—Fixed assets include furniture, equipment, computers, purchased software, capitalized software and leasehold improvements. Depreciation of fixed assets is recognized using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of their useful lives or the terms of the underlying lease. Equipment, furniture, fixtures, computers and purchased software are depreciated over periods of three to seven years. Management reviews fixed assets for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable.

**Goodwill**—Goodwill represents the cost of the Company in excess of the fair value of net assets at acquisition date. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"), goodwill is not amortized, but tested annually for impairment, or more frequently if certain events having a material impact on the Company's value occur. An impairment loss, calculated as the difference between the estimated fair value and the carrying value of goodwill, is recognized if the estimated fair value is less than the corresponding carrying value.

The Company assessed goodwill for impairment as of June 30, 2008, determining that no impairment existed. In the third quarter of 2008, the Company elected to change the timing of its annual goodwill impairment test from June 30 to October 1, aligning the impairment testing process with that of its parent company and broker-dealer affiliates. The Company believes this change to be preferable under the circumstances, and that this change does not accelerate, delay, or avoid an impairment charge. The Company has also determined that a change in the annual testing date does not result in adjustments to the statement of financial condition when applied retrospectively. Accordingly, a goodwill impairment assessment was also performed as of October 1, 2008, and did not result in any impairment.

**Intangible Assets**—Intangible assets, which consist of relationships with FAs and product sponsors, are amortized on a straight-line basis over their estimated useful lives. The Company evaluates the remaining useful lives of intangible assets each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. Intangible assets are also tested for potential impairment whenever events or changes in circumstances suggest that an asset's or asset group's carrying value may not be fully recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). An impairment loss, calculated as the difference between the estimated fair value and the carrying value of an asset or asset group, is recognized if the estimated fair value is less than the corresponding carrying value. No impairment occurred for the year ended December 31, 2008.

**Trademark and Trade Name**—The Company's business is highly dependent on its FAs, and, as a result, expenditures are regularly made to market the Company's trademark and trade name to them. The Company's trademark and trade name have an expected useful life of three years and therefore are amortized over this same period in accordance with SFAS 142. An impairment loss, calculated as the difference between the estimated fair value and the carrying value of an asset group, is recognized if the estimated fair value is less than the corresponding carrying value. No impairment occurred for the year ended December 31, 2008.

**Income Taxes**— The Company is included in the consolidated federal and certain state income tax returns filed by LPLIH. On December 21, 2007, the Company entered into an income tax allocation agreement (the "tax agreement") with LPLH and LPLIH. In accordance with the terms of the agreement, the Company shall pay to or receive from LPLH an amount equal to the total provision for income taxes that the Company discloses on its financial statements in accordance with GAAP, less the amount of income tax benefits that are excluded from the calculation of the total provision for income taxes under SFAS No. 109, *Accounting for Income Taxes* ("SFAS 109"). Since the agreement calls for a cash settlement based on the total income tax provision, the Company does not reflect a separate deferred income tax provision and corresponding deferred tax assets or liabilities.

Additionally, the Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109* ("FIN 48") at the beginning of fiscal year 2007, which clarifies the accounting uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. FIN 48 requires the Company to recognize in the financial statements the tax effects of a position only if it is "more likely than-not" to be sustained based solely on its technical merits, otherwise no benefits of the position are to be recognized. The more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of a benefit. Moreover, FIN 48 requires that each tax position meeting the recognition threshold be measured as the largest amount that is greater than 50 percent likely to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information.

**Fair Value of Financial Instruments**—The Company's financial assets and liabilities are carried at fair value or at amounts that, because of their short-term nature, approximate current fair value.

**Commitments and Contingencies**—The Company recognizes liabilities for contingencies when analysis indicates it is both probable that a liability has been incurred and the amount of loss can be reasonably estimated. When a range of probable loss can be estimated, the Company accrues the most likely amount.

**Recently Issued Accounting Pronouncements**— In September 2006, the FASB issued Staff Position (“FSP”) SFAS No. 157, *Fair Value Measurements* (“SFAS 157”), which the Company adopted on January 1, 2008. However, in February 2008, the FASB released FSP FAS 157-2, *Effective Date of FASB Statement No. 157* (“FAS 157-2”), which delayed the effective date of SFAS 157 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of SFAS 157 for financial assets and liabilities did not have a material impact on the statement of financial condition. The adoption of SFAS 157 for nonfinancial assets and liabilities, effective January 1, 2009, will not have a material impact on its statement of financial condition. See Note 4 for additional detail on fair value measurements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, (“SFAS 141R”). SFAS 141R establishes principles and requirements in a business combination for how the acquirer: recognizes and measures in the company’s financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R applies to all transactions or other events in which the company obtains control of one or more businesses, including those sometimes referred to as “true mergers” or “mergers of equals” and combinations achieved without the transfer of consideration (e.g., by contract alone or through the lapse of minority veto rights). SFAS 141R applies prospectively to business combinations for which the acquisition date occurs on or after January 1, 2009.

In January 2008, the Company adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115* (“SFAS 159”), which provides entities the option to measure many financial instruments and certain other items at fair value. Entities that choose the fair value option will recognize unrealized gains and losses on items for which the fair value option was elected in earnings at each subsequent reporting date. The Company did not elect the fair value measurement option under SFAS 159 for any of its financial assets or liabilities and, as a result, there was no impact on the Company’s statement of financial condition.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (“FAS 142-3”). FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142. FAS 142-3 must be applied prospectively to all intangible assets acquired as of and subsequent to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The implementation of this standard will not have a material impact on the Company’s statement of financial condition.

In October 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (“FAS 157-3”). FAS 157-3 clarifies the application of SFAS 157, in an inactive market and illustrates how an entity would determine fair value when the market for a financial asset is not active. The FSP is effective immediately and applies to prior periods for which financial statements have not been issued, including interim or annual periods ending on or before September 30, 2008. The implementation of FAS 157-3 did not have a material impact on the Company’s statement of financial condition.

### 3. RESTRUCTURING

On December 29, 2008, the Company committed to and implemented an organizational restructuring plan intended to reduce the cost structure and improve operating efficiencies, which resulted in a reduction in its overall workforce. Related charges consist of employee severance and other personnel-related expenses, which are accrued in accounts payable and accrued liabilities within the accompanying statement of financial condition. The Company expects to complete all activities associated with the restructuring during the first quarter of 2009.

#### 4. FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company adopted SFAS 157, which defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1—Quoted prices in active markets for identical assets or liabilities.
- Level 2—Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The Company's fair value measurements are evaluated within the fair value hierarchy, based on the nature of inputs used to determine the fair value at the measurement date. At December 31, 2008, the Company's recurring measurements included cash equivalents of \$4.81 million in money market mutual funds that have active markets and qualify as Level 1 measurements within the fair value hierarchy of SFAS 157. In addition, the Company had \$100,000 in certificates of deposit that are included in other assets on the statement of financial condition and are valued based on third-party quotations for similar assets; thus qualifying as a Level 2 measurement.

#### 5. RECEIVABLES FROM PRODUCT SPONSORS AND CLEARING BROKER-DEALERS

At December 31, 2008 receivables from product sponsors and clearing broker-dealers are as follows (in thousands):

Receivables:

Commissions receivable from product sponsors	\$ 2,327
Receivable from clearing broker-dealers	<u>232</u>
Total receivables	<u>\$ 2,559</u>

#### 6. FIXED ASSETS

The components of fixed assets at December 31, 2008 are as follows (in thousands):

Furniture and equipment	\$ 251
Computers and software	164
Leasehold improvements	<u>52</u>
Total fixed assets	467
Accumulated depreciation and amortization	<u>(152)</u>
Fixed assets—net	<u>\$ 315</u>

## 7. INTANGIBLE ASSETS

The components of intangible assets as of December 31, 2008 are as follows (in thousands):

	<b>Gross carrying value</b>	<b>Accumulated amortization</b>	<b>Net carrying value</b>
Advisor relationships	\$ 7,500	\$ (573)	\$ 6,927
Product sponsor relationships	<u>2,300</u>	<u>(176)</u>	<u>2,124</u>
Total	<u>\$ 9,800</u>	<u>\$ (749)</u>	<u>\$ 9,051</u>

The Company has recorded intangible assets representing lists and relationships with FAs and product sponsors. Identifiable intangible assets are tested for potential impairment whenever events or changes in circumstances suggest that the carrying value of an asset or asset group may not be fully recoverable in accordance with SFAS 144. These intangible assets are amortized on a straight-line basis over their estimated economic useful life of 20 years.

## 8. TRADEMARK AND TRADE NAME

The Company is highly dependent on the revenues generated from its good standing relationships with its FAs and product sponsors. The Company's trademark and trade names are amortized on a straight-line basis over their useful lives of three years.

## 9. INCOME TAXES

The following table reflects a reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits including interest and penalties (in thousands):

Balance—January 1, 2008	\$ 159
Additions related to current year tax positions	18
Additions related to current prior year tax positions	10
Reductions related to prior year tax positions	(51)
Reductions related to transfers to LPLH	<u>(4)</u>
Balance—December 31, 2008	<u>\$ 132</u>

In accordance with the acquisition and the terms of the related purchase and sale agreement, Pacific Life has indemnified the Company of any tax contingencies that existed at or prior to the date of acquisition. At December 31, 2008, the Company has \$114,000 in acquisition related gross unrecognized tax benefits, which is included in accounts payable and accrued liabilities in the accompanying statement of financial condition. At December 31, 2008, the Company has recorded an offsetting indemnification receivable from Pacific Life in the amount of \$114,000, that is inclusive of current year additions and reductions for prior year tax positions and included in other assets in the accompanying statement of financial condition.

Gross unrecognized tax benefits of \$4,000 were transferred to LPLH during fiscal year 2008 in accordance with the provisions of the tax agreement. The Company has additional gross unrecognized tax benefits of \$18,000 as of December 31, 2008, which are included in due from affiliates, net of any related tax benefit, in the accompanying statement of financial condition. Prospectively, the Company will record gross unrecognized tax adjustments through its income tax provision and settle with LPLH for cash in the period in which the activity is realized. Under the terms of the tax agreement, no additional payments will be made between the Company and LPLH for the affects of future recognition of unrecognized tax benefits settled with LPLH. As a result, unrecognized tax benefits will have no effect on the Company's annual effective tax rate when recognized.

The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes within the statement of income. At January 1, 2008, the Company had \$1,000 accrued for penalties. At December 31, 2008, the liability for unrecognized tax benefits included penalties of \$4,000. Provision for income taxes for the year ended December 31, 2008 includes penalties of \$4,000. The tax years of 2004 to 2008 remain open to examination by major taxing jurisdictions to which the Company is subject. Since future unrecognized tax benefits will be settled in accordance with the tax agreement, the Company does not anticipate a material change in unrecognized tax benefits within the next 12 months.

## 10. COMMITMENTS AND CONTINGENCIES

**Irrevocable Standby Letter of Credit**—The Company has a \$25,000 irrevocable standby letter of credit for the benefit of its landlord which is being held as a rent security deposit. As of December 31, 2008, the Company's landlord had not drawn funds against this letter of credit.

**Operating Leases**—The Company leases certain office space and equipment under various non-cancelable operating leases. These leases are generally subject to scheduled base rent and maintenance cost increases, which are recognized on a straight-line basis over the period of the leases.

Future minimum calendar-year payments for operating lease commitments with remaining terms greater than one year as of December 31, 2008 are as follows (in thousands):

2009	\$	376
2010		384
2011		393
2012		401
2013		409
Thereafter		<u>1,059</u>
Total	\$	<u><u>3,022</u></u>

**Litigation**—The Company has been named as a defendant in various legal actions, including arbitrations. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, the Company cannot predict with certainty what the eventual loss or range of loss related to such matters will be. The Company believes, based on current knowledge, after consultation with counsel, and consideration of insurance, if any, that the outcome of such matters will not have a material adverse effect on the Company's statement of financial condition.

Under the provisions of the purchase and sale agreement, Pacific Life has indemnified the Company of any legal matters that existed at or prior to the date of acquisition. The Company recognizes a liability for legal indemnification and defense costs when it believes it is probable a liability has occurred and the amount can be reasonably estimated. The Company will record indemnifications received at the time such amounts are acknowledged by the seller.

## 11. EMPLOYEE BENEFIT PLANS

The Company participates in a 401(k) defined contribution plan (the "plan") sponsored by LPL Financial Corporation ("LPL Financial"), an affiliate and wholly owned subsidiary of LPLH. All employees meeting minimum age and length of service requirements are eligible to participate. The Company has an employer matching program whereby employer contributions are made to the plan in an amount equal to 50% of the lesser of the amount designated by the employee for withholding and contribution to the plan or 10% of the employee's total compensation.

## 12. RELATED-PARTY TRANSACTIONS

The Company reimburses LPLH for payroll, 401(k) employer matching contributions and employee benefits. At December 31, 2008, the Company owed \$162,000 to LPLH for these benefits, which has been included in due from affiliates in the accompanying statement of financial condition.

As discussed in Note 2, the Company's tax agreement results in payments to or receipts from LPLH. As of December 31, 2008, the Company had an income tax receivable of \$47,000, which is included in due from affiliates in the accompanying statement of financial condition.

Effective January 1, 2008, the Company entered into an intercompany service agreement with LPL Financial to receive various infrastructure and broker-dealer support services. In exchange for these services, the Company pays a monthly administration fee. Additionally, LPL Financial processes various other transactions for the Company that create additional intercompany balances. At December 31, 2008, the Company had a receivable of approximately \$342,000 due from LPL Financial, which has been included in due from affiliates in the accompanying statement of financial condition.

## 13. NET CAPITAL/REGULATORY REQUIREMENTS

The Company is subject to the SEC's Uniform Net Capital Rule 15c3-1, which requires the maintenance of minimum net capital. The Company computes net capital requirements under the aggregate indebtedness method, which requires firms to maintain minimum net capital, as defined, of not less than 6 2/3 percent of aggregate indebtedness, as defined. At December 31, 2008, the Company had net capital of \$3.15 million, which was \$2.86 million in excess of its minimum required net capital.

The Company is exempt from the provisions of Rule 15c3-3 (pursuant to paragraph (k)(2)(ii) of such rule) of the Securities Exchange Act of 1934 as a broker-dealer that carries no margin accounts, promptly transmits all customer funds, and delivers all securities received in connection with its activities as a broker-dealer, does not otherwise hold funds, or owe money or securities to, customers and effectuates all financial transactions through one or more bank accounts maintained exclusively for this purpose. Because of such exemption, the Company is not required to prepare a determination of reserve requirement and the Company is not subject to the provisions of Rule 15c3-3 pertaining to the possession or control requirements for broker-dealers.

The Company has entered into written agreements with its two clearing firms that require the clearing firms to perform a Proprietary Accounts of Introducing Brokers reserve computation with regard to all the assets of the Company held by the clearing firms. Consequently, the assets of the Company held at the clearing firms are treated as allowable assets for purposes of the Company's net capital computation.

The Company operates in a highly regulated industry. Applicable laws and regulation restrict permissible activities and investments. These policies require compliance with various financial and customer-related regulations. The consequences of noncompliance can include substantial monetary and nonmonetary sanctions. In addition, the Company is also subjected to comprehensive examinations and supervisions by various governmental and self-regulatory agencies. These regulatory agencies generally have broad discretion to prescribe greater limitations on the operations of a regulated entity for the protection of investors or public interest. Furthermore, where the agencies determine that such operations are unsafe or unsound, fail to comply with applicable law, or are otherwise inconsistent with the laws and regulations or with the supervisory policies, greater restrictions may be imposed.

**14. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET CREDIT RISK AND CONCENTRATIONS OF CREDIT RISK**

As a securities broker, the Company is engaged in buying and selling securities for a diverse group of customers including financial institutions. The Company introduces these customer transactions for clearance through independent clearing brokers on a fully-disclosed basis.

The Company's exposure to credit risk associated with nonperformance of customers in fulfilling their contractual obligations pursuant to securities transactions can be directly impacted by volatile trading markets, which may impair the Company's ability to liquidate the customer's collateral at an amount equal to the original contracted amount. Agreements between the Company and its clearing brokers provide that the Company is obligated to assume any exposure related to such nonperformance by the Company's customers. The Company monitors its customer activity by reviewing information it receives from its clearing brokers on a daily basis, and seeks to control the aforementioned risks by requiring the registered representatives to compensate the Company for nonperformance by the customer.

\* \* \* \* \*

February 25, 2009

To the Board of Directors and Stockholder of  
Waterstone Financial Group, Inc.  
Itasca, Illinois

In planning and performing our audit of the financial statements of Waterstone Financial Group, Inc. (the "Company") as of and for the year ended December 31, 2008 (on which we issued our report dated February 25, 2009 and such report expressed an unqualified opinion on those financial statements), in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), we considered the Company's internal control over financial reporting ("internal control") as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Also, as required by Rule 17a-5(g)(1) of the Securities and Exchange Commission (the "SEC"), we have made a study of the practices and procedures followed by the Company, including consideration of control activities for safeguarding securities. This study included tests of compliance with such practices and procedures that we considered relevant to the objectives stated in Rule 17a-5(g) in making the periodic computations of aggregate indebtedness and net capital under Rule 17a-3(a)(11) and for determining compliance with the exemptive provisions of Rule 15c3-3. We did not review the practices and procedures followed by the Company in making the quarterly securities examinations, counts, verifications, and comparisons, and the recordation of differences required by Rule 17a-13 or in complying with the requirements for prompt payment for securities under Section 8 of Federal Reserve Regulation T of the Board of Governors of the Federal Reserve System, because the Company does not carry securities accounts for customers or perform custodial functions relating to customer securities.

The management of the Company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls and of the practices and procedures referred to in the preceding paragraph and to assess whether those practices and procedures can be expected to achieve the SEC's above-mentioned objectives. Two of the objectives of internal control and the practices and procedures are to provide management with reasonable but not absolute assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with generally accepted accounting principles. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in internal control and the practices and procedures referred to above, error or fraud may occur and not be detected. Also, projection of any evaluation of them to future periods is subject to the risk that they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first and second paragraphs and would not necessarily identify all deficiencies in internal control that might be material weaknesses. We did not identify any deficiencies in internal control and control activities for safeguarding securities that we consider to be material weaknesses, as defined above.

We understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the SEC to be adequate for its purposes in accordance with the Securities Exchange Act of 1934, and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the Company's practices and procedures, as described in the second paragraph of this report, were adequate at December 31, 2008, to meet the SEC's objectives.

This report is intended solely for the information and use of the Board of Directors, management, the SEC, Financial Industry Regulatory Authority, Inc., and other regulatory agencies that rely on Rule 17a-5(g) under the Securities Exchange Act of 1934 in their regulation of registered broker-dealers, and is not intended to be and should not be used by anyone other than these specified parties.

Yours Truly,

*Deloitte & Touche LLP*

