



## SWS Financial Services, Inc. Firm Disclosure Brochure

SWS Financial Services, Inc.  
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Revised September 30, 2014

This brochure provides information about the qualifications and business practices of SWS Financial Services, Inc. This information should be considered before becoming a Client. If you have any questions about the contents of this brochure, please contact us at 214-859-6735 or [FormADV2@swst.com](mailto:FormADV2@swst.com)

This information has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority. Additional information about SWS Financial Services, Inc. is available on the SEC's website at [www.Adviserinfo.sec.gov](http://www.Adviserinfo.sec.gov). You can search this site by our unique identifying number, known as a CRD number. The CRD number for SWS Financial Services, Inc. is 801-60812. Registration does not imply a certain level of skill or training.

## Summary of Material Changes

*Updated September 30, 2014*

This Brochure has been updated with the following material Changes that have occurred since the last annual update of our brochure September 30, 2013:

Removed language regarding the GTA program, as this program was terminated at the end of 2013.

SWS Group, Inc. ("SWS"), the parent company of SWS Financial, Inc. and Southwest Securities, Inc., has agreed to merge with Peruna LLC, a wholly owned subsidiary of Hilltop Holdings Inc. ("Hilltop"). As a result of this transaction, SWS Financial Services, Inc. and Southwest Securities, Inc. will become indirect, wholly owned subsidiaries of Hilltop (and direct subsidiaries of Peruna LLC). Hilltop is a Dallas-based financial holding company that provides a variety of banking and insurance services. We expect that the transaction will be completed in the fourth quarter of 2014. The transaction is subject to customary closing conditions, including regulatory approvals and approval of the shareholders of SWS.

We expect that the transaction will not result in any substantive change to the Advisory Agreement or the advisory services we provide for your account, as your investment and account management teams are expected to remain the same.

You may request a copy of our current Brochure at any time, without charge, by calling us at 214-859-6735 or e-mailing us at [FormADV2@swst.com](mailto:FormADV2@swst.com).

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## **Advisory Business**

SWS Financial Services, Inc. ("SWSFS") is a full service broker-dealer and registered investment adviser, serving the investment and capital needs of individual, corporate and institutional clients, as well as qualified accounts ("Client").

SWSFS, as a full service broker-dealer, provides brokerage, and execution services to its Clients. It is registered with the Securities and Exchange Commission ("SEC") pursuant to the Securities Exchange Act of 1934, a member of Financial Industry Regulatory Authority ("FINRA"), and the Securities Investor Protection Corporation ("SIPC").

SWSFS is also an investment adviser registered with the SEC pursuant to the Investment Advisers Act of 1940. SWSFS, a Texas corporation, is a wholly owned subsidiary of SWS Group, Inc., a publicly owned company traded on the NYSE under symbol SWS.

As of June 30, 2014, SWSFS has \$304,243,923 under management; \$265,243,923 on a non-discretionary basis and \$38,999,223 on a discretionary basis.

SWSFS makes a number of advisory programs available. The accounts managed by SWSFS are generally not intended to provide you with a complete investment program and SWSFS expects that the assets it manages do not represent all of your assets. You should be aware that Program fees charges may be higher or lower than those otherwise available if you were to select a separate brokerage services and negotiate commission in the absence of the extra advisory services available.

Our fee schedules are subject to negotiation, depending upon a range of factors including, but not limited to, account sizes and overall range of services provided.

A number of the advisory programs available to clients of SWSFS are sponsored by Southwest Securities, Inc., ("SWST") an affiliate of SWSFS.

### ***Partner***

The Partner Program ("Partner") is a non-discretionary investment advisory program\* which enables your Investment Adviser Representative ("IAR") to provide investment advice through a brokerage account with access to a wide spectrum of investments choices to help achieve portfolio diversification. Within the Partner Program, your IAR assists you in developing a personalized investment portfolio using a variety of security types. Your IAR obtains the necessary financial data from you, and assists you in determining the suitability of the advisory services and selecting the appropriate investment objective. Your IAR provides ongoing investment advice and management tailored to your individual needs.

In addition to the asset-based fee for advisory services, you may also be charged various, exchange fees and postage, handling and insurance charges on each transaction executed in your account(s). Assets are held and custodied by SWST, a full service broker-dealer.

\*We offer a limited discretionary service in the Partner Program and that is only available to a limited number of investment adviser representatives and clients who meet certain suitability and eligibility standards.

## ***Advantage***

The Advantage Program is a non-discretionary Mutual Fund/ Exchange Traded Fund portfolio advisory program sponsored and administered by SWST and made available to advisory clients of SWSFS through a co-advisory agreement between SWST and SWSFS. The asset allocation model includes a variety of asset types that, together, offer appropriate diversification to accommodate each investment objective. The models utilized are strategic in nature. Changes may occur from time to time to allocation, but adjustments to the asset allocation are expected to be infrequent. Where appropriate, multiple funds may be selected for a style to provide additional diversification.

Your IAR analyzes and reviews your individual financial situation and investment objectives to determine the asset allocation model most appropriate for their needs. SWST will identify and select various mutual funds and ETFs to be made available to you under the Program. You, with the assistance of your IAR will be responsible for the selection of investments and for the allocation of program assets among the various investments identified by SWST. You, the client, are free at all times to accept or reject any recommendation, and you have the sole authority with regard to the implementation. You agree to immediately notify your IAR of any change in your financial situation.

Additional information regarding the Advantage Program can be found in the SWST Managed Account Disclosure Brochure.

## ***Russell Strategies***

The Russell Strategies Program is a discretionary asset allocation investment program sponsored and administered by SWST and made available to advisory clients of SWSFS through a co-advisory agreement between SWST and SWSFS. The Program gives you the opportunity to allocate assets among various mutual fund portfolios of the Russell Investment Company ("Russell"). Russell is registered under the Investment Company Act of 1940. Russell determines the asset allocation and fund selection for the Russell Model Strategies. You may select a Strategy and appoint Southwest Securities to manage the portfolio on a discretionary basis.

The service begins with a consultation with your Investment Adviser Representative to review your investment objectives, financial circumstances and risk tolerance. You are asked to complete a Client Profile/Questionnaire ("Client Profile") to document the results of this assessment. After reviewing the results of the Client Profile, your IAR will recommend a target allocation of Russell Funds. These allocations seek to appropriately balance your financial objectives with your risk tolerance as part of an investment strategy. You agree to immediately notify your IAR of any change in your financial situation.

Additional information regarding the Russell Strategies Program can be found in the SWST Managed Account Disclosure Brochure.

## ***Premier Advisors***

The Premier Advisors program is a discretionary investment advisory program sponsored by SWST and made available to advisory clients of SWSFS through a co-advisory agreement between SWST and SWSFS. The Premier Advisors program provides you access to a broad selection of Separately Managed Accounts (SMA). In an SMA, you are offered access to actively managed investment portfolios managed by independent investment managers. Unlike a mutual fund, where funds are comingled, a separately managed account is a portfolio of individually owned securities that can be tailored to fit the Client's investing preferences. The asset managers who may be selected for these Programs employ different methods of analysis that are described in each managers' Disclosure Brochure.

Additional information regarding the Premier Advisors Program can be found in the SWST Managed Account Disclosure Brochure.

## Fees and Compensation

The fee schedules, shown in the tables below, are based on account size and are negotiable. The fee schedules for Partner, Advantage, and Russell are not applied incrementally; the corresponding rate is applied to the entire Account Value in the determination of the fee. The fees do not cover the fees and expenses of any underlying ETF's, closed-end funds, or mutual funds, or fees for ancillary services such as wire transfers, returned checks, etc. nor does it cover applicable exchange fees.

The fees are calculated using the market value of the account on the last day of the preceding quarter. The fee is applied to the account each calendar quarter, on a pro-rated quarterly basis and is billed in advance. A portion of any fees received by SWSFS may be paid to your IAR. SWSFS may keep between 0-100% of the fee and pay the remaining portion to the IAR as agreed upon with each IAR. This amount may vary depending on a number of factors including negotiated agreements, assets under management or other factors as determined by SWSFS.

Partner Maximum Annualized Fee Schedule		
Total Account Value	Individual Securities Accounts Fees	Mutual Fund/ETF/UIT Accounts
Up to \$249,999	2.25%	1.75%
\$250,000- \$499,999	2.00%	1.50%
\$500,000- \$999,999	1.75%	1.25%
\$1,000,000 and over	1.50%	1.00%

*\*\*When assets are added to or withdrawn from a Partner account in an amount that exceeds \$50,000 during the calendar quarter, a fee will be calculated on this increase or re-calculated on a decrease and either debited or credited based on the change and pro-rated for the number of days remaining in the billing cycle. SWST will retain between .10% and 25% of the fee assessed to the client for administrative services provided.*

Advantage Maximum Annualized Fee Schedule	
Total Account Value	Fee
Up to \$249,999	1.75%
\$250,000- \$499,999	1.50%
\$500,000- \$999,999	1.25%
\$1,000,000 and over	1.00%

*\*\* When assets are added to or withdrawn from an Advantage account in an amount that exceeds \$30,000 during the calendar quarter, a fee will be calculated on this increase or re-calculated on a decrease and either debited or credited based on the change and pro-rated for the number of days remaining in the billing cycle. SWST will retain between .10% and 25% of the fee assessed to the client as sponsor of the program*

Russell Maximum Annualized Fee Schedule	
Total Account Value	Fee
Up to \$249,999	1.75%
\$250,000- \$499,999	1.50%
\$500,000- \$999,999	1.25%
\$1,000,000 and over	1.00%

*\*\*When assets are added to or withdrawn from a Russell account in an amount that exceeds \$30,000 during the calendar quarter, a fee will be calculated on this increase or decrease and either debited or credited based on the change and pro-rated for the number of days remaining in the billing cycle. SWST will retain between .10% and 25% of the fee assessed to the client as sponsor of the program*

### Premier Advisors Program Fees

The *Premier Advisors* program pays an all-inclusive fee, out of which SWST pays for all portfolio management and administration (including Envestnet and Envestnet Manager Fees and fees payable to the Sponsor/ IARs as well as costs for transaction execution, clearing, and custody and reporting. The sub-manager's fee will generally fall within a range of 0.15% - 0.75% (annual rate) of assets under management. The fee payable to SWST, as the Sponsor will generally fall within a range of 0.10% - 0.38% (annual rate) of assets under management.

Where applicable, SWSFS may also receive a portion of the fee for providing advisory services to Clients introduced to the program. The amount retained is typically the amount remaining after the deduction of fees payable to individual portfolio managers and fees payable to SWST for clearing, program administration and sponsorships. The SWSFS portion of the fee will generally fall within a range of 0.50% - 1.75% (annual rate) of assets under management. The level of fee will vary with the amount of assets under advisement in the *Premier Advisors* program and the particular investment styles and investment options chosen or recommended.

The standard fee schedule for the *Premier Advisors* program services is set forth below, but may be negotiable in individual cases:

Premier Advisors Program Fee		
Total Account Value	Maximum Annualized Fee for Equity/Balanced Portfolios	Maximum Annualized Fee for Fixed Income Portfolios
First \$ 250,000	2.90 - 3.00%	1.55 - 1.65%
Next \$ 250,000	2.40 - 2.50%	1.40 - 1.50%
Next \$ 500,000	2.15 - 2.25%	1.25 - 1.35%
Next \$ 4,000,000	1.90 - 2.00%	1.05 - 1.15%
Over \$5,000,000	1.75 - 1.85%	0.90 - 1.00%

*\* The total fee actually charged to the Client's account(s) may vary depending upon the selection of sub-managers and allocation of total portfolio assets thereto, the total amount of portfolio assets in the program and other factors.*

### Additions and Withdrawals from a Premier Advisors Account

If you make a deposit or withdrawal of \$10,000 or more during a fee period, you will be debited or credited a pro- rated fee on the market value of the assets. The pro-rated amount will be due on the date you deposit the additional assets into your account or you will receive a pro-rated adjustment of refund of any prepaid fee.

## ***Additional Information Regarding Fees and Compensation***

You should be aware that commissions or program fees charged may be higher or lower than those otherwise available if you were to select a separate brokerage service and negotiate commissions in the absence of the extra advisory services provided. Our fee schedules are subject to negotiation, depending upon a range of factors including, but not limited to, account sizes and overall range of services provided.

Program fees do not cover exchange or similar fees (such as for ADR's) charged by third parties, including issuers, foreign taxes and fees required by the SEC. In addition, clients participating in program accounts may also be subject to various other fees, including but not limited to, postage, handling and insurance charges on each transaction executed in their account(s), wire fees, and overnight fees. These charges are described in the customer information brochure provided to all clients on account opening and annually thereafter.

You should consider the value of these advisory services when making comparisons. The combination of custodial, advisory and brokerage services may not be available separately or may require multiple accounts, documentation and fees. You should also consider the amount of anticipated trading activity when selecting among the programs and assessing the overall cost. Advisory Programs typically assume a normal amount of trading activity and, therefore, under particular circumstance, prolonged periods of inactivity or asset allocations with significant fixed income or cash weightings may result in higher fees than if commissions were paid separately for each transaction.

If you liquidate securities prior to initiating or after terminating program service, you will be subject to customary brokerage charges with respect to that transaction, in addition to any program fees that are applicable during the period.

For all Programs, cash or money market investments will be included in the determination of your Account Value. Cash balances will be automatically invested in one of several sweep options, which include money market funds, unless directed otherwise. These sweep options included the Bank Insured Deposit, Dreyfus General Money Market Fund or other selections. The Bank Insured Deposit ("BID") is a program administered by Reich and Tang Deposit Solutions ("R&T") which involves a series of FDIC Insured bank accounts maintained at various participant banks, including Southwest Securities, FSB ("SWS-FSB") in Dallas, Texas, an affiliate of the SWSFS. SWSFS anticipates receiving fees, including fees for administrative services and other financial benefits for providing sweep funds to R&T. SWSFS anticipates that SWS-FSB will receive a financial benefit from the use of sweep funds, such as net interest income. A portion of fees received may be paid to the SWSFS or IAR. SWSFS has additional arrangements with Dreyfus Funds or other funds to receive compensation based on assets invested in their respective money market funds. This compensation may be shared with the Adviser. A list of participant banks available in BID is available at [www.swst.com](http://www.swst.com). For complete sweep account disclosures, please see the Customer Information Brochure. The Sweep Compensation is in addition to any Program Fees.

Your IAR may have a financial incentive to recommend a fee-based advisory program rather than paying for investment advisory services, brokerage, performance reporting and other services separately. A portion of the annual advisory fee is paid to your IAR, which may be more than the IAR would receive under an alternative program or if you paid for these services separately. Therefore, your IAR may have a financial incentive to recommend a particular account program over another. In addition, your IAR may receive incentive compensation for utilizing a particular account program. Such incentive compensation is generally available as follows:



IARs utilizing any of the previously mentioned account programs offered by SWSFS generally receive compensation in the form of asset-based fees, and this compensation is typically credited to the IAR on a quarterly basis. Such compensation may be more than the representative would receive if clients participated in other programs or paid separately for investment advice, brokerage and other services and, therefore, the representatives may have a financial incentive to recommend the advisory programs over other services.

IARs are typically compensated based on their annual gross production, whereby higher gross production will generally result in higher payouts. These compensation programs constitute a targeted payout increase to certain qualified IARs based on economies of scale achieved by SWSFS, its affiliates and IARs at increasing asset levels. However, such compensation arrangements may represent a conflict of interest where an IAR may be incentivized to recommend an asset-based fee account program rather than recommending an alternative product or service, if comparable or if available separately to clients. Clients should be aware of such arrangements and should consult their IAR for additional details regarding the financial advisor's compensation levels in fee-based accounts.

You should be aware that only those mutual fund companies with which SWST has a selling agreement will be available for purchase within the programs available through SWSFS. and are generally limited to those fund companies that provide SWST marketing service and support fees. As a result, not all mutual funds available to the investing public will be available for investment. However, SWST has selling agreements with over 200 fund companies.

You should be aware that mutual funds contain internal expenses which are apart from and in addition to Program Account fees and which are described in the respective funds' prospectuses. Certain funds offered in the Program, while not having sales charges or having sales charges waived, may assess distribution fees, such as those assessed pursuant to SEC Rule 12b-1 of the Investment Company Act of 1940, as amended ("12b-1 Fees") which may be paid to SWSFS. You understand and acknowledge that SWSFS will retain any fees, including but not limited to 12b-1 Fees, that are paid by such mutual funds and further acknowledges that any reduction in fees charged to accounts containing any mutual fund is intended to offset any 12b-1 Fee that may be payable by a mutual fund in which your Program Account is invested. A portion of these 12b-1 Fees may be paid to the IAR. You are referred to the respective mutual fund prospectuses for detailed information about such fees.

As part of its fiduciary duties to clients, SWSFS endeavors at all times to put the interests of its advisory clients first. You should be aware, however, that the receipt of economic benefits by SWSFS (or its related persons) in and of itself creates a potential conflict of interest.

## **Performance-Based Fees and Side-by-Side Management**

SWSFS does not charge for performance-based fees in any of its managed account programs. SWSFS does not have any situations of Side-by-Side management.

## **Types of Clients and Account Requirements**

The minimum initial account values for the Programs described in this document are listed below. We may terminate Client Accounts with written notices if they fall below minimum account value guidelines established by the firm. Under certain circumstances, an exception to the minimum account size may be granted.

Program Name	Minimum Account Size
Partner	\$50,000 (\$30,00 if mutual Funds, ETF's and UIT's)
Advantage	\$30,000
Russell Strategies	\$30,000
Premier Advisors	\$100,000 (Subject to Managers Minimum)

## Methods of Analysis, Investment Strategies and Risk of Loss

Each IAR has the independence to take the approach he or she believes is most appropriate when analyzing investment products and strategies for clients. There are several sources of information that SWSFS and/or IARs may use as part of the investment analysis process. These sources include, but are not limited to:

- Financial publications
- Research materials prepared by third parties
- Corporate rating services
- SEC Filings (annual reports, prospectus, 10-K, etc.)
- Company press releases
- Regulatory and self-regulatory reports
- Other public sources

As a firm, SWSFS does not favor any specific method of analysis over another and therefore would not be considered to have one approach deemed to be a “significant strategy.” There are, however, a few common approaches that may be used by SWSFS or your IAR, individually or collectively, in the course of providing advice to clients. Please note that there is no investment strategy that will guarantee a profit or prevent loss. Following are some common strategies employed in the management of client accounts:

- **Dollar Cost Averaging (“DCA”):** The technique of buying a fixed dollar amount of a particular investment on a regular schedule, regardless of the share price. More shares are purchased when prices are low, and fewer shares are bought when prices are high. Periodic investment programs cannot guarantee a profit or protect against a loss in a declining market. Dollar-cost averaging is a long-term strategy that involves continuous investing, regardless of fluctuating price levels, and, as a result, you should consider your financial ability to continue to invest during periods of fluctuating price levels.
- **Asset Allocation:** An investment strategy that aims to balance risk and reward by allocating assets among a variety of asset classes. At a high level, there are three main asset classes—equities (stocks), fixed income (bonds), and cash/cash equivalents—each of which has different risk and reward profiles/behaviors. Asset classes are often further divided into domestic and foreign investments, and equities are often divided into small, intermediate, and large capitalization. The general theory behind asset allocation is that each asset class will perform differently from the others in different market conditions. By diversifying a portfolio of investments among a wide range of asset classes, IARs seek to reduce the overall volatility and risk of a portfolio through avoiding overexposure to any one asset class during various market cycles. Asset allocation does not guarantee a profit or protect against loss.
- **Technical Analysis (a.k.a. “Charting”):** A method of evaluating securities by analyzing statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security’s intrinsic value. Instead, they use charts and other tools to identify patterns

that can suggest future activity. When looking at individual equities, a person using technical analysis generally believes that performance of the stock, rather than performance of the company itself, has more to do with the company's future stock price. It is important to understand that past performance does not guarantee future results.

- **Fundamental Analysis:** A method of evaluating a security that entails attempting to measure its intrinsic value by examining related economic, financial, and other qualitative and quantitative factors. Fundamental analysts attempt to study everything that can affect the security's value, including macroeconomic factors (e.g., the overall economy and industry conditions) and company-specific factors (e.g., financial condition and management). The end goal of performing fundamental analysis is to produce a value that an investor can compare with the security's current price, with the aim of figuring out what sort of position to take with that security (underpriced = buy, overpriced = sell or short). This method of security analysis is considered to be the opposite of technical analysis.
- **Quantitative Analysis:** An analysis technique that seeks to understand behavior by using complex mathematical and statistical modeling, measurement, and research. By assigning a numerical value to variables, quantitative analysts try to replicate reality mathematically. Some believe that it can also be used to predict real-world events, such as changes in a share price.
- **Qualitative Analysis:** Securities analysis that uses subjective judgment based on non-quantifiable information, such as management expertise, industry cycles, strength of research and development, and labor relations. This type of analysis technique is different from quantitative analysis, which focuses on numbers. The two techniques, however, are often used together.

We may use the following investment strategies, as appropriate, when managing client assets:

- **Long-term Purchases:** Where appropriate, our firm employs a long-term investment strategy when formulating the investment advice given to clients. This entails the purchase of securities with the idea of holding them in your account for a year or longer. We may do this because we believe the securities to be currently undervalued. We may do this because we want exposure to a particular asset class over time, regardless of the current projection for this class. A risk in a long-term purchase strategy is that, by holding the security for this length of time, we may not take advantages of short-term gains that could be profitable to you. Moreover, if our predictions are incorrect, a security may decline sharply in value before we make the decision to sell.
- **Short-term Purchases:** Where appropriate, we may also purchase securities with the idea of selling them within a relatively short time (typically a year or less). We do this in an attempt to take advantage of conditions that we believe will soon result in a price swing in the securities we purchase. A risk in a short-term purchase strategy is that, should the anticipated price swing not materialize, we are left with the option of having a long-term investment in a security that was designed to be a short-term purchase, or potentially taking a loss. In addition, this strategy involves more frequent trading than does a longer-term strategy, and may result in increased brokerage and other transaction-related costs, as well as less favorable tax treatment of short-term capital gains.
- **Short Sales:** In addition, we may borrow shares of a stock for your portfolio from someone who owns the stock on a promise to replace the shares on a future date at a certain price. We then sell the shares we have borrowed. On the agreed-upon future date, we buy the same stock and return the shares to the original owner. We engage in short selling based on our determination that the

stock will go down in price after we have borrowed the shares. If the stock has gone down since we purchased the shares from the original owner, the client keeps the difference. One risk in selling short is that losses are theoretically unlimited; we are obligated to repurchase the stock no matter how much the price has climbed. In addition, even if we are correct in determining that the price of a stock will decline, we run the risk of incorrectly determining when the decline will take place. Short selling may not be appropriate in times of inflation, as prices may adjust upwards regardless of the value of the stock.

- **Margin:** If your account is approved for margin trading, you may be required to deposit additional securities or cash on short notice to maintain your position and/or to maintain sufficient assets to meet firm requirements. If you do not meet requirements in the required time frame, we may liquidate all or a portion of your holdings. You will be liable for any resulting deficit in your Account. Margin trading can work against you as well as for you, for example, larger losses as well as the potential for larger gains. Before you begin using margin, please read the "Margin Disclosure" brochure available from your Investment Adviser Representative. Maintaining a margin account balance will also increase the wrap fee to the extent of the margin exposure.
- **Options:** Certain types of option trading are permitted in order to generate income or hedge a security held in the Partner Program; namely, the selling (writing) of covered call options or the purchasing of put options on a security held in the program account. You should be aware that the use of options involves additional risks. The risks of covered call writing include the potential for the market to rise sharply. In such case, the security may be called away and the program account will no longer hold the security. The risk of buying long puts is limited to the loss of the premium paid for the purchase of the put if the option is not exercised or otherwise sold by the program account. Options involve risk and are not suitable for all investors. You should read "Characteristics and Risks of Standardized Options" brochure provided by your IAR.

## ***Risk of Loss***

You should understand that all investments involve a certain amount of risk. Investment performance can never be predicted or guaranteed and that the values of your accounts will fluctuate due to market conditions and other factors. You should also understand that we make no representations or warranties with respect to the present or future level of risk or volatility in, or the future performance of your account. You should further understand that you are assuming the risks involved with investing in securities and other investment products, and should understand that you could lose all or a portion of the amount held in your account(s).

Below are some of the common risks you should consider prior to investing. This list is not a complete enumeration or explanation of the risks involved and you should also consult with your IAR and your legal/tax advisers before investing in any particular strategy.

- **Market risks:** The prices of, and the income generated by, the common stocks, bonds, and other securities you own may decline in response to certain events taking place around the world, including those directly involving the issuers; conditions affecting the general economy; overall market changes; local, regional, or global political, social, or economic instability; governmental or governmental agency responses to economic conditions; and currency, interest rate, and commodity price fluctuations.
- **Small-Cap Risk.** Historically, small-cap stocks have been riskier than large- and mid-cap stocks. Stock prices of smaller companies may be based in substantial part on future expectations rather

than current achievements and may move sharply, especially during market upturns and downturns. Small-cap companies themselves may be more vulnerable to adverse business or economic events than larger, more established companies. During a period when small-cap stocks fall behind other types of investments —large-cap stocks, for instance—a client’s small-cap holdings could reduce performance.

- Fixed Income: Bonds may “guarantee” return of principal if held to maturity, but any guarantee remains subject to the creditworthiness of the guarantor and, prior to maturity, the bond may be subject to interest rate, inflations and credit risks.
- International/Global securities expose the investor to currency risk and political, social and economic risks of the countries in which the securities are domiciled, in addition to the equity or debt nature of the securities involved.
- Pooled Investments: Certain strategies may invest in one or more pooled investment funds including mutual funds ETF’s, UIT’s, Real Estate Investment Trusts, etc. You should read the offering documents (e.g., prospectus, offering memorandum, etc.) carefully to fully understand the various risks, investment objectives, expenses and other information about the company associated with the investment.
- Trading Frequency: Frequent trading may result in short-term capital gains which are taxed at a higher rate than long term capital gains.

## Disciplinary Events

In January 2004, predecessor firm MLS of affiliate SWST reached a settlement with the NASD for failure to properly report municipal transactions and inaccurate municipal filings. MLS agreed to pay a fine of \$5,000.

In January 2004, predecessor firm MLS of affiliate SWST reached a settlement with the NASD for allowing two registered persons to act as registered representatives while ineligible due to a failure to complete continuing education requirements. MLS agreed to pay a fine of \$5000.

In February 2004, SWST reached a settlement with the NASD for failure to provide appropriate breakpoint discounts described in mutual fund offering documents to customers purchasing mutual funds from January 1, 1999 through November 3, 2003. SWST agreed to a \$66,468 fine, censure, and to refund to customers of any amounts overcharged related to the mutual fund transactions during the review period.

In February 2004, affiliate SWST reached a settlement with the NASD for failure to provide firm customers reductions in mutual fund sales charges as allowed by fund prospectus. The firm agreed to a censure, \$36,971 fine, and further agreed to provide written notification to certain mutual fund customers that they may be entitled to a refund. In addition, the firm agreed to perform an analysis of each mutual fund trade in question and provide refunds to all customers who did not receive the applicable sales charge reduction, and certify to the NASD that the firm has implemented procedures reasonably designed to prevent and detect failures to provide sales charge reductions for customers who are eligible.

In September 2004, affiliate SWST reached a settlement with the NYSE for failure to supervise business activities, failure to preserve accurate books and records, executing trades at prices that were not based on the current value, and improperly purchasing or liquidating shares after the close of the market with respect to mutual fund business. The firm agreed to a censure, cease and desist/injunction, \$8 million penalty, and \$2 million disgorgement.

In April 2005, predecessor firm MLS of affiliate SWST reached a settlement with the NASD for failure to file MSRB Forms G-36 in a timely manner. MLS agreed to pay a fine of \$5,000.

In June 2005, affiliate SWST reached a settlement with the NASD for failure to properly maintain quotes on the relevant trading systems. SWST agreed to revise its written procedures to comply with the requirement to properly maintain quotes, and further agreed to a censure and a \$10,000 fine.

In September 2005, an NYSE hearing panel found affiliate SWST failed to respond accurately to NYSE requests for trading information, and failed to establish and maintain systems and procedures reasonably designed to comply with industry rules and regulations. The firm consented to a censure and a \$300,000 fine and a requirement to conduct a validation of all required elements of the above referenced NYSE trading information requirements, and to inform the NYSE in writing that the validation has been completed.

In May 2006, affiliate SWST reached a settlement agreement with the NYSE permitting employees to engage in the securities business prior to proper registration, failure to obtain written supervisory pre-approval for account designation changes, failure to obtain NYSE approval for supervisory employees who are dually employed, failure to accurately report customer complaints to the NYSE, and failure to exercise reasonable supervision and control when insuring that all branch offices are annually inspected and trade corrections are pre-approved in writing. The firm agreed to a censure and a \$100,000 fine.

In June 2007, the firm reached a settlement with the NASD for failure to properly report trades in the appropriate system within 15 minutes of execution and failure to have adequate supervisory systems in place to reasonably insure compliance with the applicable regulations. The firm agreed to a \$10,000 fine, censure, and to revise its written supervisory procedures regarding trade reporting activity.

In June 2007, affiliate SWST reached a settlement with the NASD for failure to properly register trading personnel as principals, and the failure to detect that individuals charged with the supervision of trading desk activity were not properly registered as supervisors/principals. In addition, the NASD alleged that SWST submitted inaccurate quarterly trading information, and failed to file certain trading activity reports, failed to properly report trades, executed trades at prices that were inferior than those in the prevailing market, and did not have policies and procedures in place reasonably designed to achieve compliance with applicable securities rules and regulations concerning trade reporting. The firm agreed to a censure, \$160,000 fine and to revise policies and procedures regarding the above reference alleged failures within 30 business days.

In September 2007, affiliate SWST reached a settlement with FINRA for failure to make timely MSRB filings related to municipal underwriting. The firm agreed to a \$5,000 fine.

In May 2008, affiliate SWST reached a settlement with FINRA for failure to preserve accurate order records for 3 years, failure to obtain the best possible price for customers when executing orders, and failure to report trades in a timely and accurate manner through the appropriate reporting systems. FINRA alleged that the firm's supervisory systems were not reasonably designed to achieve compliance with the applicable rules and regulations. The firm agreed to a censure, and a \$67,500 fine.

In February 2011, affiliate SWST reached a settlement with FINRA for the alleged conduct of MLS prior to its acquisition by SWST. FINRA alleges that MLS bought or sold securities from customers at prices that were not considered fair given the current market conditions. The firm agreed to a censure, \$12,500 fine, and \$1,846 restitution plus interest.

In March 2011, affiliate SWST reached a settlement with FINRA for the payment to individuals not associated with the firm to solicit municipal securities business and failure to make municipal filings in a timely manner in violation of MSRB rules. The firm agreed to a censure, \$500,000 fine, and to certify within 60 days that new systems and procedures have been established that are reasonably designed to comply with applicable rules and regulations.

In March 2011, affiliate SWST reached a settlement with FINRA for failure to establish and enforce systems and procedures designed to achieve adequate due diligence and risk assessments of the firm's clearing services business. FINRA alleged that these failures allowed the firm to establish a relationship with an introducing firm for which SWST was to provide clearing services without performing proper due diligence and risk assessment initially, and on an ongoing basis. In addition, FINRA alleges that the firm failed to properly respond to alerts indicating that the introducing firm had exceeded trading thresholds resulting in an unsecured loss to SWST in the amount of \$6.3 million. The firm agreed to a censure, administrative fine of \$650,000 and to certify in writing to FINRA that SWST had designated a risk management officer to oversee systems and procedures in the correspondent clearing business, that the firm has revised its procedure in a manner that is reasonably designed to achieve compliance with the rules and regulations.

In April 2011, affiliate SWST reached a settlement with FINRA for failure to take the appropriate steps to eliminate security deficits related to stock loan activities. FINRA further alleged that the firm failed to properly document the steps taken by SWST to resolve the deficits. The firm agreed to a censure and a \$50,000 fine.

In November 2012, affiliate SWST reached a settlement with the state of Illinois after allegations were made that the firm failed to properly respond to a subpoena issued by the state. The firm agreed to a consent order and a \$7,500 fee to reimburse the state for the cost of the investigation

In November 2012, affiliate SWST reached a settlement with FINRA for failure to properly provide Official Statements in a municipal securities offering to customers. The firm agreed to a censure and an \$85,000 fine.

In March 2013, affiliate SWST reached a settlement agreement with FINRA after allegations were made that the firm bought or sold municipal securities from customers at prices that were not considered fair given the current market conditions and also failed to properly report certain trades within the required time period. In addition, FINRA further alleged that the firm's supervisory system with respect to the alleged conduct was insufficient. The firm agreed to a censure, \$77,500 fine and \$32,167.14 restitution plus interest.

In August 2013, affiliate SWST reached a settlement agreement with FINRA for failure to transmit last sale reports to the appropriate trade reporting facility within the required time period. The firm agreed to a \$5,000 fine.

In November 2013, affiliate SWST reached a settlement agreement with FINRA for failing to execute the proper and timely close out of short positions creating a fail-to-delivery position in violation of FINRA rules regarding short positions. SWST agreed to a censure and \$10,000.00 fine.

In June 2014, affiliate SWST reached a settlement agreement with FINRA for failing to report the correct time of trade executions as required and failure to properly maintain record of the time of execution as required within the Firm's records. SWST agreed to a censure and \$12,500.00 fine.

## **Other Financial Industry Activities and Affiliations**

SWS Group, Inc. ("**SWS**"), the parent company of SWSFS, has agreed to merge with Peruna LLC, a wholly owned subsidiary of Hilltop Holdings Inc. ("**Hilltop**"). As a result of this transaction, SWSFS and SWST will become indirect, wholly owned subsidiaries of Hilltop (and a direct subsidiaries of Peruna LLC). Hilltop is a Dallas-based financial holding company that provides a variety of banking and insurance services. We expect that the transaction will be completed in the fourth quarter of 2014. The transaction is subject to customary closing conditions, including regulatory approvals and approval of the shareholders of SWS.

We expect that the transaction will not result in any substantive change to the Advisory Agreement or the advisory services we provide for your account, as your investment and account management teams are expected to remain the same.

SWSFS is a wholly owned subsidiary of SWS Group, Inc., a publicly owned company.

SWS Group, Inc. ("SWS") through its subsidiaries operates through multiple segments: Clearing, Retail, Institutional, and Banking. . Active subsidiaries for SWS Group, Inc. include the following:

- Southwest Securities, Inc.
- SWS Financial Services, Inc.
- Southwest Insurance Agency, Inc.
- Southwest Financial Insurance Agency, Inc.
- Southwest Securities, FSB
- Southwest Capital Corp

SWS Financial Services, Inc. is a wholly owned subsidiary of SWS Group, Inc. As such, SWSFS is affiliated with Southwest Securities, Inc., a fully disclosed broker-dealer and Investment Adviser; Southwest Securities, FSB, a bank; and Southwest Insurance Agency ("SWIA").

We will earn commission-based compensation for selling insurance type products, such as life, disability, long term-care insurance, fixed and variable annuities. In addition, IARs may also be licensed and operate as insurance agents, and may receive commission-based compensation for the sale of these types of products. Insurance commissions earned by IARs from the sale of these products are separate and in addition to our advisory fees. Therefore, the sale of insurance and annuity products presents a conflict of interest because IARs who are insurance agents may have an incentive to recommend insurance and annuity products to you for the purpose of generating commissions. You are under no obligation to purchase products or services recommended by us or members of our firm in connection with any advisory service that we offer.

SWSFS has arrangements with SWST which are material to its advisory business. SWSFS utilizes SWST as its custodian. SWST is also the sponsor of the Premier Advisors, Advantage, and Russell Programs. SWSFS offers these Programs to clients via a "co-advisory" arrangement it has with SWST. For programs sponsored by SWSFS, SWST retains a portion of the program fee for performing administrative services (such as reporting, record keeping and fee billing administration). The portion of the program fee retained by SWST generally ranges between 0.10% - 0.35% (annual rate) of the account value of each program.



Southwest Securities, FSB (SWSFSB) is a member of SWS Group Inc. which wholly owns SWSFS. The Bank Insured Deposit (BID) is a program administered by Reich and Tang Deposit Solutions ("R&T") which involves a series of FDIC Insured bank accounts maintained at various participant banks, including Southwest Securities, FSB (SWS-FSB) in Dallas, Texas, an affiliate of the Adviser. Adviser anticipates receiving fees, including fees for administrative services and other financial benefits for providing sweep funds to R&T.

## **Registration as a Broker Dealer**

SWSFS is an independent broker dealer and investment adviser. As a registered broker dealer, SWSFS is a member of Financial Industry Regulatory Authority ("FINRA") and the Securities Investor Protection Corporation ("SIPC").

IARs are also associated with SWSFS as registered representatives ("RRs"). IARs may recommend the purchase of securities offered by our firm as a securities broker dealer. If you purchase these products through these individuals as RR in regular brokerage account, they will receive normal commissions, including 12b-1 fees for the sale of investment company products, which may be separate to the advisory fees you pay. As such, IARs may have incentive to sell you commissionable products in addition to providing you with advisory services when such commissionable products may not be suitable. Therefore, a conflict of interest may exist between their interests and your interests. While our security sales are reviewed for suitability by an appointed supervisor, you should be aware of the incentives we have to sell certain securities products and are encouraged to ask us about any conflict presented. Please be aware that you are under no obligation to purchase products or services recommended by us or members of our firm in connection with providing you with any advisory service that we offer.

## **Registration as an NFA introducing broker dealer**

SWSFS is registered as an introducing broker and is member of the National Futures Association ("NFA"), which is the self-regulatory organization for the U.S. futures industry. SWSFS does not offer clients futures products in any of our advisory programs.

# **Code of Ethics, Participation in Client Transactions and Personal Trading**

## **Code of Ethics**

SWSFS has adopted a Code of Ethics that governs a number of potential conflicts of interest we have when providing our advisory services to you. Our Code of Ethics is designed to ensure that we meet our fiduciary obligations to you and to foster a culture of compliance throughout our firm.

Our Code of Ethics is comprehensive and is designed to help us detect and prevent violations of securities laws and to help ensure that we keep your interests first at all times. We distribute our Code of Ethics to each supervised person at SWSFS at the time of his or her initial affiliation with our firm; we make sure it remains available to each supervised person for as long as he or she remains associated with our firm; and we ensure that updates to our Code of Ethics are communicated to each supervised person as changes are made. Our Code of Ethics asserts that all supervised persons have a fiduciary responsibility to clients and they must always adhere to federal securities laws. The Code also covers client confidentiality, gifts, undue influence in personal securities transactions and use of client or company assets to benefit one personally.

Additionally, the Code mandates monitoring, review, reporting and sanctions for violations of the Code of Ethics. SWSFS will provide a copy of the Code of Ethics to any client or prospective client upon request.

### **Participation or Interest in Client Transactions**

SWSFS, as a broker/dealer, may act as an agent or, where permitted by law, principal (including instances wherein we are an underwriter or selling group member). Even though we may be permitted by contract or by law to do so, as a matter of policy, we generally do not execute principal trades or agency cross transactions in our advisory programs. Although in some instances, we may be able to provide a more favorable market price to you if we participate in principal trade or an agency cross transaction with client accounts, we do so only when consistent with our obligations to provide best execution, due to regulatory requirements when executing such transactions. Therefore, you will not have access to new issues or syndicate offerings in these accounts. You may make such purchases in a retail brokerage account, and you should be aware that they will be subject to the customary fees and compensations charged in such accounts.

In case-by-case exceptions, in which we enter into principal trades or agency cross transactions, we will provide specific disclosures and obtain your consent. If the transaction is a principal transaction in which SWSFS is a market maker in the security, we provide you with disclosure regarding the capacity in which we are acting, and obtain your consent before completing such transaction. We rely on codes and restrictions in our systems as well as additional software to prevent non-permissible principal trades. In some instances, we do not act as an investment advisor (according to Section 206(3) of the Investment Adviser Act of 1940) with respect to an advisory program transaction if the transaction is directed to us by a nonrelated portfolio manager, to whom the client has granted discretionary trading authority and we do not recommend, select or play a role, direct or indirect, in the portfolio manager's selection of particular securities to be purchased for, or on behalf of, program clients. We have implemented systems and procedures that are designed to comply with the policy stated above and to monitor related activities. We may also affect cross-transactions between client accounts, where one client purchases a security held by another client. Neither SWSFS nor any related party receives any compensation in connection with a cross-transaction. We effect these transactions only when we deem the transaction to be in best interests of both clients and at prices we have determined to reflect their value.

You should understand that, to the extent permitted by applicable law, we may, in transactions involving your securities, act as agent while also representing another client on the other side of the transaction (provided, however, that no such agency transaction will be effected for the Program Account(s) of any ERISA Plan or an individual retirement account ("Agency Cross-Transaction")).

If the transaction is an agency cross transaction, in which we act as your broker or agent by purchasing or selling securities from or to one of our brokerage customers, we obtain your written consent and will provide you with a written confirmation at or before the completion of the transaction. The confirmation will describe the nature of the transaction, plus information about its date and time, and the remuneration that the Investment Adviser or another person may receive as a result. At least annually, we will provide you a written disclosure statement identifying the total number of such agency cross transactions for your account during the period, and the total amount of all commissions or other remuneration we received or will receive in connection with these transactions, if any.

We generally will not effect agency cross transactions between clients if we have recommended the security to both clients. Such Agency Cross-Transactions may have a potential of conflicting division of loyalty and responsibility regarding, both parties to the Agency Cross Transaction. Such transactions are generally limited brokerage (non-advisory) clients only unless specific consent by the client has been granted to the transaction in accordance with regulatory requirements. We may have a financial interest

for securities or investment products that the Firm's investment Adviser representatives recommend to advisory clients. In certain cases, the products may only be used with restrictions within the advisory programs.

Principal trades and agency cross transactions are also subject to additional restrictions, procedures and controls that are in place for the securities transactions in advisory accounts. As discussed more fully below, we seek to obtain the best execution for each of our advisory clients.

### **Personal Trading**

SWSFS and its officers, directors, shareholders, employees and affiliates may buy or sell securities for themselves that it also recommends to clients. We receives duplicate confirms for all trades conducted by SWSFS personnel, and reviews them for potential conflicts of interests.

## **Brokerage Practices**

In the advisory programs offered by SWSFS, you agree in the investment advisory agreement that trades are generally to be introduced by SWSFS and executed by SWST in their capacity as an introducing and executing broker-dealer respectively. By directing brokerage, clients may not also receive best execution on account transactions.

Independent Investment Managers in the Premier Advisors Program have the option of executing transactions away from SWST if they believe it is in the client's best interest to do so.

SWSFS receives no soft-dollar compensation.

In order to seek a more advantageous net price, it is our practice to aggregate, when feasible, orders for purchase or sale of a particular security for accounts of several program clients for execution as a single transaction. Any benefit to such aggregation generally is allocated pro-rata among the client accounts that participated in the aggregated transaction.

SWSFS, SWST or the sub-managers may but are not required to aggregate orders for client accounts with the orders of other clients, their own accounts, their employees and their related persons. In such cases, the transactions, as well as the expenses incurred in the transactions are allocated according to SWSFS, SWST or the applicable sub-manager's policy in a manner believed by it to be equitable to the client. In such cases, each account will be charged with the average price per unit, and where applicable, with brokerage costs and other fees.

Sub-managers participating in the Premier Advisors or Direct Access Program may determine that the purchase or sale of a particular security is appropriate for more than one client account. In such cases, the sub-manager may decide to aggregate multiple client orders into one "block" order for execution purposes. This can have the advantage of avoiding an adverse effect on the price of a security which can result from simultaneously placing a number of separate competing orders. In the event a block transaction is effected by a sub-manager, you will receive the average price of all transactions effected to satisfy the order.

As a result, the average price received by you may be higher or lower than the price at which you may have received had the transaction been effected for you independently from the block transaction. When aggregating orders, and in the process of allocating block purchases and block sales to individual client accounts, it is SWST' policy to treat all clients fairly and to achieve an equitable distribution of aggregated orders. Sub-managers participating in the SWST program may also participate in other wrap fee programs sponsored by broker/dealers not affiliated with SWST. In addition, sub-manager typically manages

institutional accounts not referred through a directed brokerage, wrap fee program. In the event a sub-manager wishes to buy or sell a security for all accounts within a particular discipline, the sub-manager may have to potentially effect such transactions through a large number of broker/dealers. Depending on the liquidity of the security and the size of the transaction, among other factors, certain sub-managers may utilize a trade rotation process where one group of clients (i.e. SWST clients) may have a transaction effected before or after another group of the sub-manager's clients so as to limit the market impact of the transaction. A sub-manager's trade rotation policies are at their discretion, typically utilize a random selection process and are intended to equitably allocate transactions over time across the sub-manager's entire client base so that each group of clients can expect to receive executions at the beginning, middle and the end of the rotation. Additional information regarding the sub-manager's trade rotation policies, if any, is available in the sub-manager's Form ADV Part II.

## **Review of Accounts**

Program Services include periodic reviews and monitoring of your Account by your IAR. In addition, monthly and/or quarterly reviews are conducted by the Investment Management Group (IMG). In addition, for Clients of IARs registered through SWSFS, trading activity is reviewed on a daily basis by the, Office of Supervisory Jurisdiction (OSJ), or designee assigned to the IAR. Other reviews as deemed appropriate may be conducted by the OSJ or OSJ designee. IARs conduct reviews on at least an annual basis, which can provide an opportunity for you to update SWSFS with any material changes in your financial condition and/or investment constraints.

We will provide you with an annual performance review. We use our best efforts to ensure timely delivery of these reports, but reserve the right to delay delivery to ensure accuracy and completeness. In addition, you will receive written (or, if elected by you, electronic) account statements at least quarterly.

## **Clients Referrals and Other Compensation**

SWSFS may pay referral fees to persons for referring advisory business to SWSFS pursuant to Rule 206 (4)-3 of the Investment Advisers Act. Such fees may only be paid to persons with whom SWSFS has entered into formal referral agreements. SWSFS also requires that a referral fee disclosure statement be given to you (or prospective clients) that discloses, among other things, the amount of fee to be paid to the referring person and the fact that the payment of such referral fees has not increased the amount of the total advisory fee that you (or prospective client) will pay.

## **Custody**

SWSFS accounts are custodied at SWS Securities, Inc., an affiliate of SWSFS. SWST as the custodian will provide clients with account statements at least quarterly. These statements identify the positions in the account at the end of the statement period, as well as all transactions in the account during the statement period. Clients should review these statements carefully.

## **Investment Discretion**

In Premier Advisors, you authorize and direct the Platform Manager to delegate discretionary authority to each manager selected. The Russell Strategies Program is a discretionary program. Russell Investment Company determines the asset allocation and fund selection, and SWST will implement the strategy. For Partner Discretion accounts, you delegate discretionary trading authority to your IAR.

## **Voting Client Securities**

We will not vote on matters requiring shareholder voting in connection with the securities held in a your account, or with respect to certain legal actions involving securities including, for example, voting proxies, mergers, bankruptcies, or restructuring, class actions or similar matters. Under the circumstances where we receive material on your behalf, we will promptly forward such material to your attention. With respect to Premier Advisors programs, the manager with discretion may vote the proxy. You may contact your Investment Adviser Representative to request information regarding how managers in those programs voted their proxies.

## **Financial Information**

SWSFS has not been the subject of a bankruptcy petition at any time in its existence. Under no circumstance will we earn fees more than six months in advance of services rendered.