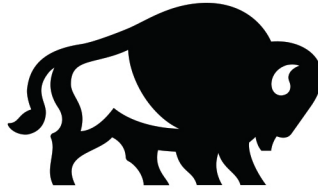


# HilltopSecurities



A Hilltop Holdings Company<sup>SM</sup>

## Hilltop Securities Inc.

Statement of Financial Condition

For the Six-months Ended June 30, 2019

Filed pursuant to Rule 17a(3)(3) under the  
Securities Exchange Act of 1934  
as a PUBLIC DOCUMENT

**Hilltop Securities Inc.**  
**Statement of Financial Condition**  
**June 30, 2019**  
*(unaudited)*

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*(dollars in thousands, except par and redemption values)*

**Assets**

Cash	\$ 10,036
Assets segregated for regulatory purposes	151,271
Receivable from brokers, dealers and clearing organizations	2,028,910
Receivable from clients, net of allowance of \$46	367,309
Securities owned, at fair value	595,654
Securities purchased under agreements to resell	50,660
Goodwill	7,008
Customer intangible, net of accumulated amortization of \$11,525	5,275
Operating lease right-of-use assets	18,711
Fixed assets, at cost, less accumulated depreciation of \$20,876	16,685
Net deferred tax asset	8,962
Other assets (including \$3,887 due from affiliates)	64,896
Total assets	<u>\$ 3,325,377</u>

**Liabilities and Stockholder's Equity**

Short-term borrowings	\$ 231,000
Payable to brokers, dealers, and clearing organizations (including \$457 due to affiliate)	1,532,348
Payable to clients (including \$300 clearing deposit due to affiliate)	417,949
Drafts payable	18,787
Securities sold, not yet purchased, at fair value	45,447
Securities sold under agreements to repurchase	488,042
Notes payable due to affiliate	62,402
Operating lease liabilities	23,646
Subordinated debt due to affiliate	42,000
Accrued expenses and other liabilities (including \$16,131 due to affiliates)	110,031
Total liabilities	<u>2,971,652</u>

Stockholder's equity:

Series A preferred stock, \$20 par value, \$1,000 redemption value; authorized 100,000 shares; no shares issued and outstanding	-
Class A voting common stock of \$1 par value; authorized 10,000 shares; issued and outstanding 2,820 shares	3
Class B nonvoting common stock of \$1 par value; authorized 10,000 shares; none issued	-
Additional paid-in capital	289,038
Retained earnings	64,684
Total stockholder's equity	<u>353,725</u>
Total liabilities and stockholder's equity	<u>\$ 3,325,377</u>

The accompanying notes are an integral part of this financial statement.

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**1. Organization**

Hilltop Securities Inc. (the "Company"), a Delaware Company and a wholly owned subsidiary of Hilltop Securities Holdings LLC ("Securities Holdings"), a wholly owned subsidiary of Hilltop Holdings Inc. ("Parent"), is a New York Stock Exchange ("NYSE") member broker/dealer, a registered investment advisor and a member of the Financial Industry Regulatory Authority ("FINRA"). The Company is registered with the Securities and Exchange Commission (the "SEC") as a broker/dealer under the Securities Exchange Act of 1934 ("Exchange Act") and as a registered investment advisor under the Investment Advisors Act of 1940. The Company is also registered with the Commodity Futures Trading Commission ("CFTC") as a non-guaranteed introducing broker and is a member of the National Futures Association ("NFA").

Pursuant to the SEC Rule 11(a) of the Exchange Act, over 50% of the Company's revenues are comprised of Section 11(a) items, indicating the Company is primarily engaged in trading on behalf of customers.

**2. Summary of Significant Accounting Policies**

**Securities Transactions**

Proprietary securities transactions are recorded on trade date, as if they had settled. Clients' securities and commodities transactions are reported on a settlement date basis, which approximates trade date basis.

Marketable securities are valued at fair value, based on quoted market prices, and securities not readily marketable are valued at fair value as determined by management. The Company evaluates fair value measurements by considering observable data that may include prices from independent pricing services, dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, and the financial instruments' terms and conditions, among other factors.

**Fixed Assets and Depreciation**

Fixed assets are comprised of furniture and equipment (\$29,085) and leasehold improvements (\$8,476) which are stated at cost. Depreciation of furniture and equipment is provided over the estimated useful lives of the assets (from three to seven years), and depreciation on leasehold improvements is provided over the shorter of the useful life or the lease term (up to fifteen years) using the straight-line method. Additions, improvements and expenditures for repairs and maintenance that significantly extend the useful life of an asset are capitalized. Other expenditures for repairs and maintenance are charged to expense in the period incurred.

**Goodwill and Customer Intangible**

The Parent performs required annual impairment tests of its goodwill as of October 1st for each of its reporting units. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill. The goodwill impairment test requires the Parent to make judgments in determining what assumptions to use in the calculation. The process consists of estimating the fair value of each reporting unit based on valuation techniques, including a discounted cash flow model using revenue and profit forecasts and recent industry transaction and trading multiples of the Parent's peers, and comparing those estimated fair values with the carrying values of the assets and liabilities of the reporting unit, which includes the allocated goodwill. If the estimated fair value is less

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than the carrying value, the Parent will recognize an impairment charge, pushed down to the reporting unit, for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized will not exceed the total amount of goodwill allocated to that reporting unit.

At October 1, 2018, the Parent determined that the estimated fair value of each of its reporting units, including the Company, exceeded its carrying value. As a result, the Parent concluded that the Company's goodwill was fully realizable, indicating no impairment of the Company's goodwill.

The Company recorded two separate customer relationship intangibles as part of the acquisition of First Southwest Company, LLC ("FSC") by the Parent in November 2012 and the merger of the Company with the Parent in January 2015, which are being amortized over a 12 and 14 year period, respectively, at a rate based on the sum of the years digits.

The Company determined that no impairment for the Company's intangible assets was necessary upon their evaluation on October 1, 2018.

**Resale and Repurchase Agreements**

Transactions involving purchases of securities under agreements to resell (reverse repurchase agreements or reverse repos) or sales of securities under agreements to repurchase (repurchase agreements or repos) are accounted for as collateralized financings. It is the policy of the Company to obtain possession of collateral with a fair value equal to or in excess of the principal amount loaned under resale agreements. Collateral is valued daily, and the Company may require counterparties to deposit additional collateral or return collateral pledged when appropriate. Interest payable and interest receivable on these amounts are included in the Statement of Financial Condition in other liabilities and other assets, respectively.

**Leases**

In February 2016, the Financial Accounting Standards Board issued the Leasing Standard, which is codified in Accounting Standards Update ("ASU") 842, *Leases*, and is intended to increase transparency and comparability among organizations and require lessees to record a right-of-use ("ROU") asset and a liability representing the obligation to make lease payments for long-term leases. The Company adopted the standard on January 1, 2019, using the modified retrospective transition under the option to apply the leasing standard at its effective date without adjusting the prior period comparative financial statements. The Company elected the package of practical expedients to not reassess: (i) whether any existing contracts are or contain a lease, (ii) the lease classification of any existing leases and (iii) initial direct costs related to existing leases. The Company also elected to apply an additional practical expedient to include both the lease and non-lease components of all leases as a single component and account for it as a lease. The Company implemented internal controls and key system functionality to enable the preparation of financial information upon adoption. On January 1, 2019, the Company recorded operating lease liabilities of \$26,877 and ROU assets of \$21,317, which included the write-off of \$5,560 of deferred rent, upon adoption of the leasing standard. The lease liabilities (at their present value) represent predominantly all of the future minimum lease payments required under operating leases.

The Company determines if an arrangement is a lease at inception. Operating leases with a term of greater than one year are included in operating lease right-of-use ("ROU") assets and operating lease liabilities on the Company's consolidated balance sheets. The Company has lease agreements with lease and non-lease components, which are generally accounted for as a single lease component. Leases of low-value assets are assessed on a lease-by-lease basis to determine the need for statement of financial condition

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capitalization. ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized on the lease commencement date based on the present value of lease payments over the lease term. As most of the Company's leases do not provide an implicit rate, the Company uses the incremental borrowing rate commensurate with the lease term based on the information available at the lease commencement date in determining the present value of lease payments. No significant judgments or assumptions were involved in developing the estimated operating lease liabilities as the Company's operating lease liabilities largely represent the future rental expenses associated with operating leases, and the incremental borrowing rates are based on publicly available interest rates. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. The Company's lease terms may include options to extend or terminate the lease. These options to extend or terminate are assessed on a lease-by-lease basis, and the ROU assets and lease liabilities are adjusted when it is reasonably certain that an option will be exercised.

**Securities Borrowing and Lending Activities**

Securities borrowed and securities loaned transactions are generally reported as collateralized financings. Securities borrowed transactions require the Company to deposit cash, letters of credit, or other collateral with the lender. With respect to securities loaned, the Company receives collateral in the form of cash in an amount generally in excess of the fair value of securities loaned. The Company monitors the fair value of securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as necessary. Securities borrowed and securities loaned transactions are recorded at the amount of cash collateral advanced or received adjusted for additional collateral obtained or received. Securities borrowed and securities loaned, as well as the interest accrued on such transactions are included in the Statement of Financial Condition in receivables from and payables to brokers, dealers and clearing organizations.

**Drafts Payable**

In the normal course of business, the Company uses drafts to make payments relating to its brokerage transactions. These drafts are presented for payment through an unaffiliated bank and are sent to the Company daily for review and acceptance. Upon acceptance, the drafts are paid.

**Cash Flow Reporting**

The Company considers cash to include cash on hand and in bank accounts. In addition, highly liquid debt instruments purchased with maturities of three months or less, when acquired, are considered to be cash equivalents. The Federal Deposit Insurance Corporation ("FDIC") insures deposit accounts up to \$250. At June 30, 2019, the cash balances included \$8,542 that was not federally insured because they exceeded federal insurance limits. This at-risk amount is subject to fluctuation on a daily basis, but management does not believe there is significant risk on these deposits.

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**Derivative Financial Instruments**

Derivative financial instruments arise from the execution of forward purchase commitments of mortgage-backed securities with certain clients that allow those clients to make mortgage loans at agreed-upon rates. The Company hedges the interest rate risk generated by the forward purchase commitments by executing forward sales of to-be-announced mortgage-backed securities (TBA). The amount hedged is influenced by the Company's estimated ratio of the forward purchase commitments that will not be securitized into mortgage-backed securities as part of the program (fallout rate). The Company uses historical experience, changes in interest rates, and other factors to estimate the fallout rate.

Additionally, the Company enters into TBA agreements to assist clients (generally small to mid-size mortgage loan originators) in hedging the interest rate risk associated with the mortgages owned by the clients. In general, the Company will enter into a TBA purchase agreement with the client and then immediately enter into a TBA sale agreement with identical terms and the same settlement date with a separate counter-party. The Company mitigates interest rate risk and earnings volatility by selling TBAs with characteristics similar to the forward purchase commitments of mortgage-backed securities.

The Company also utilizes a portfolio of exchange-traded derivative instruments to achieve a fair value return that economically hedges changes in the fair value of their securities products. These derivative instruments include both Eurodollar and Treasury Futures.

While the forward purchase commitments, TBAs, and U.S. Treasury and Eurodollar futures and options meet the definition of a derivative under the provisions of ASC 815 "*Derivatives and Hedging*," they do not qualify for hedge accounting. These derivative securities are carried at fair value and recorded in other assets and other liabilities in the Statement of Financial Condition with unrealized and realized gains recorded in net gains (losses) on principal transactions in the Statement of Operations.

**Income Taxes**

The Company files a consolidated federal income tax return with its Parent. For purposes of these financial statements, income taxes are computed on the benefits-for-loss method.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

**Fair Value of Financial Instruments**

Fair value accounting establishes a framework for measuring fair value. Under fair value accounting, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date in the principal market in which the reporting entity transacts. Further, fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, fair value accounting establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. Under the standard, fair value measurements are separately disclosed by level within the fair value hierarchy.

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The standard describes three levels of inputs that may be used to measure fair value:

- Level 1 — Quoted prices in an active market for identical assets or liabilities. Assets and liabilities utilizing Level 1 inputs include certain inventories held in the Company's securities owned and securities sold, not yet purchased portfolio. Valuation of these instruments does not require a high degree of judgment as the valuations are based on quoted prices in active markets that are readily available.
- Level 2 — Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Assets and liabilities utilizing Level 2 inputs include certain inventories held in the Company's securities owned and securities sold, not yet purchased portfolio and the Company's commitments to purchase and sell derivative securities. These financial instruments are valued by quoted prices that are less frequent than those in active markets or by models that use various assumptions that are derived from or supported by data that is generally observable in the marketplace. Valuations in this category are inherently less reliable than quoted market prices due to the degree of subjectivity involved in determining appropriate methodologies and the applicable underlying observable market assumptions.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. These assets and liabilities would have significant inputs that could not be validated by readily determinable market data and generally would involve considerable judgment by management. The Company does not have any financial instrument assets or liabilities utilizing Level 3 inputs.

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying Statement of Financial Condition, as well as the general classification of such instruments pursuant to the valuation hierarchy.

***Securities Owned and Securities Sold, Not Yet Purchased Portfolio (including the Company's derivative securities).***

Securities classified as Level 1 securities primarily consist of financial instruments whose values are based on quoted market prices in active markets such as corporate equity securities and U.S. government and government agency obligations primarily in U.S. treasury securities.

Securities classified as Level 2 securities include financial instruments that are valued using models or other valuation methodologies. These models are primarily industry standard models that consider various assumptions, including time value, yield curve, volatility factors, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Securities in this category include corporate obligations, U.S. government and government agency obligations, municipal obligations, unit investment trusts (UIT) and the Company's commitments to purchase and sell derivative securities.

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Substantially all of the Company's financial assets and liabilities are carried at fair value or at amounts which, because of their short-term nature, approximate current fair value.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the recorded amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**3. Assets Segregated For Regulatory Purposes**

At June 30, 2019, the Company held cash of \$151,271 segregated in special reserve bank accounts for the exclusive benefit of customers under Rule 15c3-3 under the Securities Exchange Act of 1934 ("Exchange Act Rule 15c3-3").

**4. Receivable From and Payable to Brokers, Dealers and Clearing Organizations**

At June 30, 2019, the Company had receivable from and payable to brokers, dealers and clearing organizations related to the following:

**Receivable:**

Securities borrowed	\$ 1,569,362
Correspondent broker/dealers	232,501
Trades in process of settlement, net	96,247
Clearing organizations	89,160
Securities failed to deliver	24,310
Other	17,330
	<u>\$ 2,028,910</u>

**Payable:**

Securities loaned	\$ 1,459,218
Securities failed to receive	37,562
Correspondent broker/dealers	29,700
Other	5,868
	<u>\$ 1,532,348</u>

The Company participates in the securities borrowing and lending business by borrowing and lending securities other than those of its clients. Securities borrowed and loaned represent deposits made to or received from other broker/dealers relating to these transactions. These deposits approximate the market value of the underlying securities. All open positions are adjusted to market values daily. The Company obtains or releases collateral as prices of the underlying securities fluctuate.

The Company clears securities transactions for correspondent broker/dealers. Proprietary settled securities and related transactions for these correspondents are included in the receivable from and



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payable to brokers, dealers and clearing organizations. At June 30, 2019, the Company held collateral for the receivables from correspondents in the amount of \$353,217.

Securities failed to deliver and receive represent the contractual value of securities that have not been delivered or received subsequent to settlement date.

Certain securities lending arrangements may be eligible for offset in the statement of financial condition and /or subject to master netting arrangements or similar agreements.

The following table provides information about these receivables and payables subject to an enforceable master netting arrangement or similar agreements with offsetting rights and related collateral amounts at June 30, 2019:

Description	Gross amounts of recognized assets/liabilities <sup>(2)</sup>	Gross amounts offset in the statement of financial condition	Net amounts of assets/liabilities presented in the statement of financial condition	Gross amounts not offset in the statement of financial condition		
				Financial instruments <sup>(3)</sup>	Cash Collateral	Net Amount
Securities borrowed	\$ 1,569,362	\$ -	\$ 1,569,362	\$ (1,517,772)	\$ -	\$ 51,590
Securities loaned <sup>(1)</sup>	1,459,218	-	1,459,218	(1,410,580)	-	48,638

<sup>(1)</sup>Under securities lending agreements, the Company repledged \$1,384,953.

<sup>(2)</sup>Securities borrowed and loaned are not presented net on the Statement of Financial Condition.

<sup>(3)</sup>Amounts reflect fair value of underlying collateral.

**Securities Lending Activities.** The Company's securities lending activities includes lending securities for other broker/dealers, lending institutions and its own clearing and retail operations. These activities involve lending securities to other broker/dealers to cover short sales, to complete transactions in which there has been a failure to deliver securities by the required settlement date and as a conduit for financing activities.

When lending securities, the Company receives cash or similar collateral and generally pays interest (based on the amount of cash deposited) to the other party to the transaction. Securities lending transactions are executed pursuant to written agreements with counterparties that generally require securities loaned to be marked-to-market on a daily basis. The Company receives collateral in the form of cash in an amount generally in excess of the fair value of securities loaned. The Company monitors the fair value of securities loaned on a daily basis, with additional collateral obtained or refunded, as necessary. Collateral adjustments are made on a daily basis through the facilities of various clearinghouses. The Company is a principal in these securities lending transactions and is liable for losses in the event of a failure of any other party to honor its contractual obligation. The Company's

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management sets credit limits with each counterparty and reviews these limits regularly to monitor the risk level with each counterparty. The Company is subject to credit risk through its securities lending

activities if securities prices decline rapidly because the value of the Company's collateral could fall below the amount of the indebtedness it secures. In rapidly appreciating markets, credit risk increases due to short positions. The Company's securities lending business subjects the Company to credit risk if a counterparty fails to perform or if collateral securing its obligations is insufficient. In securities transactions, the Company is subject to credit risk during the period between the execution of a trade and the settlement by the customer.

The following table presents the remaining contractual maturities of securities lending transactions accounted for as secured borrowings at June 30, 2019:

	<b>Remaining Contractual Maturity of the Agreements</b>				<b>Total</b>
	<b>Overnight and Continuous</b>	<b>Up to 30 days</b>	<b>30-90 days</b>	<b>Greater than 90 days</b>	
<b>Securities lending transactions</b>					
Corporate securities	\$ 113	\$ -	\$ -	\$ -	\$ 113
Equity securities	1,459,105	-	-	-	1,459,105
<b>Total borrowings</b>	<b>\$ 1,459,218</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 1,459,218</b>
Gross amount of recognized liabilities for securities lending					\$ 1,459,218
Amount related to agreements not included in offsetting disclosure					\$ -

**5. Receivable From and Payable to Clients**

Receivable from and payable to clients include amounts due on cash and margin transactions. Included in these amounts are receivable from and payable to noncustomers (as defined by Exchange Act Rule 15c3-3, principally officers, directors and related accounts), which aggregated approximately \$1,115 and \$2, respectively, at June 30, 2019. Securities accounts of noncustomers are subject to the same terms and regulations as those of customers. Securities owned by customers and noncustomers that collateralize the receivables are not reflected in the accompanying financial statements.

The Company pledges client securities as collateral in conjunction with the Company's securities lending activities. At June 30, 2019, the Company has approximately \$471,466 of client securities under customer margin loans that are available to be pledged, of which the Company has repledged approximately \$74,265 under securities loan agreements.

The Company pays interest on certain customer "free credit" balances available for reinvestment. The aggregate balance of such funds was approximately \$325,105 at June 30, 2019. During the six-months ended June 30, 2019 and at June 30, 2019, the interest rate paid on these balances and the weighted average interest rate paid during the six-months ended June 30, 2019 was 0.85%.

The Company maintains an allowance for doubtful accounts of \$46 which represents amounts that, in the judgment of management, are necessary to adequately absorb losses from known and inherent risks in

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receivables from customers. At June 30, 2019, all unsecured customer receivables had been provided for in this allowance.

**6. Securities Owned and Securities Sold, not yet Purchased**

At June 30, 2019, securities owned and securities sold, not yet purchased, both of which are carried at fair value, included the following:

**ASSETS**

**Securities owned:**

U. S. treasury securities	\$	5,203
U. S. government agencies:		
Bonds		6,194
Residential mortgage-backed securities		246,655
Collateralized mortgage obligations		149,449
Corporate debt securities		54,729
States and political subdivisions		116,202
Unit investment trusts:		
Corporate securities		11,743
Municipal securities		4,176
Private-label issuers:		
Mortgage-backed securities		1,149
Asset-backed securities		118
Options		35
Equity securities		1
	\$	<u><u>595,654</u></u>

**LIABILITIES**

**Securities sold, not yet purchased:**

U. S. treasury securities	\$	8,679
Corporate debt securities		30,550
Equity securities		6,218
	\$	<u><u>45,447</u></u>

At June 30, 2019, none of the above securities were pledged as security deposits at clearing organizations for the Company's clearing business. Additional securities have been pledged to secure short-term borrowings, see **Note 10**.

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**7. Derivative Financial Instruments**

As described in **Note 2**, the Company participates in various hedging activities and at June 30, 2019, the Company's derivative positions associated with these activities are presented below:

	<u>Notional Amount</u>	<u>Estimated Fair Value</u>
Commitments to purchase TBAs	\$ 3,323,653	\$ 21,730
Commitments to sell TBAs	3,191,775	(11,059)
U.S. Treasury futures and options	38,000	-
Eurodollar futures	98,000	-

At June 30, 2019, the Company advanced cash collateral totaling \$574 on its U.S. Treasury bond futures and options and Eurodollar futures. This amount is included in other assets within the Statement of Financial Condition.

Certain derivative arrangements may be eligible for offset in the statement of financial condition and /or subject to master netting arrangements or similar agreements.

The following table provides information about these derivative arrangements subject to an enforceable master netting arrangement or similar agreements with offsetting rights and related collateral amounts at June 30, 2019:

<u>Description</u>	<u>Gross amounts of recognized assets/liabilities</u>	<u>Gross amounts offset in the statement of financial condition</u>	<u>Net amounts of assets/liabilities presented in the statement of financial condition</u>	<u>Gross amounts not offset in the statement of financial condition</u>		
				<u>Financial instruments</u>	<u>Cash Collateral</u>	<u>Net Amount</u>
Derivative assets	\$ 21,732	\$ -	\$ 21,732	\$ (21,732)	\$ -	\$ -
Derivative liabilities	11,061	-	11,061	(11,061)	-	-

**8. Fair Value of Financial Instruments**

The following table summarizes by level within the fair value hierarchy securities owned, at fair value, securities sold, not yet purchased, at fair value and derivative securities as of June 30, 2019:

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	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b><u>ASSETS</u></b>				
<b>Securities owned, at fair value</b>				
U. S. treasury securities	\$ 5,203	\$ -	\$ -	\$ 5,203
U. S. government agencies:				
Bonds	-	6,194	-	6,194
Residential mortgage-backed securities	-	246,655	-	246,655
Collateralized mortgage obligations	-	149,449	-	149,449
Corporate debt securities	-	54,729	-	54,729
States and political subdivisions	-	116,202	-	116,202
Unit investment trusts:				
Corporate securities	-	11,743	-	11,743
Municipal securities	-	4,176	-	4,176
Private-label issuers:				
Mortgage-backed securities	-	1,149	-	1,149
Asset-backed securities	-	118	-	118
Options	-	35	-	35
Equity securities	1	-	-	1
	<u>\$ 5,204</u>	<u>\$ 590,450</u>	<u>\$ -</u>	<u>\$ 595,654</u>
<b>Derivative financial instruments</b>				
Commitments to purchase TBAs	<u>\$ -</u>	<u>\$ 21,732</u>	<u>\$ -</u>	<u>\$ 21,732</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b><u>LIABILITIES</u></b>				
<b>Securities sold, not yet purchased, at fair value</b>				
U. S. treasury securities	\$ 8,679	\$ -	\$ -	\$ 8,679
Corporate debt securities	-	30,550	-	30,550
Equity securities	6,218	-	-	6,218
	<u>\$ 14,897</u>	<u>\$ 30,550</u>	<u>\$ -</u>	<u>\$ 45,447</u>
<b>Derivative financial instruments</b>				
Commitments to sell TBAs	<u>\$ -</u>	<u>\$ 11,061</u>	<u>\$ -</u>	<u>\$ 11,061</u>
<b>Net assets (liabilities)</b>	<u>\$ (9,693)</u>	<u>\$ 570,571</u>	<u>\$ -</u>	<u>\$ 560,878</u>

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At the end of each respective quarterly reporting period, the Company recognizes transfers of financial instruments between levels. During the year ended June 30, 2019, the Company did not have any transfers of financial instruments between levels.

**9. Securities Purchased/Sold Under Agreements to Resell/Purchase**

At June 30, 2019, the Company held reverse repurchase agreements, collateralized by U.S. government and government agency obligations and securities sold under repurchase agreements. These securities are reported on a gross basis in the Statement of Financial Condition.

Securities sold under repurchase agreements, which are secured borrowings, generally mature overnight with some maturing up to 30 days from the transaction date. Securities sold under repurchase agreements are reflected at the amount of cash received in connection with the transactions. The Company may be required to provide additional collateral based on the fair value of the underlying securities. The Company monitors the fair value of the underlying securities on a daily basis.

Certain reverse repurchase and repurchase agreements may be eligible for offset in the statement of financial condition and /or subject to master netting arrangements or similar agreements.

The following table provides information about these instruments subject to an enforceable master netting arrangement, repurchase agreements or similar agreements with offsetting rights and any related collateral amounts at June 30, 2019:

Description	Gross amounts of recognized assets/liabilities	Gross amounts offset in the statement of financial condition	Net amounts of assets/liabilities presented in the statement of financial condition	Gross amounts not offset in the statement of financial condition		
				Financial instruments <sup>(1)</sup>	Cash Collateral	Net Amount
Reverse repurchase agreements	\$ 50,660	\$ -	\$ 50,660	\$ (50,575)	\$ -	\$ 85
Repurchase agreements	488,042	-	488,042	(488,042)	-	-

<sup>(1)</sup>Amounts reflect fair value of underlying collateral.

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The following table presents the remaining contractual maturities of repurchase agreements accounted for as secured borrowings at June 30, 2019:

	<b>Remaining Contractual Maturity of the Agreements</b>				<b>Total</b>
	<b>Overnight and Continuous</b>	<b>Up to 30 days</b>	<b>30-90 days</b>	<b>Greater than 90 days</b>	
<b>Repurchase agreements</b>					
U.S. treasury and agency securities	\$ 17,869	\$ -	\$ -	\$ -	\$ 17,869
Asset backed securities	470,173	-	-	-	470,173
<b>Total borrowings</b>	<b>\$ 488,042</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 488,042</b>
Gross amount of recognized liabilities for repurchase agreements					\$ 488,042
Amount related to agreements not included in offsetting disclosure					\$ -

**10. Short-Term Borrowings**

**Uncommitted lines of credit**

The Company has credit arrangements with commercial banks, which include broker loan lines up to \$725,000. These lines of credit are used primarily to finance securities owned, securities held for correspondent broker/dealer accounts, receivables in customers' margin accounts and underwriting activities. These lines may also be used to release pledged collateral against day loans. These credit arrangements are provided on an "as offered" basis and are not committed lines of credit. These arrangements can be terminated at any time by the lender. Any outstanding balances under these credit arrangements are due on demand and bear interest at rates indexed to the federal funds rate (2.40% at June 30, 2019). At June 30, 2019, the amount outstanding under these secured arrangements was \$231,000, which was collateralized by securities held for firm and correspondent broker/dealer accounts valued at \$474,003.

**Committed lines of credit**

At June 30, 2019, the Company had a \$50,000 committed revolving credit facility with an unaffiliated bank. The commitment fee is 25 basis points per annum, and when drawn, the interest rate is equal to the federal funds rate plus 100 basis points. The agreement requires the Company to maintain a tangible net worth of at least \$170,000. At June 30, 2019, there were no outstanding amounts under the committed revolving credit facility.

The Company pledges customer securities to the Option Clearing Corporation to support open customer positions. At June 30, 2019, the Company had pledged \$67,169 to support these open customer positions.

**11. Note Payable Due to Affiliate & Subordinated Debt Due to Affiliate**

In January 2016, the Company entered into an agreement with First Southwest Holdings LLC for a non collateralized, 10 year, \$88,127 promissory note paying interest semi-annually at a rate of 5% per annum and a \$42,000 subordinated loan agreement with Securities Holdings paying interest semi-annually at a

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rate of 4.35% per annum. Both the agreements were entered into as part of the merger of FSC with the Company. In August of 2018, the promissory note held by First Southwest Holdings LLC and the subordinated loan with Securities Holdings were contributed to the Parent, with the remaining balance of \$111,652, at the time of the contribution, plus interest to be paid to the Parent. At June 30, 2019, there was \$104,402 outstanding under these agreements.

**12. Income Taxes**

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at June 30, 2019 are presented below:

<b>Deferred tax assets:</b>	
Compensation and benefits	\$ 5,082
Realized built-in loss carryforward	2,528
Deferred income	1,692
Deferred rent	1,364
Legal and other reserves	646
Other	619
Total gross deferred tax asset	<u>11,931</u>
<b>Deferred tax liabilities:</b>	
Intangible assets	(1,369)
Fixed Assets	(996)
Other	(604)
Total gross deferred tax liability	<u>(2,969)</u>
Net deferred tax asset	<u>\$ 8,962</u>

The Company assesses the ability to realize its deferred tax assets based upon the weight of available evidence, both positive and negative. To the extent the Company believes that it is more likely than not that some portion or all of the deferred tax assets will not be realized, the Company will establish a valuation allowance. The Company evaluated the realizability of its deferred tax assets and concluded, based on the Company's past history of profitability and future earnings projections, that a valuation allowance was not required.

At June 30, 2019, the Company had recognized built-in losses ("RBIL") of \$2,528 from the 2015 merger with the Parent. At June 30, 2019, the Company had net operating loss ("NOL") carryforwards for state income tax purposes of \$712. These net operating loss carryforwards expire in 2030 and later years. The RBILs and NOLs are expected to be fully realized prior to any expiration.

At June 30, 2019, the total amount of gross unrecognized tax benefits was \$313, if recognized, and the total amount that would favorably impact the Company's effective tax rate and reduce income tax expense was \$247.



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The aggregate changes in gross unrecognized tax benefits, which exclude interest and penalties, are as follows:

<b>Balance at December 31, 2018</b>	\$	293
Increases related to tax positions taken during the current year		20
<b>Balance at June 30, 2019</b>	\$	<u>313</u>

With limited exception, the Company is no longer subject to U.S. federal, state or local tax audits by taxing authorities for years preceding 2015.

At June 30, 2019, the amount of current federal taxes payable to the Parent included in other liabilities on the Statement of Financial Condition was \$3,271 and the amount of current state taxes receivable from the Parent included in other assets on the Statement of Financial Condition was \$170.

### **13. Net Capital Requirements**

The Company is subject to the Securities and Exchange Commission's Uniform Net Capital Rule (the "Rule"), which requires the maintenance of minimum net capital. The Company has elected to use the alternative method, permitted by the Rule, which requires that it maintain minimum net capital, as defined in Rule 15c3-1 under the Exchange Act, equal to the greater of \$1,000 or 2% of aggregate debit balances, as defined in Exchange Act Rule 15c3-3. At June 30, 2019, the Company had net capital of approximately \$225,288 which is approximately \$215,317 in excess of its minimum net capital requirement of approximately \$9,971 at that date. Additionally, the Rule provides that equity capital may not be withdrawn or cash dividends paid if resulting net capital would be less than 5% of aggregate debit items. At June 30, 2019, the Company had net capital of approximately \$200,359 in excess of 5% of aggregate debit items.

### **14. Affiliate Transactions**

The Company clears all customer transactions for HTIN, an affiliate. The Company also provides all accounting, administrative services, management services and office facilities to HTIN in accordance with an expense sharing agreement in the amount of \$50 per year.

The Company, as clearing broker for its affiliate, has the right to charge customer losses back to the affiliate.

Clients and correspondents of the Company have the option to invest in a savings account called Bank Insured Deposits at the Company's banking affiliate, PlainsCapital Bank ("Bank"). These funds are FDIC insured up to \$250.

The Company makes loans to employees, primarily financial advisors, mainly for recruiting and retention purposes. The amount of loans to employees is included in other assets in the Statement of Financial Condition in the amount of \$14,152 for which the Company has recorded an allowance, included in other assets in the Statement of Financial Condition, of \$2,614 for terminated relationships.

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The Company is named as the lessee for two leases which are subleased to the Bank. Additionally, the Company subleases office space and utilizes space in a property owned by the Bank for its business recovery centers.

The Company has various expense sharing arrangements with the Parent, Securities Holdings and other subsidiaries of the Parent. These expense sharing agreements outline the types of expenses that will be passed through to the Company, including but not limited to compensation expense, use of Parent assets, and administrative services performed by the Parent or subsidiaries of the Parent. On the Statement of Financial Condition, the total receivable includes \$2,822 from First Southwest Holdings LLC and its subsidiaries, \$903 from the Bank and \$162 from Southwest Insurance Agency. The total payable includes \$6,797 to Securities Holdings, \$3,888 to the Parent, \$2,832 to First Southwest Holdings LLC and its subsidiaries, including \$457, which is reported in payable to brokers, dealers, and clearing organizations on the Statement of Financial Condition, \$1,539 to HTIN, \$1,493 to Southwest Insurance Agency, a \$300 clearing deposit to HTIN, which is reported in payable to clients on the Statement of Financial Condition and \$39 from the National Lloyds Corporation, a wholly owned subsidiary of the Parent.

**15. Leases**

The Company leases space, primarily for corporate offices, branch facilities and certain equipment under operating lease agreements. Certain of the Company's leases have options to extend, with the longest extension option being ten years, and some of the Company's leases include options to terminate within one year. The Company's leases contain customary restrictions and covenants. The Company has certain intercompany leases and subleases with the Parent's other subsidiaries and are reflected in the table and information presented below.

The Company does not generally enter into leases which contain variable payments, other than due to the passage of time. The Company's weighted average remaining lease term and weighted average discount rate as of June 30, 2019 are 5 years and 6.22%, respectively.

Future minimum lease payments under the leasing standard as of June 30, 2019, under lease agreements that had commenced as of January 1, 2019, are presented below:

2020	\$	4,685
2021		8,743
2022		5,168
2023		3,451
2024		2,571
Thereafter		1,870
Total minimum lease payments	\$	<u>26,488</u>
Amount representing interest		(2,842)
Present value of minimum lease payments	\$	<u><u>23,646</u></u>

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**16. Commitments and Contingencies**

**Underwriting.** Through its participation in underwriting corporate and municipal securities, the Company could expose itself to material risk that securities the Company has committed to purchase cannot be sold at the initial offering price. Federal and state securities laws and regulations also affect the activities of underwriters and impose substantial potential liabilities for violations in connection with sales of securities by underwriters to the public. At June 30, 2019, the Company had no liabilities due under outstanding underwriting arrangements.

**Litigation.** In the general course of its brokerage business and the business of clearing for other brokerage firms, the Company has been named as a defendant in various lawsuits and arbitration proceedings. These claims allege violation of federal and state securities laws among other matters. Management believes that resolution of these claims will not result in any material adverse effect on the Company's financial position or results of operations.

**Guarantees.** The Company provides representations and warranties to counterparties in connection with a variety of commercial transactions and occasionally indemnifies them against potential losses caused by the breach of those representations and warranties. These indemnifications generally are standard contractual indemnifications and are entered into in the normal course of business. The maximum potential amount of future payments that the Company could be required to make under these indemnifications cannot be estimated. However, the Company believes that it is unlikely it will have to make material payments under these arrangements and has not recorded any contingent liability in the financial statements for these indemnifications.

The Company is a member of multiple exchanges and clearinghouses. Under the membership agreements, members are generally required to guarantee the performance of other members. Additionally, if a member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet shortfalls. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. The Company's maximum potential liability under these arrangements cannot be quantified. However, the potential for the Company to be required to make payments under these arrangements is unlikely. Accordingly, no contingent liability is recorded in the financial statements for these arrangements.

**17. Financial Instruments with Off-Balance-Sheet Risk**

In the normal course of business, the Company engages in activities involving the execution, settlement and financing of various securities transactions. These activities may expose the Company to off-balance-sheet credit and market risks in the event the customer or counterparty is unable to fulfill its contractual obligation. Such risks may be increased by volatile trading markets.

As part of its normal brokerage activities, the Company sells securities not yet purchased (short sales) for its own account. The establishment of short positions exposes the Company to market risk if prices increase, as the Company may be obligated to acquire the securities at prevailing market prices.

The Company seeks to control the risks associated with its customers' activities, including those of customer accounts of its correspondents for which it provides clearing services, by requiring customers to maintain margin collateral in compliance with various regulatory and internal guidelines. The required

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margin levels are monitored daily and, pursuant to such guidelines, customers are required to deposit additional collateral or to reduce positions when necessary.

A portion of the Company's customer activity involves short sales and the writing of option contracts. Such transactions may require the Company to purchase or sell financial instruments at prevailing market prices in order to fulfill the customers' obligations.

At times, the Company lends money using reverse repurchase agreements. These positions are collateralized by U.S. government and government agency securities. Such transactions may expose the Company to off-balance-sheet risk in the event such borrowers do not repay the loans and the value of collateral held is less than that of the underlying receivable. These agreements provide the Company with the right to maintain the relationship between market value of the collateral and the receivable.

The Company arranges secured financing by pledging securities owned and unpaid customer securities for short-term borrowings to satisfy margin deposits of clearing organizations. The Company also actively participates in the borrowing and lending of securities. In the event the counterparty in these and other securities loaned transactions is unable to return such securities pledged or borrowed or to repay the deposit placed with them, the Company may be exposed to the risks of acquiring the securities at prevailing market prices or holding collateral possessing a market value less than that of the related pledged securities. The Company seeks to control the risks by monitoring the market value of securities pledged and requiring adjustments of collateral levels where necessary.

#### **18. Preferred Stock**

On October 17, 1997, the Company's Board of Directors ("Board") authorized 100,000 shares of preferred stock. Simultaneously, the Board designated 5,000 shares of the authorized preferred stock as Series A Preferred Stock. Up to 50 shares of the Series A Preferred Stock, which has a par value of \$20, can be issued to each of up to 100 qualified participants. Qualified participants are broker/dealers registered under the Exchange Act who clear their proprietary transactions through the Company and who represent that they are subject to net capital rules of the SEC and other self-regulatory organizations to which such broker/dealers report. The Series A Preferred Stock is nonvoting and nonconvertible to common stock, and it is entitled to noncumulative cash dividends when, as and if declared by the Board. The Series A Preferred Stock is redeemable at any time by the Company at a redemption price of \$1,000 per share.

#### **19. Proprietary Accounts of Broker/Dealers ("PAB") Reserve Requirements**

The Company performs calculations of PAB reserve requirements. At June 30, 2019, the Company did not have a PAB reserve requirement and has no amount on deposit.